

MONEY LAUNDERING PROVISIONS INSTRUMENT 2006

Powers exercised

- A. The Financial Services Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 ("the Act"):
- (1) section 64(1) and 64(2) (Conduct: statements and codes);
 - (2) section 138 (General rule-making power);
 - (3) section 146 (Money laundering rules);
 - (4) section 149 (Evidential provisions);
 - (5) section 150(2) (Actions for damages);
 - (6) section 156 (General supplementary powers); and
 - (7) section 157(1) (Guidance).
- B. The rule-making powers listed above are specified for the purpose of section 153(2) (Rule-making instruments) of the Act.

Commencement

- C. Annex A, Part 2 of Annex D and Annex K to this instrument come into force on 31 August 2006. Otherwise, this instrument comes into force on 1 March 2006.

Revocation of the Money Laundering sourcebook

- D. The Money Laundering sourcebook (ML) is revoked in its entirety with effect from 31 August 2006.

Amendments to the Handbook

- E. The modules of the FSA's Handbook of rules and guidance listed in column (1) below are amended or deleted in accordance with the Annexes listed in column (2).

(1)	(2)
Glossary of definitions	Annex A
Senior Management Arrangements, Systems and Controls (SYSC)	Annex B
Threshold Conditions (COND)	Annex C
Statements of Principle and Code of Practice for Approved Persons (APER)	Annex D
Amendments to the Interim Prudential sourcebook for Banks (IPRU(BANK))	Annex E
Interim Prudential sourcebook for Building Societies (IPRU(BSOC))	Annex F
Conduct of Business sourcebook (COB)	Annex G
Insurance: Conduct of Business sourcebook (ICOB)	Annex H
Mortgages: Conduct of Business sourcebook (MCOB)	Annex I
Market Conduct sourcebook (MAR)	Annex J

Money Laundering sourcebook (ML)	Annex K
Authorisation manual (AUTH)	Annex L
Supervision manual (SUP)	Annex M
Enforcement manual (ENF)	Annex N
Collective Investment Schemes sourcebook (CIS)	Annex O
Credit Unions sourcebook (CRED)	Annex P
Electronic Money sourcebook (ELM)	Annex Q
Professional Firms sourcebook (PROF)	Annex R

Citation

- F. This instrument may be cited as the Money Laundering Provisions Instrument 2006.

By order of the Board
26 January 2006

Annex A

Amendments to the Glossary of definitions

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

<i>client</i>	<p>(1) (except in <i>ML</i>; in <i>PROF</i>; in relation to a <i>regulated mortgage contract</i>) any <i>person</i> with or for whom a <i>firm</i> conducts or intends to conduct <i>designated investment business</i> or any other <i>regulated activity</i>); and</p> <p>(a) ...</p> <p>...</p> <p>(2) (in <i>ML</i>) (in relation to a <i>relevant firm</i>) any <i>person</i> engaged in, or who has had contact with the <i>relevant firm</i> with a view to engaging in, any <i>transaction</i> with that <i>relevant firm</i>:</p> <p>(a) on his own behalf; or</p> <p>(b) as agent for or on behalf of another. <u>[deleted]</u></p> <p>(3) ...</p> <p>(4) (in relation to a <i>regulated mortgage contract</i>, except in <i>ML</i> and <i>PROF</i>) the individual or trustee who is the borrower or potential borrower under that contract.</p>		
<i>group</i>	<p>(1) ...</p> <p>(2) (in relation to an <i>ICVC</i>) a group as in (1) but (in <i>ML</i> and <i>SYSC</i>) including also the <i>ICVC's authorised corporate director</i> (if any).</p> <p>...</p> <p>(3) ...</p>		
<i>identification evidence</i>	Evidence of the type referred to in <i>ML</i> 3.1.3R(1).		
<i>insolvent</i>	(in <i>ML</i>) insolvent under regulation 13 of the <i>Money Laundering Regulations</i> .		
<i>know your business information</i>	(in <i>ML</i>) information which a <i>relevant firm</i> has about:	(a) the financial circumstances of a <i>client</i> or any <i>person</i> on whose behalf the <i>client</i> has been acting or is acting; and	(b) the features of the <i>transactions</i> which the <i>relevant firm</i> has entered into with or for the <i>client</i> (or that <i>person</i>).
<i>ML</i>	the Money Laundering sourcebook.		

<i>Money Laundering Regulations</i>	the Money Laundering Regulations 2003 (SI 2003/3075) (see <i>ML</i>).
<i>money laundering reporting officer</i>	the individual appointed by a <i>relevant firm</i> in accordance with <i>ML</i> 7.1 <u><i>SYSC 3.2.6IR</i></u> .
<i>relevant firm</i>	(in <i>ML</i>) a <i>firm</i> of the kind described in <i>ML</i> 1.1.2R.
<i>relevant regulated activities</i>	(in <i>ML</i>) activities of the kind described in <i>ML</i> 1.1.4R.
<i>transaction</i>	(in <i>ML</i>) any transaction, including the giving of advice and any other business or service undertaken in the course of carrying on a <i>regulated activity</i> .

Annex B

Amendments to Senior Management Arrangements, Systems and Controls

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

Who?

1.1.1 R SYSC 2 and SYSC 3 apply to every *firm* except that:

...

(2A) for an incoming Treaty firm which has permission only for cross border services and which does not carry on regulated activities in the United Kingdom, SYSC 3.2.6AR to SYSC 3.2.6JG do not apply;

(3) ~~SYSC 2 does not apply to a sole trader as long as he does not employ any person who is required to be approved under section 59 of the Act (Approval for particular arrangements); and~~

for a sole trader:

(a) SYSC 2 does not apply as long as he does not employ any person who is required to be approved under section 59 of the Act (Approval for particular arrangements);

(b) SYSC 3.2.6IR does not apply if he has no employees;

(4) for a UCITS qualifier:

(a) SYSC 2.1.1R and SYSC 2.1.2G do not apply;

(b) SYSC 2.1.3R to SYSC 2.2.3G apply, but only in relation to allocation of the function in SYSC 2.1.3R(2) and only with respect to the activities in SYSC 1.1.4R;

(c) SYSC 3 applies, but only with respect to the activities in SYSC 1.1.4R; and

(5) for an authorised professional firm when carrying on non-mainstream regulated activities, SYSC 3.2.6AR to SYSC 3.2.6JG do not apply.

...

What?

1.1.3 R SYSC 2 and SYSC 3 apply with respect to the carrying on of:

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

except that SYSC 3.2.6AR to SYSC 3.2.6JG do not apply as described in SYSC 1.1.3AR.

1.1.3A R SYSC 3.2.6AR to SYSC 3.2.6JG do not apply:

- (1) with respect to the activities described in SYSC 1.1.3R(2) and (3); or
- (2) in relation to the following regulated activities:
 - (a) general insurance business;
 - (b) insurance mediation activity in relation to a general insurance contract or pure protection contract;
 - (c) long-term insurance business which is outside the Consolidated Life Directive (unless it is otherwise one of the regulated activities specified in this rule);
 - (d) business relating to contracts which are within the Regulated Activities Order only because they fall within paragraph (e) of the definition of “contract of insurance” in article 3 of that Order;
 - (e) (i) arranging, by the Society of Lloyd’s, of deals in general insurance contracts written at Lloyd’s; and
(ii) managing the underwriting capacity of a Lloyd’s syndicate as a managing agent at Lloyd’s; and
 - (f) mortgage mediation activity and administering a regulated mortgage contract.

1.1.4 R SYSC 2 and SYSC 3, except SYSC 3.2.6AR to SYSC 3.2.6JG, also apply with respect to the *communication and approval of financial promotions* which:

...

1.1.5 R SYSC 2 and SYSC 3, except SYSC 3.2.6AR to SYSC 3.2.6JG, also:

- (1) apply with respect to the carrying on of *unregulated activities* in a *prudential context*; and

- (2) take into account any activity of other members of a *group* of which the *firm* is a member.

...

Where?

...

- 1.1.9 R *SYSC 2 and SYSC 3, except SYSC 3.2.6AR to SYSC 3.2.6JG, also apply in a prudential context to a UK domestic firm with respect to activities wherever they are carried on.*
- 1.1.10 R *SYSC 3, except SYSC 3.2.6AR to SYSC 3.2.6JG, also applies in a prudential context to an overseas firm (other than an incoming EEA firm, incoming Treaty firm or UCITS qualifier) with respect to activities wherever they are carried on.*

...

Systems and controls in relation to €compliance, financial crime and money laundering

- 3.2.6 R *A firm must take reasonable care to establish and maintain effective systems and controls for compliance with applicable requirements and standards under the regulatory system and for countering the risk that the firm might be used to further financial crime.*
- 3.2.6A R *A firm must ensure that these systems and controls:*
- (1) *enable it to identify, assess, monitor and manage money laundering risk; and*
- (2) *are comprehensive and proportionate to the nature, scale and complexity of its activities.*
- 3.2.6B G *“Money laundering risk” is the risk that a firm may be used to further money laundering. Failure by a firm to manage this risk effectively will increase the risk to society of crime and terrorism.*
- 3.2.6C R *A firm must carry out regular assessments of the adequacy of these systems and controls to ensure that it continues to comply with SYSC 3.2.6AR.*
- 3.2.6D G *A firm may also have separate obligations to comply with relevant legal requirements, including the Terrorism Act 2000, the Proceeds of Crime Act 2002 and the Money Laundering Regulations. SYSC 3.2.6R to SYSC 3.2.6JG are not relevant for the purposes of regulation 3(3) of the Money Laundering Regulations, section 330(8) of the Proceeds of Crime Act 2002 or section 21A(6) of the*

Terrorism Act 2000.

- 3.2.6E G The FSA, when considering whether a breach of its *rules* on systems and controls against *money laundering* has occurred, will have regard to whether a *firm* has followed relevant provisions in the guidance for the UK financial sector issued by the Joint Money Laundering Steering Group.
- 3.2.6F G In identifying its *money laundering* risk and in establishing the nature of these systems and controls, a *firm* should consider a range of factors, including:
- (1) its customer, product and activity profiles;
 - (2) its distribution channels;
 - (3) the complexity and volume of its transactions;
 - (4) its processes and systems; and
 - (5) its operating environment.
- 3.2.6G G A *firm* should ensure that the systems and controls include:
- (1) appropriate training for its employees in relation to *money laundering*;
 - (2) appropriate provision of information to its *governing body* and senior management, including a report at least annually by that *firm's money laundering reporting officer (MLRO)* on the operation and effectiveness of those systems and controls;
 - (3) appropriate documentation of its risk management policies and risk profile in relation to *money laundering*, including documentation of its application of those policies (see SYSC 3.2.20R to SYSC 3.2.22G);
 - (4) appropriate measures to ensure that *money laundering* risk is taken into account in its day-to-day operation, including in relation to:
 - (a) the development of new products;
 - (b) the taking-on of new customers; and
 - (c) changes in its business profile; and
 - (5) appropriate measures to ensure that procedures for identification of new customers do not unreasonably deny access to its services to potential customers who cannot reasonably be expected to produce detailed evidence of identity.

3.2.6H R A firm must allocate to a director or senior manager (who may also be the money laundering reporting officer) overall responsibility within the firm for the establishment and maintenance of effective anti-money laundering systems and controls.

The money laundering reporting officer

3.2.6I R A firm must:

- (1) appoint an individual as MLRO, with responsibility for oversight of its compliance with the FSA's rules on systems and controls against money laundering; and
- (2) ensure that its MLRO has a level of authority and independence within the firm and access to resources and information sufficient to enable him to carry out that responsibility.

3.2.6J G The job of the MLRO within a firm is to act as the focal point for all activity within the firm relating to anti-money laundering. The FSA expects that a firm's MLRO will be based in the United Kingdom.

The compliance function

- 3.2.7 G (1) Depending on the nature, scale and complexity of its business, it may be appropriate for a firm to have a separate compliance function. The organisation and responsibilities of a compliance function should be documented. A compliance function should be staffed by an appropriate number of competent staff who are sufficiently independent to perform their duties objectively. It should be adequately resourced and should have unrestricted access to the firm's relevant records as well as ultimate recourse to its governing body.
- (2) ~~The regulatory objectives are defined in section 2 of the Act and include the reduction of financial crime. This objective is more fully described in section 6 of the Act. This describes financial crime as including any offence involving (a) fraud or dishonesty, (b) misconduct in, or misuse of information relating to, a financial market, or (c) handling the proceeds of crime.~~[deleted]
- (3) ~~In applying SYSC 3.2.6R, where financial crime is concerned, firms must also comply with other Handbook requirements (in particular, ML) and their legal obligations under the Money Laundering Regulations and the Proceeds of Crime Act 2002.~~[deleted]

...

SYSC TP 1.1

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

Money Laundering Transitional Provisions

Extra time provisions

Compliance with ML and SYSC 3.2.6AR to SYSC 3.2.6JG

<u>(1)</u>	<u>(2)</u> <u>Material to which the transitional provision applies</u>	<u>(3)</u>	<u>(4)</u> <u>Transitional provision</u>	<u>(5)</u> <u>Transitional provision: dates in force</u>	<u>(6)</u> <u>Handbook provision: coming into force</u>
<u>(1)</u>	<u>SYSC 3.2.6AR to SYSC 3.2.6JG</u>	<u>R</u>	<u>Compliance with ML also counts as compliance with SYSC 3.2.6AR to SYSC 3.2.6JG and vice versa.</u>	<u>From 1 March 2006 to 31 August 2006</u>	<u>(1) 1 March 2006</u>
<u>(2)</u>	<u>ML</u>				<u>(2) In force until 31 August 2006</u>

Annex C

Amendments to Threshold Conditions

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

2.5.7 G ...

...

- (10) the *firm* has in place ~~the appropriate money laundering prevention systems and training, including identification, record keeping and internal reporting procedures (see *ML*)~~ systems and controls against money laundering of the sort described in SYSC 3.2.6R to SYSC 3.2.6JG;

...

...

Annex D

Amendments to Statements of Principle and Code of Practice for Approved Persons

In this Annex, underlining indicates new text and striking through indicates deleted text. The changes detailed in Part 1 to this Annex take effect on 1 March 2006 and those detailed in Part 2 take effect on 31 August 2006.

Part 1

- 4.7.9 E In the case of the *money laundering reporting officer*, failing to discharge the responsibilities imposed on him by the *firm* in accordance with chapter 7 of the *Money Laundering* sourcebook (*ML*) or SYSC 3.2.6IR falls within *APER* 4.7.2E.

...

Part 2

- 4.7.9 E In the case of the *money laundering reporting officer*, failing to discharge the responsibilities imposed on him by the *firm* in accordance with ~~chapter 7 of the *Money Laundering* sourcebook (*ML*) or SYSC 3.2.6IR~~ falls within *APER* 4.7.2E.

...

Annex E

Amendments to the Interim Prudential sourcebook for Banks

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

Volume 2

Adequate records, systems and controls

AR Section 3: Accounting and other records and internal – ~~control systems~~ systems and controls

- 3.3.7 22 It is a requirement of the Money Laundering Regulations 1993 that authorised banks have policies and procedures in place to guard against their business and the financial system being used for the purpose of money laundering. ~~The Joint Money Laundering Steering Group Guidance Notes ('Money Laundering Guidance Notes for the Financial Sector' revised and consolidated by the Joint Money Laundering Steering Group in June 1997) provide a practical interpretation of the Regulations. The FSA expects banks to adopt policies and procedures in line with those Guidance Notes.~~ The FSA, when considering whether a breach of its *rules* on systems and controls against *money laundering* has occurred, will have regard to whether a *firm* has followed relevant provisions in the guidance for the UK financial sector issued by the Joint Money Laundering Steering Group.
- a) ~~See also the sourcebook on money laundering. See Money Laundering Sourcebook SYSC 3.2 for the FSA's *rules* on systems and controls against *money laundering*.~~

Annex F

Amendments to the Interim Prudential sourcebook for Building Societies

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

Volume 1

Annex 9B: Internal ~~control systems~~ systems and controls

Section 3.3

- 3.3.7 22 It is a requirement of the Money Laundering Regulations 1993 that authorised banks have policies and procedures in place to guard against their business and the financial system being used for the purpose of money laundering. ~~The Joint Money Laundering Steering Group Guidance Notes ('Money Laundering Guidance Notes for the Financial Sector' revised and consolidated by the Joint Money Laundering Steering Group in June 1997) provide a practical interpretation of the Regulations. The FSA expects banks to adopt policies and procedures in line with those Guidance Notes. The FSA, when considering whether a breach of its *rules* on systems and controls against *money laundering* has occurred, will have regard to whether a *firm* has followed relevant provisions in the guidance for the UK financial sector issued by the Joint Money Laundering Steering Group.~~ The FSA, when considering whether a breach of its *rules* on systems and controls against *money laundering* has occurred, will have regard to whether a *firm* has followed relevant provisions in the guidance for the UK financial sector issued by the Joint Money Laundering Steering Group.
(a) ~~See also the sourcebook on money laundering, SYSC 3.2 for the FSA's *rules* on systems and controls against *money laundering*.~~ See also the sourcebook on money laundering, SYSC 3.2 for the FSA's *rules* on systems and controls against *money laundering*.

Annex G

Amendments to the Conduct of Business sourcebook

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

- 4.1.6 G *Firms* are reminded that *COB* 4.1.5 R:
- (1) ~~does not relieve them of any obligation under the *Money Laundering* sourcebook relating to C2 (there is a different definition of “*client*” in that sourcebook); [deleted]~~
- ...
- ...
- 5.2.2 G A *firm* that arranges an *execution-only transaction* for a *private customer* is not generally required to obtain any personal or financial information about that *customer*; ~~except when the *Money Laundering* sourcebook applies~~. However, the *Insurance Mediation Directive* requires that a statement of the demands and needs of a *client* is provided to the *client*, whether advice is given or not. ...
- ...
- 10.1.4 G ...
- (6) an *operator* of an *authorised unit trust scheme* is also required to comply with the *Collective Investment Schemes sourcebook (CIS)*; and
- (7) an *operator* of an *ICVC* is also required to comply with the *Collective Investment Schemes sourcebook (CIS)*; ~~and~~ .
- (8) ~~an *operator* is also required to comply with the *Money Laundering sourcebook (ML)*. [deleted]~~
- ...
- 11.1.11 G All *depositories* and *trustee firms* are also required to comply in particular with the *Principles for Businesses (PRIN)*; and *Senior Management Arrangements, Systems and Controls (SYSC)* ~~and the *Money Laundering sourcebook (ML)*~~.
- ...

Annex H

Amendments to the Insurance: Conduct of Business sourcebook

In this Annex, striking through indicates deleted text.

1 Annex G Summary of Handbook provisions for insurance intermediaries

2

...

	Module	Application
High Level Standards	...	...
	Senior Management Arrangements, Systems and Controls, SYSC	Applies in respect of (1) and (2), <u>except SYSC 3.2.6AR to SYSC 3.2.6JG.</u>
Business Standards	...	...
	Money Laundering sourcebook, ML	Does not apply when the firm is doing (1) or (2). However ML will apply to an insurance intermediary if it also carries on relevant regulated activities as defined in ML 1.1.4R.
...		

...

Annex I

Amendments to the Mortgages: Conduct of Business sourcebook

In this Annex, striking through indicates deleted text.

1 Annex G Summary of the application of the Handbook to firms carrying on regulated
4 mortgage activities and firms that communicate or approve qualifying credit promotions

...

	Module	Application
...
Business Standards	...	...
	Money Laundering sourcebook, <i>ML</i> [*]	<i>Applies to every mortgage administrator and mortgage lender. This includes in circumstances where the mortgage administrator is appointed by a person who is not an authorised person to administer regulated mortgage contract on its behalf.</i>
...

...

Annex J

Amendments to the Market Conduct sourcebook

In this Annex, striking through indicates deleted text.

3.3.2 G ...*Firms* should also consider the other provisions of the *Handbook*, especially but not exclusively ~~*ML*~~, *IPRU* and *PRU*.

...

3.5.2 G ... Under *Principle 1* (Integrity) and *Principle 5* (Market conduct), a *firm* acting as *arranger* (or *name-passing broker*) should not conclude the arrangement if there is information from which it ought reasonably to conclude that the transaction is improper, whether or not it is at a non-market price~~market price~~. ~~Notwithstanding their limited role, firms acting as arrangers (or name passing brokers) as well as other firms should also comply with obligations upon them arising from ML.~~

...

5.5 Parts of the Handbook applicable to the operation of an ATS

5.5.3 G Handbook provisions applicable to ATSs

	Part of Handbook	Applicability to ATSs
High Level Standards	...	...
Business Standards	...	...
	Money Laundering sourcebook (ML)	This applies.
...

Annex K

Deletion of the Money Laundering sourcebook

In this Annex, the Money Laundering sourcebook (ML) is deleted in its entirety with effect from 31 August 2006, the deleted text is not shown struck through.

ML [deleted – material amended and moved to SYSC]

Annex L

Amendments to the Authorisation manual

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

- 1.5.3 G ...
- (1) ...
- (2) Systems, controls and internal arrangements:
- (a) ...
- (b) the detailed requirements, many of which are *regulated activity* specific, in the sourcebooks in the Business Standards part of the *Handbook*; for example, in *IPRU*, *PRU*, the Training and Competence sourcebook (*TC*), ~~the Money Laundering sourcebook (*ML*)~~ and ...
- ...
- ...
- ...

Annex M

Amendments to the Supervision manual

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

8.2.7 G Rules which can be waived (see *SUP* 8.2.6G)

Rules	Section of the Act or other provision under which rules are made	Chapters of the Handbook where such rules appear (Note 1)
...
Money laundering rules	Section 146	ML <u>SYSC 3.2</u>
...

...

Money laundering reporting function (CF11)

- 10.7.13 R The *money laundering reporting function* is the function of acting in the capacity of the *money laundering reporting officer* of a firm.
- 10.7.13A G A firm's obligations in respect of its money laundering reporting officer are set out in SYSC 3.2.6IR and the scope of application of that rule is set out in SYSC 1.1.
- 10.7.14 G ~~The rules in the Money Laundering sourcebook (ML) provide that a firm must have a money laundering reporting officer unless:-~~
- (1) ~~it is a sole trader with no employees; or~~
 - (2) ~~its regulated activities are certain insurance business only; or~~
 - (3) ~~it is an incoming firm providing only services into the United Kingdom; or~~
 - (4) ~~its regulated activities are insurance mediation activity in relation to a general insurance contract or pure protection contract or mortgage mediation activity. [deleted]~~
- 10.7.15 G The specific responsibilities of the ~~money laundering reporting officer~~ are set out in ~~ML 7.1. [deleted]~~
- 10.7.16 G ~~ML 7.1.9R provides that a money laundering reporting officer must have a "sufficient level of seniority" within the firm, so that he can carry out his controlled function effectively. [deleted]~~

...

SUP 13A Annex 1 G Application of the Handbook to Incoming EEA Firms G

G 1. ...

2. ...

3. ...

(1) Module of Handbook	(2) Potential application to an incoming EEA firm with respect to activities carried on from an establishment of the firm (or its appointed representative) in the United Kingdom	(3) Potential application to an incoming EEA firm with respect to activities carried on other than from an establishment of the firm (or its appointed representative) in the United Kingdom
...		
<i>ML</i>	Applies (<i>ML</i> 1.1.2R).	Does not apply (<i>ML</i> 1.1.2R).
...		

...

Annex N

Amendments to the Enforcement manual

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

- 11.9.1 G The *FSA's money laundering rules* are set out in ~~ML 1 to ML 8~~ SYSC 3.2. The *FSA*, when considering whether to take disciplinary action in respect of a breach of those *rules*, will have regard to whether a *firm* has followed relevant provisions in the Joint Money Laundering Steering Group's Guidance Notes for the Financial Sector.

...

Annex O

Amendments to the Collective Investment Schemes sourcebook

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

1.2.21 G ~~*ML* is also relevant in particular when considering *CIS* 4.4.3R, *CIS* 7.10 and *CIS* 15.4.3R. [deleted]~~

...

Annex P

Amendments to the Credit Unions sourcebook

In this Annex, underlining indicates new text and striking through indicates deleted text. Where entire sections of text have been deleted, this is indicated in the text and the deleted text is not shown struck through.

Systems and controls in relation to ~~€~~compliance and financial crime

...

- 4.3.37A G SYSC 3.2.6AR requires a *credit union* to ensure that these systems and controls:
- (1) enable it to identify, assess, monitor and manage *money laundering* risk; and
 - (2) are comprehensive and proportionate to the nature, scale and complexity of that *credit union*'s activities.
- 4.3.37B G '*Money laundering* risk' is the risk that a *credit union* may be used to further *money laundering*. Failure by a *credit union* to manage this risk effectively will increase the risk to society of crime and terrorism.
- 4.3.37C G SYSC 3.2.6CR requires a *credit union* to carry out regular assessments of the adequacy of these systems and controls to ensure that they continue to meet this requirement.
- 4.3.37D G A *credit union* may also have separate obligations to comply with relevant legal requirements, including the Terrorism Act 2000, the Proceeds of Crime Act 2002 and the *Money Laundering Regulations*. SYSC 3.2.6R to 3.2.6JG are not relevant guidance for the purposes of regulation 3(3) of the *Money Laundering Regulations*, section 330(8) of the Proceeds of Crime Act 2002 or section 21A(6) of the Terrorism Act 2000.
- 4.3.37E G The FSA, when considering whether a breach of its *rules* on systems and controls against *money laundering* has occurred, will have regard to whether a *credit union* has followed relevant provisions in guidance for the UK financial sector issued by the Joint Money Laundering Steering Group.
- 4.3.37F G In identifying its *money laundering* risk and in establishing the nature of these systems and controls, a *credit union* should consider a range of factors, including:
- (1) its customer, product and activity profile;

- (2) its distribution channels;
- (3) the complexity and volume of its transactions;
- (4) its processes and systems; and
- (5) its operating environment.

4.3.37G G A credit union should ensure that these systems and controls include:

- (1) appropriate training for that credit union's employees in relation to money laundering;
- (2) appropriate provision of information to that credit union's governing body and senior management, including a report at least annually by that credit union's money laundering reporting officer on the operation and effectiveness of those systems and controls;
- (3) appropriate documentation of that credit union's risk management policies and risk profile in relation to money laundering, including documentation of that credit union's application of those policies (see SYSC 3.2.20R to SYSC 3.2.22G);
- (4) appropriate measures to ensure that money laundering risk is taken into account in the day-to-day operation of that credit union, including in relation to:
 - (a) the development of new products;
 - (b) the taking-on of new customers; and
 - (c) changes in its business profile; and
- (5) appropriate measures to ensure that procedures for identification of new customers do not unreasonably deny access to that credit union's services to potential customers who cannot reasonably be expected to produce detailed evidence of identity.

4.3.37H G SYSC 3.2.6HR requires a credit union to allocate to a director or senior manager (who may also be the money laundering reporting officer) overall responsibility within the credit union for the establishment and maintenance of effective anti-money laundering systems and controls.

The money laundering reporting officer

4.3.37I G SYSC 3.2.6IR requires a credit union to:

- (1) appoint a money laundering reporting officer, who shall be responsible for oversight of that credit union's compliance with the FSA's rules on systems and controls against money laundering; and
- (2) ensure that its money laundering reporting officer has a level of authority and independence within that credit union and access to resources and information sufficient to enable him to carry out that responsibility.

4.3.37J G The job of the money laundering reporting officer within a credit union is to act as the focal point for all activity within that credit union relating to anti-money laundering. The FSA expects that a credit union's money laundering reporting officer will be based in the United Kingdom.

The compliance function

4.3.37K G Depending on the nature, scale and complexity of its business, it may be appropriate for a credit union to have a separate compliance function. The organisation and responsibilities of a compliance function should be documented. A compliance function should be staffed by an appropriate number of competent staff who are sufficiently independent to perform their duties objectively. It should be adequately resourced and should have unrestricted access to the credit union's relevant records as well as ultimate recourse to its governing body.

4.3.38 G *Guidance on compliance is located in SYSC 3.2.68R – SYSC 3.2.9G.*

...

4.3.71 G ...

...

- (8) *money laundering prevention (see ~~CRED 12~~ CRED 4.3.37G and SYSC 3.2);*

...

...

CRED 12 is deleted in its entirety.

CRED 12 [deleted]

...

App 1.1 This is the table referred to in *CRED* 2.2.2G.

App 1.1.1		Sourcebook or manual	Reference code

	Business Standards	...	...
		Money laundering	<i>ML</i>

App 2.1 Detailed contents of *CRED*

App 2.1.1	...		
	12	Money Laundering [deleted]	
	12.1	Introduction	
		12.1.1	What is Money laundering?
	12.2	Money laundering and the FSA	
	12.3	Identification of the Client	
	12.4	External Reporting	
	12.5	Government and Financial Action Task Force findings	
	12.6	Compliance Monitoring	
	12.7	Record keeping	
	...		

Sch 1.2 G

Handbook reference	Subject of reference	Contents of record	When record must be made	Retention period
...				
<i>CRED</i> 12.2.3 G	<i>Money Laundering</i>	Reference to <i>ML</i> 7 in relation to compliance and record	On-going in accordance with <i>ML</i> 7	5 years from dates specified in <i>ML</i> 7.3

		keeping.		
<i>CRED 12.7.1 G</i>	<i>Money Laundering</i>	Specifies retention periods in relation to evidence of identity etc.	On-going	As per <i>ML 7</i>
...				

Sch 2 G ...

Handbook reference	Subject of reference	Contents of record	When record must be made	Retention period
...				
<i>CRED 12.6.1G</i>	<i>Money Laundering</i>	Report from MLRO.	Upon request	As soon as reasonably practical
...				

...

Annex Q
Amendments to the Electronic Money sourcebook

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

1.5.2 G Application of other parts of the *Handbook* to *ELMIs*

Block	Module	Application
...
Business Standards	...	...
<u>Money Laundering sourcebook (ML)</u>	For the avoidance of doubt, it is the FSA's view that, where it has an establishment in the United Kingdom, an <i>ELMI</i> is subject to the <i>Money Laundering Regulations</i>. In addition, <i>ML</i> applies to every <i>ELMI</i>.	
...

...

6.3.5 R ...

(1) ~~prohibited by any of the rules in *ML*; or [deleted]~~

...

...

Annex R

Amendments to the Professional Firms sourcebook

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

~~Money Laundering sourcebook~~ Senior Management Arrangements, Systems and Controls

- 5.3.4 G ~~ML 8.1.3R provides that the Money Laundering sourcebook does~~ SYSC 3.2.6AR to SYSC 3.2.6JG, in relation to money laundering, do not apply to *authorised professional firms* when carrying on *non-mainstream regulated activities*.

...

**CAPITAL RESOURCES FOR INSURANCE AND MORTGAGE MEDIATION
ACTIVITIES INSTRUMENT 2006**

Powers exercised

- A. The Financial Services Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):
- (1) section 138 (General rule-making powers);
 - (2) section 156 (General supplementary powers); and
 - (3) section 157(1) (Guidance).
- B. The rule-making powers listed above are specified for the purpose of section 153(2) (Rule-making instruments) of the Act.

Commencement

- C. This instrument comes into force on 1 March 2006.

Amendments to the Handbook

- D. The Integrated Prudential sourcebook is amended in accordance with Annex A to this instrument.
- E. The Supervision manual is amended in accordance with Annex B to this instrument.

Citation

- F. This instrument may be cited as the Capital Resources for Insurance and Mortgage Mediation Activity Instrument 2006.

By order of the Board
26 January 2006

Annex A

Amendments to the Integrated Prudential sourcebook

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

...

9.3.52 R Table: Items which are eligible to contribute to the capital resources of a firm

	Item	Additional explanation
1.	...	...
...		
3.	Audited <u>Reserves (Notes 1 and 2)</u>	<p>These are, <u>subject to Note 1</u>, the audited accumulated profits retained by the <i>firm</i> (after deduction of tax, dividends and proprietors' or <i>partners'</i> drawings) and other reserves created by appropriations of share premiums and similar realised appropriations. Reserves also include gifts of capital, for example, from a <i>parent undertaking</i>.</p> <p>For the purposes of calculating capital resources, a <i>firm</i> must make the following adjustments to its audited reserves, where appropriate.</p> <p>(1) ...</p> <p>...</p>
4.	<u>Interim net profits (Notes 1 and 2)</u>	If a <i>firm</i> seeks to include interim net profits in the calculation of its capital resources, the profits have, <u>subject to Note 1</u> , to be verified by the <i>firm's</i> external auditor, net of tax, anticipated dividends or proprietors' drawings and other appropriations.
...		

Notes:

1 In general, small insurance intermediaries which only carry on insurance mediation activities in relation to non-investment insurance contracts and small mortgage intermediaries may be exempt from the requirement to appoint an auditor under the Companies Act 1985 (section 249A (Exemptions from audit)). If so, the firm may include unaudited reserves and unverified interim net profits in the calculation of its capital resources.

2 Mortgage lenders and mortgage administrators to which the Companies Act 1985 applies are required to appoint an auditor under that Act (section 249B (Cases where exemptions not available)). These firms will only be able to include audited reserves and verified interim net profits in the calculation of its capital resources.

9.3.52A G ...

...

Annex B

Amendments to the Supervision manual

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

SUP 16 Annex 18AR

Section D1: Regulatory Capital

Eligible capital (mortgage and non-investment insurance)

Incorporated firms

~~Audited~~ Reserves

RR0229

Interim net profits (~~audited~~)

RR3234

~~Interim net profits (not audited)~~

RR3232

SUP 16 Annex 18BG

Section D1: guide for completion of individual fields

...	
Audited <u>Reserves</u>	<p>These are the audited accumulated profits retained by the <i>firm</i> (after deduction of tax and dividends) and other reserves created by appropriations of share premiums and similar realised appropriations. Reserves also include gifts of capital, for example, from a <i>parent undertaking</i>.</p> <p>Any reserves that have not been audited this field should not be included <u>in this field unless the <i>firm</i> is eligible to do so under <i>PRU 9.3.52R(3)</i>.</u></p>
Interim net profits (audited)	<p>Interim net profits should be audited <u>verified</u> by the <i>firm's</i> external auditor, net of tax or anticipated dividends and other appropriations to be included as capital.</p> <p><u>Any interim net profits that have not been verified should not be included in this field unless the <i>firm</i> is eligible to do so under <i>PRU 9.3.52R(4)</i>.</u></p>
Interim net profits (not audited)	Other unverified profits (not included in total capital resources)
...	

PENSION TERM ASSURANCE INSTRUMENT 2006

Powers exercised

- A. The Financial Services Authority makes this instrument in the exercise of the powers and related provisions in:
- (1) the following sections of the Financial Services and Markets Act 2000 (“the Act”):
 - (a) section 138 (General rule-making powers);
 - (b) section 156 (General supplementary powers); and
 - (c) section 157 (Guidance); and
 - (2) the other powers referred to in Schedule 4 of the General Provisions.
- B. The rule-making powers listed above are specified for the purpose of section 153(2) (Rule-making instruments) of the Act.

Commencement

- C. This instrument comes into force on 6 April 2006.

Amendments to the Handbook

- D. The Glossary of definitions is amended in accordance with Annex A to this instrument.
- E. The Insurance: Conduct of Business sourcebook is amended in accordance with Annex B to this instrument.

Citation

- F. This instrument may be cited as the Pension Term Assurance Instrument 2006.

By order of the Board
23 February 2006

Annex A

Amendments to the Glossary of definitions

In this Annex, underlining indicates new text and striking through indicates deleted text. Where new definitions are being inserted, the text is not underlined.

- life policy*
- ~~(1)~~ ~~(except in COB, AUTH App 1 and AUTH App 5):~~
 - ~~(a)~~ ~~(in accordance with the definition of 'qualifying contract of insurance' in article 3(1) of the Regulated Activities Order) a long-term insurance contract other than a reinsurance contract and a pure protection contract; or~~
 - ~~(b)~~ ~~a long-term care insurance contract.~~
 - ~~(2)~~ ~~(in COB except COB 3):~~
 - ~~(a)~~ ~~a long-term insurance contract in (1) or~~
 - ~~(b)~~ ~~a pension policy.~~
 - ~~(3)~~ ~~(in COB 3) a long-term insurance contract in (1) (a) or a pension policy.~~
 - (1) (in accordance with the definition of 'qualifying contract of insurance' in article 3(1) of the Regulated Activities Order) a long-term insurance contract other than a reinsurance contract and a pure protection contract; or
 - (2) (except in PERG and COB 3) a long-term care insurance contract; or
 - (3) (in COB) a pension policy; or
 - (4) (in relation to a firm's permission) a pension term assurance policy.

Insert the following new definition in the appropriate alphabetical position:

- pension term assurance policy* a personal pension policy which is a pure protection contract and in connection with which tax relief is available under Chapter 4 of Part 4 of the Finance Act 2004.

Annex B

Amendments to the Insurance: Conduct of Business sourcebook

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

Pension term assurance policies: election to apply COB rules

- 1.2.17 R (1) ICOB does not apply to the extent that:
- (a) the activities within ICOB 1.2.1R relate to a *pension term assurance policy*; and
 - (b) the *firm* has elected to comply with COB;
- but the *firm* must then comply with the rest of the Handbook treating the *pension term assurance policy* as a *life policy* and a *designated investment*, and not as a *non-investment insurance contract*.
- (2) A *firm* must make a record in a *durable medium* of the election (and any reversal of or amendment to the election) which includes:
- (a) the date from which the election takes effect; and
 - (b) a precise description of the part of the *firm's* business to which the election applies;
- and must retain that record indefinitely.

...

- 4.3.4 G An *insurance intermediary* should base his *personal recommendation* on what the *customer* tells him. ~~Subject to ICOB 4.3.2R(1), ICOB 4.3.2R(2) and ICOB 4.3.5R~~ Provided it complies with the *rules* in this section, the *insurance intermediary* is not required to take into account the *customer's* existing insurance cover (or, in the case of a *personal recommendation* relating to a *pension term assurance policy*, existing pension arrangements), or details of that cover (or those arrangements), if the *customer* is not able to provide this information.

...

Pension term assurance policies

- 4.3.8 R Unless the *insurance intermediary* has sufficient information to conclude whether or not the *customer's* existing pension arrangements are likely to significantly affect the suitability of any *personal recommendation* of a *pension term assurance policy* that it might make, it must either:

- (1) not make a *personal recommendation* until details of the pension arrangements are made available to it; or
- (2) make clear to the *customer* that the *personal recommendation* may not be suitable because it has not taken into account full details of the *customer's* existing pension arrangements.

...

5.5.8 G A significant exclusion or limitation is one that would tend to affect the decision of *retail customers* generally to buy. In determining what exclusions or limitations are significant an *insurer* should, in particular, consider the exclusions or limitations that relate to the significant features and benefits in *ICOB 5.5.5R(4)* and factors which may have an adverse effect on the benefit payable under the contract. Another type of significant limitation might be that the contract only operates through certain means of communication e.g. telephone or Internet.

...

Schedule 1 Record keeping requirements

...

3 Table

Handbook reference	Subject of record	Contents of record	When record must be made	Retention period
<u><i>ICOB 1.2.17R(2)</i></u>	<u>Record of election to comply with <i>COB rules</i> for <i>pension term assurance policies</i> (including amendment or reversal of election)</u>	<u>Date of election and precise description of parts of the <i>firm's</i> business that will comply with <i>COB</i> provisions</u>	<u>Not specified</u>	<u>Indefinitely</u>
...

...

**INSURANCE: CONDUCT OF BUSINESS SOURCEBOOK (AMENDMENT
NO 2) INSTRUMENT 2006**

Powers exercised

- A. The Financial Services Authority makes this instrument in the exercise of the powers listed in Schedule 4 to the Insurance: Conduct of Business sourcebook.
- B. The rule-making powers listed above are specified for the purpose of section 153(2) (Rule-making instruments) of the Act.

Commencement

- C. This instrument comes into force on 6 March 2006.

Amendments to the Glossary of definitions

- D. The Glossary of definitions is amended in accordance with Annex A to this instrument.

Amendments to the Insurance: Conduct of Business sourcebook

- E. The Insurance: Conduct of Business sourcebook is amended in accordance with Annex B to this instrument.

Citation

- F. This instrument may be cited as the Insurance: Conduct of Business Sourcebook (Amendment No 2) Instrument 2006.

By order of the Board
23 February 2006

Annex A

Amendments to the Glossary of definitions

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

Amend the following definitions as shown:

- charge* (1) ...
- (2) (except in *LR*) any *fee* or charge made to ~~a *client* in connection with:~~
- (a) a *client* in connection with *designated investment business*; or
- (b) a *customer* in connection with any *insurance mediation activities* in respect of a *non-investment insurance contract*;
- whether levied by the *firm* or any other *person*, including a *mark-up* or *mark-down*.
- customer* ...
- (3) (in *ICOB*) ~~a *person* who is a *policyholder*, or a prospective *policyholder*, of a *policy* other than a *reinsurance contract* but~~ (except in *ICOB* 2 (general rules), *ICOB* 7 (claims handling) and (in respect of those chapters) *ICOB* 1 (application and purpose)) excluding a *policyholder* or prospective *policyholder* who does not make the arrangements preparatory to him concluding the *contract of insurance*.
- ...

Annex B

Amendments to the Insurance: Conduct of Business sourcebook

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

...

- 1.2.1 R (1) ...
- (2) Where a *firm* (or its *appointed representative*) ("A") has outsourced *insurance mediation activities* to a *third party processor*, any rule in *ICOB* which requires the *third party processor*, when acting as such, to disclose its identity to a *customer* must be read as applying to the *third party processor* only to the extent that it applies to A and as requiring disclosure of the identity of A ~~the *firm* (or *appointed representative*, as appropriate)~~ which is taking responsibility for the acts and omissions of the *third party processor* when carrying on the outsourced activities.

...

Customers and policyholders

- 1.2.5A G (1) In *ICOB 2* (General rules) and *ICOB 7* (Claims handling) (and in *ICOB 1* (Application and purpose) in respect of those chapters), a *customer* is a *policyholder* or a prospective *policyholder*. Otherwise, only a *policyholder* or prospective *policyholder* who makes the arrangements preparatory to him concluding the *contract of insurance* (directly or through an agent) is a *customer*.
- (2) A *policyholder* includes anyone who, upon the occurrence of the contingency insured against, is entitled to make a *claim* directly to the *insurance undertaking*.

...

- 1.2.15 R (1) If a *non-investment insurance contract* is a *group policy*, *ICOB* (except for *ICOB 2* (General rules) and *ICOB 7* (Claims handling)) does not apply with respect to a *person* under such a *policy* who is not the legal holder of the *policy*, subject to (2).

...

- 1.2.16 G (1) ...
- (2) ~~In *ICOB* a *customer* is a *policyholder* or a prospective *policyholder*. A *policyholder* includes anyone who, upon the occurrence of the contingency insured against, could expect to have a *claim*, made by him directly to the *insurance undertaking*, accepted by the *insurance*~~

~~undertaking. PA~~ policyholder includes a member of a *group policy* who did not conclude the *group policy* with the *insurance undertaking* but who is entitled under the terms of that *policy* to make a *claim* on the *insurance undertaking*. This would include a dependant of a *policyholder* member of a *group policy* if that dependant has a direct right to *claim*. Where ~~such a customer person does not~~ concludes a *group policy*, only limited provisions in *ICOB* will apply to ~~him~~ other policyholders as specified in *ICOB* 1.2.15R and by the definition of *customer*.

- (3) A *person* whose right or interest in a *contract of insurance* that is a *group policy* does not entitle him to make a *claim* directly to an *insurance undertaking* (for example, because he is required to make his *claim* to an employer or trustees) is not a *customer* or a policyholder.
- (4) ~~The rules at~~ *ICOB* 5.3.29R and *ICOB* 5.4.8R provides for ~~commercial~~ *customers* who conclude *group policies* to be given a *policy summary*, unless the customer is a commercial customer and there is no policyholder who is capable of being a retail customer, and to be informed that they should give that *policy summary* to each *policyholder* who is capable of being a retail customer.

...

...

2.10 Excessive charges to retail customers

- 2.10.1 R An insurance intermediary must ensure that its charges to a retail customer are not excessive.
- 2.10.2 G When determining whether a charge is excessive, an insurance intermediary should consider:
- (1) the amount of its charges for the services or product in question, compared with charges for similar services or products in the market;
- (2) whether the charges are an abuse of the trust that the retail customer has placed in the insurance intermediary; and
- (3) the nature and extent of the disclosure of the charges to the retail customer.
- 2.10.3 G In assessing whether an insurance intermediary's charges are excessive, the FSA will take account of the charges imposed by insurance intermediaries of similar size and that conduct a similar volume of business.
- 2.10.4 G ICOB 2.10.1R does not apply to premiums, but does cover fees (including any fees that an insurance intermediary charges where it receives no commission from an insurer in respect of the contract of insurance).

...

4.1.3 R Table: Application of *ICOB* 4 by activity and customer type

This table belongs to *ICOB* 4.1.1R

Insurance mediation activity	Type of customer	Applicable section
...
<i>arranging</i> except <i>introducing</i>	<i>commercial customer</i>	Whole chapter except <i>ICOB</i> 4.2.19R, <i>ICOB</i> 4.3, <i>ICOB</i> 4.5 and <i>ICOB</i> 4.7
...
<i>advising</i>	<i>commercial customer</i>	Whole chapter except <i>ICOB</i> 4.2.19R, <i>ICOB</i> 4.5 and <i>ICOB</i> 4.7
...

4.1.4 R The following provisions in *ICOB* do not apply to an *insurance intermediary* that is an *insurer* ~~when dealing with a *commercial customer*~~:

- (1) *ICOB* 4.2 (Status disclosure) ~~except *ICOB* 4.2.4G to *ICOB* 4.2.7R (permitting use of the initial disclosure document and combined initial disclosure document) and *ICOB* 4.2.19R (overseas business for UK retail customers)~~, provided that when providing the service on the telephone to a *retail customer* wishing to enter into a *non-investment insurance contract*, the *insurer* proceeds on the basis of providing at least the following information:
 - (a) its name;
 - (b) (if it initiated the call) the commercial purpose of the call; and
 - (c) the identity of the *person* in contact with the *customer* and his link with the *insurer*;
- (2) *ICOB* 4.4.1R(1) (Statement of demands and needs), in accordance with *ICOB* 4.4.2R(1) and (1A) (commercial customers and non-advised sales to retail customers) ~~unless the *insurer* makes a *personal recommendation* to the *commercial customer*~~; and
- (3) ...

However, an *insurer* must ensure that its *appointed representative* nevertheless complies with the requirements of this chapter (unless acting as the *insurer's third party processor*).

...

4.1.7 G The purpose of this chapter is to ensure that:

...

(4) ~~the charges that an insurance intermediary imposes on a retail customer are not excessive;~~[deleted]

...

...

4.2.2 R ...

(3) Exemption: telephone sales

(a) ...

(aa) The insurance intermediary must provide its name and (if it initiated the call) the commercial purpose of the call.

(b) Provided the customer gives his explicit consent to receiving only limited information, the insurance intermediary may proceed on the basis of at least the following information:

(i) ~~the name of the insurance intermediary;~~

(ii) ~~(if the call is initiated by the insurance intermediary) the commercial purpose of the call;~~

(iii) the identity of the person in contact with the customer and his link with the insurance intermediary; and

(iv) that other information is available on request, and the nature of the information.

(c) ...

...

...

4.2.8 R Table: Information to be provided before conclusion of the contract or immediately after conclusion of the contract

This table belongs to *ICOB 4.2.2R*.

...	...
(4)	Unless the insurance intermediary is an insurer, or a third party processor acting as such on behalf of an insurer, d Details of any holding, direct or indirect, that an insurance intermediary has that

	represents more than 10 per cent of the voting rights or of the capital in an <i>insurance undertaking</i> .
(5)	Unless the <i>insurance intermediary</i> is an <i>insurer</i>, or a third party processor acting as such on behalf of an <i>insurer</i>, d Details of any holding, direct or indirect, that an <i>insurance undertaking</i> or parent of an <i>insurance undertaking</i> has that represents more than 10 per cent of the voting rights or of the capital in the <i>insurance intermediary</i> .
...	...

...

4.4.2 R (1) ...

(1A) Non-advised sales by insurers to retail customers

- (a) ICOB 4.4.1R(1) does not apply to an *insurance intermediary* that is an *insurer* when dealing with a *retail customer*, unless the *insurer* makes a *personal recommendation* to that *retail customer*.
- (b) Where ICOB 4.4.1R(1) does not apply under (a), the *insurer* must provide the *retail customer* with a statement that confirms the *insurer* has not *personally recommended* that contract.
- (c) Unless (d) or (e) applies, the statement in (b) must be provided in a *durable medium* before the conclusion of the contract (including at *renewal*).
- (d) If the *customer* requests the statement in (b) orally or requires immediate cover, the *insurer* may provide the statement orally provided that it does so before the conclusion of the contract and provides the statement in a *durable medium* immediately after the conclusion of the contract.
- (e) Where a contract is concluded by telephone, the statement in (b) must be provided immediately after the conclusion of the contract in a *durable medium*.

(2) ...

(3) Notwithstanding (1) and (1A), an *insurer* must ensure that its *appointed representative* complies with the requirements of this section (unless acting as the *insurer's third party processor*).

...

Delete ICOB 4.5 in its entirety, the deleted text is not shown struck through.

4.5 [deleted – material moved to ICOB 2.10]

...

- 5.3.18 R No less than 21 days before the expiry of the policy, An insurance intermediary must:
- (1) if the *insurance undertaking* is willing to invite *renewal* of the *policy*, take reasonable steps to provide the retail customer with renewal terms in a durable medium in accordance with ICOB 5.3.21R ~~no less than 21 days before the expiry of the policy~~; or
 - (2) take reasonable steps to notify the retail customer ~~no less than 21 days before the expiry of the policy~~ if the *insurance undertaking* is not willing to invite *renewal*; or
 - (3) notify the retail customer that the *insurance intermediary* no longer deals with the *insurance undertaking*.

...

- 5.3.30 G (1) ... Such a *policyholder* will typically be capable of being a retail customer under ICOB.
- (2) ...

...

5.4.8 R When an *insurance intermediary* sells a *group policy* to a *commercial customer* ... the *insurance intermediary* must...:

- (1) ... (but a *policy summary* need not be supplied if there is no *policyholder* who ~~would~~ is capable of being a retail customer);

...

5.4.9 G (1) ... Such a *policyholder* will typically be capable of being a retail customer under ICOB. ...

- (2) ...

...

7.3.6 R An *insurer* must not:

- (1) ...
- (2) ...refuse to meet a *claim* made by a *retail customer* on the grounds:
- (a) of non-disclosure of a fact material to the risk that the *retail customer* who took out the policy could not reasonably be expected to have disclosed;

...

- (d) ...
 - (i) ...
 - (ii) ...drawn to the attention of the *retail customer* who took out the policy before ...

...

7.4.7 G ... Where an *insurance intermediary* acts for a *customer* in arranging a *policy*, it is likely to be the agent for ~~the~~that customer and any other customers who are policyholders under that policy in connection with the preparation and handling of any *claim* against the *insurance undertaking*. ... duty either to the *insurance undertaking* or the *customer* making the claim.
...

7.4.8 R If an *insurance intermediary* acts for an *insurance undertaking* and not a *customer* in relation to a *claim* on a contract which it arranged ~~for that customer~~, the *insurance intermediary* must inform the *customer* that, in relation to that *claim*, it is acting on behalf of the *insurance undertaking*, and not the *customer*.

...

TP1 Transitional Provisions

(1)	(2)	(3)	(4)	(5)	(6)
	Material to which the transitional provision applies		Transitional provision	Transitional provision: dates in force	Handbook provision: coming into force
...					
10	<u>ICOB 4.1.4R and ICOB 4.4.2R(3)</u>	<u>R</u>	<u>To the extent that an insurer need not comply with provisions of ICOB 4 when dealing with a commercial customer, it is not responsible for ensuring that its appointed representative appointed prior to 6 March 2006 complies with those provisions.</u>	<u>6 March 2006 to 6 July 2006</u>	<u>6 March 2006</u>

...

**COLLECTIVE INVESTMENT SCHEMES SOURCEBOOKS
(MISCELLANEOUS AMENDMENTS) INSTRUMENT 2006**

Powers Exercised

- A. The Financial Services Authority makes this instrument in the exercise of the following powers and related provisions:
- (1) the following sections of the Financial Services and Markets Act 2000 (“the Act”):
 - (a) section 138 (General rule-making power);
 - (b) section 140 (Restriction on managers of authorised unit trust schemes);
 - (c) section 156 (General supplementary powers);
 - (d) section 157(1) (Guidance);
 - (e) section 238(5) (Restrictions on promotion);
 - (f) section 242 (Applications for authorisation of unit trust schemes);
 - (g) section 247 (Trust scheme rules); and
 - (h) section 248 (Scheme particulars rules); and
 - (2) regulation 6 (FSA rules) of the Open-Ended Investment Companies Regulations 2001 (SI 2001/1228).
- B. The rule-making powers and related provisions listed above are specified for the purpose of section 153(2) of the Act (Rule-making instruments).

Commencement

- C. This instrument comes into force on 6 April 2006.

Amendments to the Handbook

- D. The modules of the FSA's Handbook of rules and guidance listed in column (1) below are amended in accordance with the Annexes to this instrument listed in column (2).

(1)	(2)
Glossary of definitions	Annex A
Collective Investment Schemes sourcebook (CIS)	Annex B
New Collective Investment Schemes sourcebook (COLL)	Annex C

Citation

- E. This instrument may be cited as the Collective Investment Schemes Sourcebooks (Miscellaneous Amendments) Instrument 2006.

By order of the Board
23 February 2006

Annex A

Amendments to the Glossary of definitions

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

Amend the following definition as shown:

IMA SORP the Statement of Recommended Practice for financial statements of *authorised funds* issued by the Investment Management Association and effective as at ~~1 December 2003~~ 1 January 2006.

Annex B

Amendments to the Collective Investment Schemes sourcebook

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

...

Borrowing limits

5.5.4 R ...

- (4) ~~[deleted] For an ICVC, borrowing does not include any arrangement for the ICVC to pay to a third party (including the ACD) any costs which the ICVC is entitled to amortise under CIS 8.3.4R (Set up costs) and which were paid on behalf of the ICVC by the third party.~~

...

Borrowing limits

5A.15.4 R ...

- (6) ~~[deleted] For an ICVC, borrowing does not include any arrangement for the ICVC to pay to a third party (including the ACD) any costs which the ICVC is entitled to amortise under CIS 8.3.4R (Set up costs) and which were paid on behalf of the ICVC by the third party.~~

...

Appointment of an ACD

7.2.2 R ...

- (3) For an ICVC that holds annual general meetings under the OEIC Regulations, The the ...

...

Set up costs

8.3.4 R

- (1) ~~[deleted] When (2) applies, costs of the *authorisation* and incorporation of an ICVC and of its *initial offer* or *issue of shares* (or *initial offer* or *issue of shares* in respect of a *sub-fund*) may, subject to CIS 8.3.1R (Promotional payments), be amortised over a period not exceeding five years.~~
- (2) ~~[deleted] Amortisation under (1) is only permitted if, on or before 30 November 2000, it had commenced and been disclosed in the *prospectus*.~~

...

Resolutions

11.2.5 R ...

(3) Where a resolution (including an extraordinary resolution) is required to conduct business at a meeting of shareholders and every shareholder is prohibited under CIS 11.2.6R(4)(a) (Voting rights) from voting, it shall not be necessary to convene such a meeting and a resolution may, with the prior written agreement of the depositary to the process, instead be passed with the written consent of shareholders representing 50% or more, or for an extraordinary resolution 75% or more, of the shares of the scheme in issue.

...

Voting rights

11.3.9 R ...

(7) Where every unitholder is prohibited under (6)(a) from voting, the unitholders may, with the prior written agreement of the trustee to the process, instead approve the business of the meeting by written resolution and any resolution approved in this manner by unitholders representing 75% or more of the units of the scheme in issue shall have the effect of an extraordinary resolution, duly approved under the rules of this chapter.

...

Consequences of commencement of winding up

14.2.5 R ...

- (3) The ACD must as soon as practicable after the effective time:
- (a) ~~[deleted] publish notice of the commencement of the winding up (if the head office of the ICVC is situated in England and Wales or Wales) in the London Gazette, or (if the head office of the ICVC is situated in Scotland) in the Edinburgh Gazette; and~~
 - (b) if the ACD has not previously notified ...

...

Annex C

Amendments to the New Collective Investment Schemes sourcebook

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

...

Table: contents of the prospectus

4.2.5

R

...

Authorised fund

2 A description of the *authorised fund* including:

...

(b) ...

(ba) whether it is a UCITS scheme or a non-UCITS retail scheme;

...

...

Contracts and other relationships with parties

11 ...

(a) (i) a summary of the material provisions of the contract between the ICVC and the ~~authorised fund manager~~ ACD which may ...

...

(iii) ... a statement of that fact; ~~and~~

(iv) ... in summary form; and

(v) for an ICVC that does not hold annual general meetings, a statement that copies of contracts of service between the ICVC and its directors, including the ACD, will be provided to a unitholder on request;

...

...

General information

23 ...

- (c) ... *units*; ~~and~~
- (d) ... *scheme property* ~~;~~ and
- (e) for an ICVC, whether or not annual general meetings will be held.

...

Guidance on contents of the prospectus

- 4.2.6 G (1) ...
- (a) ...
 - (b) ...
 - (ii) a statement of the policy of the *authorised fund manager* in relation to insurance ~~and~~ of immovables forming part of ...

...

...

- (3) In relation to *COLL 4.2.5R(27)*, the *prospectus* might include a statement of the *authorised fund manager's* policy in relation to *holding units* in the *scheme* as *principal*, and in particular whether it seeks to make a profit from doing so. It might also include a prominent statement of non-accountability ...

...

Guidance on significant changes

- 4.3.7 G ...
- (3) Where the *directors* of an ICVC elect to discontinue holding annual general meetings under paragraph 37A of the *OEIC Regulations*, they are required to give 60 days' written notice to *shareholders*. For the purpose of *COLL 4.3.6R* this should be treated as a significant change to the operation of the *scheme*.

...

Resolutions

- 4.4.7 R ...
- (3) Where a resolution (including an *extraordinary resolution*) is required to conduct business at a meeting of *unitholders* and every *unitholder* is prohibited under *COLL 4.4.8R(4)* from voting, it shall not be necessary to convene such a meeting and a resolution may, with the prior written

agreement of the *depository* to the process, instead be passed with the written consent of *unitholders* representing 50% or more, or for an *extraordinary resolution* 75% or more, of the *units* of the *scheme* in *issue*.

Voting rights

4.4.8 R ...

- (3) ~~For joint *unitholders* of a *unit*, only the vote of the first named in the *register* of *unitholders* can be taken.~~
For joint *unitholders*, the vote of the most senior who votes, whether in person or by proxy, must be accepted to the exclusion of the votes of the other joint *unitholders*. For this purpose seniority must be determined by the order in which the names stand in the *register* of *unitholders*.

...

...

Chairman, adjournment and minutes

4.4.11 R (1) A meeting of *unitholders* must have a chairman, nominated;

(a) in the case of an *AUT*, by the *trustee*;

(b) in the case of an *ICVC*, by a *director* other than the *ACD* or an *associate* of the *ACD* or, if no such nomination is made, by the *depository*.

...

Notices to unitholders

4.4.12 R (1) ...

(a) ...

(i) ~~delivered to~~ sent by post to or left at the *unitholder's* address as appearing in the *register*; or

(ii) ~~delivered~~ sent by using an electronic medium in accordance with *COLL* 4.4.13R (Other notices); or

...

...

...

Contents of the annual long report

- 4.5.7 R (1) ...
- (2) An annual long report on a *scheme* which is an *umbrella* must be prepared for the *umbrella* as a whole and must contain:
...
- (3) The *directors* of an *ICVC* or the *manager* of an *AUT* must ensure that the accounts referred to in (1)(a) ~~and~~, (2)(a) and (4)(a) give a true and fair view of the net income and the net gains and the losses on the *scheme property* of the *authorised fund* or, in the case of (2)(a) and (4)(a), the *sub-fund*, for the *annual accounting period* in question ...
- (4) The *authorised fund manager* of a *scheme* which is an *umbrella* may, in addition to complying with (2), prepare a further annual long report for any one or more individual *sub-funds* of the *scheme*, in which case it must contain:
- (a) in relation to the *sub-fund*:
- (i) the full accounts for the *annual accounting period* which must be prepared in accordance with the requirements of the *IMA SORP*;
- (ii) the report of the *authorised fund manager* in accordance with *COLL 4.5.9R*; and
- (iii) the comparative table in accordance with *COLL 4.5.10R*;
- (b) the report of the *depository* in accordance with *COLL 4.5.11R*; and
- (c) the report of the auditor in accordance with *COLL 4.5.12R*.

Contents of the half-yearly long report

- 4.5.8 R ...
- (2) A half-yearly long report on a *scheme* which is an *umbrella* must be prepared for the *umbrella* as a whole and must contain:
- (a) for each *sub-fund*:
- (i) the full accounts for the ~~annual~~ *half-yearly accounting period* which must be ...
- ...
- ...

- (3) The authorised fund manager of a scheme which is an umbrella may, in addition to complying with (2), prepare a further half-yearly long report for any one or more individual sub-funds of the scheme. Such reports must contain the full accounts and the report of the authorised fund manager that would be required by (1) if the sub-fund were a separate authorised fund.

Annual and half-yearly long reports for sub-funds of an umbrella

4.5.8A G The authorised fund manager may, but need not, prepare annual and half-yearly long reports for any individual sub-fund of an umbrella in accordance with COLL 4.5.7R(4) and COLL 4.5.8R(3) and make them available on request to any unitholder investing in the relevant sub-fund. However, if the authorised fund manager does so, this does not relieve it of its duty:

- (1) to prepare annual and half-yearly long reports on the umbrella as a whole (COLL 4.5.7R(2) and COLL 4.5.8R(2)); and
- (2) to make available and publish the annual and half-yearly long reports for the umbrella as a whole (COLL 4.5.14R).

Authorised fund manager's report

4.5.9 R The matters set out in (1) to ~~(12)~~(13) must be included in any authorised fund manager's report, except where otherwise indicated:

...

(11) for a report on an umbrella prepared in accordance with COLL 4.5.7R(2) or COLL 4.5.8R(2):

(a) (for an ICVC), a statement to the effect that, ...

(b) ... as a whole; and

(12) ... that scheme invests-; and

(13) for a report on an individual sub-fund of a scheme which is an umbrella prepared in accordance with COLL 4.5.7R(4) or COLL 4.5.8R(3):

(a) (for an ICVC) a statement corresponding to that required by (11)(a) making it clear that if the liability relates to another sub-fund of the umbrella, the shortfall or any part of it might have to be met out of the assets of the sub-fund to which the report relates; and

(b) a statement that the latest long report prepared for the

umbrella as a whole is available on request.

...

Provision of short report

- 4.5.13 R (1) ...
- (2) ...
- (a) ... accounting period; ~~and~~
- (b) ... at his request; and
- (c) to any other person free of charge on request.

...

Publication and availability of annual and half-yearly long report

- 4.5.14 R (1) The *authorised fund manager* must, within four *months* after the end of each *annual accounting period* and two *months* after the end of each *half-yearly accounting period* respectively, make available and publish the long reports prepared in accordance with *COLL 4.5.7R(1) to (3)* (Contents of the annual long report) ~~or and~~ *COLL 4.5.8R(1) to (2)* (Contents of the half-yearly report).
- (2) ...
- (a) be supplied free of charge to ~~unitholders who request it~~ any person on request;
- ...

...

Investment in collective investment schemes

- 5.2.13 R ...
- (2) and *COLL 5.2.16R* (Investment in other group schemes); ~~and~~
- (3) ... in *collective investment schemes*; and
- (4) where the second scheme is an umbrella, the provisions in (2) and (3) apply to each sub-fund as if it were a separate scheme.

...

5.5.2 R Table of application

This table belongs to *COLL 5.5.1R*

Rule	<i>ICVC</i>	<i>ACD</i>	<i>Manager of an AUT</i>	<i>Depositary of an ICVC</i>	<i>Trustee of an AUT</i>
...					
5.5.5R(4)	*	*			
...					

...

Borrowing limits

5.5.5 R ...

- (4) ~~[deleted] For an *ICVC*, borrowing does not include any arrangement for the *ICVC* to pay to a third party (including the *ACD*) any costs which the *ICVC* is entitled to amortise under the rules in this sourcebook and which were paid on behalf of the *ICVC* by the third party.~~

...

Investment in collective investment schemes

5.6.10 R *A non-UCITS retail scheme* must not invest in *units* in a *collective investment scheme* (second *scheme*) unless the second *scheme* meets each of the requirements at (1) to ~~(4)~~(5):

...

- (3) ... in *collective investment schemes*; ~~and~~

- (4) ...

- (b) in accordance with the *scheme*; ~~and~~

- (5) where the second *scheme* is an *umbrella*, the provisions in (2) to (4) apply to each *sub-fund* as if it were a separate *scheme*.

...

Investment limits for immovables

5.6.19 R ...

(5) not more than 20% in value of the *scheme property* is to consist of ~~mortgaged~~ immovables that are subject to a mortgage and ... ;

(6) ~~an immovable may be mortgaged up to 100% of the value in (4) provided that no more than 20% of the value of the *scheme property* consists of such immovables and any *transferable securities* which are not *approved securities*;~~

the aggregate value of:

(a) mortgages secured on immovables under (5);

(b) borrowing of the *scheme* under *COLL 5.6.22R(5)*; and

(c) any *transferable securities* that are not *approved securities*;

must not at any time exceed 20% of the value of the *scheme property*;

...

...

Cash, borrowing, lending and other provisions

5.6.22 R ...

(5) *COLL 5.5.5R(1)*, and (2) and (4) (Borrowing limits);

...

...

Appointment of an ACD

6.5.3 R ...

(3) For an *ICVC* that holds annual general meetings under the *OEIC Regulations*, ~~The the~~ ...

...

...

Application

6.9.1 R This section applies to ~~the~~ an *authorised fund manager*, and the a *depository*, of an *authorised fund* an *ICVC* and any other *directors* of an *ICVC*.

...

Consequences of commencement of winding up or termination

7.3.6 R ...

(3) The *ACD* must as soon as practicable after winding up or termination has commenced:

(a) ...

(b) if winding up an *ICVC* that has its head office situated in Northern Ireland, publish notice of the commencement of the winding up ~~(if the head office of the *ICVC* is situated in England and Wales or Wales) in the London Gazette, or (if the head office of the *ICVC* is situated in Scotland) in the Edinburgh Gazette or (if the head office of the *ICVC* is situated in Northern Ireland) in the Belfast Gazette.~~

...

Drawing up and availability of prospectus

8.3.2 R (1) ...

(b) ... *prospectus*, ~~and~~ ;

(c) ... to the *FSA*; ~~and~~

(d) review the *prospectus* periodically and revise it to take account of any significant change or new matter.

...

Report and accounts

8.3.5 R ...

(2A) Where the first *annual accounting period* of a *scheme* is less than 12 months, a half-yearly report need not be prepared.

...

(4) ~~[deleted] The *authorised fund manager* must comply with the requirements of the *IMA SORP*.~~

(5) The *authorised fund manager* must provide free of charge on the request of ~~a purchaser of units~~ any person eligible to invest in the *scheme* a copy of the latest annual or half-yearly report before the conclusion of ~~that~~ any sale to such person.

...

(7) For a *scheme* which is an *umbrella*, any annual report provided under (3) or (5) may be a report prepared under *COLL 8.3.5AR(3)*,

but the *authorised fund manager* must nevertheless provide free of charge the report prepared under *COLL 8.3.5AR(2)* if a *unitholder* or any other *person* eligible to invest in the *scheme* requests it.

Contents of the annual report

- 8.3.5A R (1) An annual report, other than for a *scheme* which is an *umbrella*, must contain:
- (a) the full accounts for the *annual accounting period* prepared in accordance with the requirements of the *IMA SORP*;
 - (b) the report of the *authorised fund manager* in accordance with *COLL 8.3.5CR* (*Authorised fund manager's report*);
 - (c) the report of the *depository* in accordance with *COLL 8.3.5DR* (*Report of the depository*); and
 - (d) the report of the auditor in accordance with *COLL 4.5.12R* (*Report of the auditor*).
- (2) An annual report on a *scheme* which is an *umbrella* must be prepared for the *umbrella* as a whole and must contain:
- (a) for each *sub-fund*, the full accounts required by (1)(a) and the report of the *authorised fund manager* in accordance with *COLL 8.3.5CR*;
 - (b) an aggregation of the accounts required by (a);
 - (c) the report of the *depository* in accordance with *COLL 8.3.5DR*; and
 - (d) the report of the auditor in accordance with *COLL 4.5.12R*.
- (3) The *authorised fund manager* of a *scheme* which is an *umbrella* may, in addition to complying with (2), prepare a further annual report for any one or more individual *sub-funds* of the *umbrella*, in which case it must contain:
- (a) for the *sub-fund*, the full accounts required by (1)(a) and the report of the *authorised fund manager* in accordance with *COLL 8.3.5CR*;
 - (b) the report of the *depository* in accordance with *COLL 8.3.5DR*; and
 - (c) the report of the auditor in accordance with *COLL 4.5.12R*.

- (4) The directors of an ICVC or the manager of an AUT must ensure that the accounts referred to in (1)(a), (2)(a) and (3)(a) give a true and fair view of the net income and the net gains and losses on the scheme property of the authorised fund or sub-fund for the relevant annual accounting period, and of the financial position of the authorised fund or sub-fund as at the end of that period.

Contents of the half-yearly report

- 8.3.5B R (1) A half-yearly report on an authorised fund or sub-fund must contain:
- (a) the full accounts for the half-yearly accounting period which must be prepared in accordance with the requirements of the IMA SORP; and
 - (b) the report of the authorised fund manager in accordance with COLL 8.3.5CR.
- (2) For a scheme which is an umbrella, the authorised fund manager may choose whether the half-yearly report is prepared for the umbrella as a whole, or for each individual sub-fund, or both.

Authorised fund manager's report

- 8.3.5C R The report of the authorised fund manager must include:
- (1) a review of the investment activities during the period to which the report relates;
 - (2) particulars of any fundamental or significant change to the authorised fund made since the date of the last report; and
 - (3) any other information which would enable unitholders to make an informed judgement on the development of the activities of the authorised fund during the period and the results of those activities as at the end of the period.

Report of the depositary

- 8.3.5D R (1) The depositary must make an annual report to unitholders which must be included in the annual report.
- (2) The depositary's report must contain:
- (a) a description, which may be in summary form, of the duties of the depositary under COLL 8.5.4R (Duties of the depositary) and in respect of the safekeeping of the scheme property; and
 - (b) a statement whether in any material respect:

- (i) the issue, sale, redemption and cancellation and calculation of the price of the units and the application of the authorised fund's income, have not been carried out in accordance with the rules in this sourcebook and, where applicable, the OEIC Regulations and the instrument constituting the scheme; and
- (ii) the investment and borrowing powers and restrictions applicable to the authorised fund have been exceeded.

...

Investment in a collective investment scheme that is an umbrella

8.4.5A R Where the second scheme in COLL 8.4.5R is an umbrella, the provisions apply to each sub-fund as if it were a separate scheme.

...

Valuation of an OTC derivative

8.4.7A R A transaction in an OTC derivative must be capable of valuation which it will only be if the authorised fund manager having taken reasonable care determines that, throughout the life of the derivative (if the transaction is entered into), it will be able to value the investment concerned with reasonable accuracy:

- (1) on the basis of the pricing model; or
 - (2) on some other reliable basis reflecting an up-to-date market value;
- which has been agreed between the authorised fund manager and the depositary.

...

COLL Sourcebook – Transitional Provisions

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional Provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
Extra time provision					
...					

13	<u>COLL 4.2.5R, Table paragraphs 2 (bb), 11 (a)(v) and 23 (e)</u>	<u>R</u>	<p><u>In relation to any authorised fund in existence on the day before 6 April 2006 there is no obligation to revise the <i>prospectus</i> as a result of the application of <i>COLL</i> 4.2.5R, Table paragraphs 2 (bb), 11 (a)(v) or 23 (e) until the earlier of:</u></p> <p><u>(1) the date the <i>prospectus</i> is next revised; and</u></p> <p><u>(2) 6 April 2007.</u></p>	<u>From 6 April 2006 to 6 April 2007</u>	<u>6 April 2006</u>
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...

PERIMETER GUIDANCE (PENSION TERM ASSURANCE) INSTRUMENT 2006

Powers exercised

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

Commencement

- B. This instrument comes into force on 6 April 2006.

Amendments to Perimeter guidance

- C. General guidance on FSA regulatory perimeter issues, amending the Perimeter Guidance manual, is made in the form set out in the Annex to this instrument. This general guidance does not form part of the FSA Handbook.

Citation

- D. This instrument may be cited as the Perimeter Guidance (Pension Term Assurance) Instrument 2006.

By order of the Board
23 February 2006

Annex

Amendments to the Perimeter Guidance manual

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

PERG 2 Annex 2G

Regulated activities and the permission regime

...

3 Table

Notes to Table 1
...
Note 5B: <u>In PERG, lifeLife policy</u> is the term used in the <i>Handbook</i> to mean 'qualifying contract of insurance' (as defined in article 3(1) of the <i>Regulated Activities Order</i>). and, except in COB 3, PERG 5 and PERG 8 For the purpose of the <u>permission regime</u> , the term also includes a <u>long-term care insurance contract</u> which is a <u>pure protection contract</u> and a <u>pension term assurance policy</u> .
...

**PERIMETER GUIDANCE (PROPERTY AND LAND INVESTMENT SCHEMES)
INSTRUMENT 2006**

Powers exercised

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

Commencement

- B. This instrument comes into force on 6 March 2006.

Amendments to Perimeter guidance

- C. General guidance on FSA regulatory perimeter issues, amending the Perimeter Guidance manual, is made in the form set out in the Annex to this instrument. This general guidance does not form part of the FSA Handbook.

Citation

- D. This instrument may be cited as the Perimeter Guidance (Property and Land Investment Schemes) Instrument 2006.

By order of the Board
23 February 2006

Annex

Amendments to the Perimeter Guidance manual

In this Annex, underlining indicates new text. This is with the exception of the insertion of the new Chapter 11 which is all new text and is not underlined.

1.4.2 G Table: list of general guidance to be found in *PERG*

Chapter:	Applicable to:	About:
...		
<u>PERG 11:</u> Property investment clubs and land investment schemes	<u>Any person who needs to know whether his activities in relation to property investment clubs and land investment schemes will amount to regulated activities or whether the restriction in section 21 of the Act will apply to any financial promotions he may make.</u>	<ul style="list-style-type: none">• <u>the regulated activities that may arise in connection with the establishment and operation of property investment clubs and land investment schemes and any exclusions that may be relevant</u>• <u>the extent to which the financial promotion restriction in section 21 of the Act applies</u>

2.7.12 G ... CIS 16 (Applicaton and Notification). Guidance on whether certain types of scheme (property and land investment schemes) may amount to collective investment schemes is set out in PERG 11 (Property investment clubs and land investment schemes).

Insert the following new text to be added as Chapter 11

Chapter 11 Guidance on property investment clubs and land investment schemes

11.1 Background

Q1. What is the purpose of these questions and answers (“Q&As”) and who should be reading them?

These Q&As are principally aimed at those involved in the running of property investment clubs or schemes involving the sale of plots of land with arrangements for obtaining planning permission in respect of them or for the disposal of the land as a whole. They are intended to help such persons understand whether they will be carrying on a *regulated activity* and need

to be an *authorised person* or *exempt person* under section 19 of the Financial Services and Markets Act 2000. The Q&As may also be of assistance to investors in such schemes concerned about whether the scheme they are investing in should be run by an authorised or exempt person.

The Q&As that follow are set out in two sections:

- Guidance on property investment clubs (PERG 11.2)
- Guidance on land investment schemes (PERG 11.3)

11.2 Guidance on property investment clubs

Q2. What are property investment clubs?

In general, property investment clubs, (sometimes also known as buy-to-let schemes, buy-to-let syndicates or property investment syndicates) are schemes allowing members of the public to invest in property and which possess some or all of the following characteristics:

- a pooling of resources to allow investment in, or collective management of, real property;
- much or all of the property purchased being financed by money borrowed by the members of the scheme (a typical split being 15% equity and 85% debt), with the borrowing often being arranged by the property investment club itself for members;
- the offer of educational training on the property market;
- other help given to members by the property investment club, including help with the purchase, and the sale, of the property (sometimes involving forward purchase contracts);
- the properties concerned are often newly, or not yet, built; and
- discounts are often offered, or are purported to be offered, on the price of the property (usually from the developer in recognition of a bulk purchase by club members).

Q3. Does the FSA regulate property investment clubs?

The FSA regulates the operation and promotion of property investment clubs if, in substance, they amount to *collective investment schemes*.

If a scheme, in substance, is a collective investment scheme, it cannot escape the need for regulation by being dressed up as something else.

Q4. What is a collective investment scheme and will my property investment club be one?

Broadly speaking, a collective investment scheme is any arrangement:

- the purpose or effect of which is to enable those taking part (either by owning the property, or part of it, or otherwise) to participate in or receive profits or income arising from the acquisition, holding, management or disposal of the property;
- where persons taking part do not have day-to-day control over the management of the property; and
- where either the contributions and profits or income are pooled, or the property is managed as a whole by or on behalf of the operator of the scheme, or both.

Whether your property investment club is a collective investment scheme or not will depend on its individual structure and the facts surrounding it. If your club meets each of the above conditions and is not exempt, then its operation and promotion should come under FSA regulation. This is regardless of whether that was intended by the person operating or promoting the club.

Q5. Can a body corporate be used rather than a collective investment scheme?

Yes, if all your rights in a scheme derive from ownership of securities issued by a body corporate, the scheme will not be a collective investment scheme. This is unless the body corporate is an *open-ended investment company* or a limited liability partnership. PERG 9 has guidance on the meaning of open-ended investment company.

Q6. What is the purpose of the ‘day-to-day control’ test and the nature of day-to-day control?

The purpose of the ‘day-to-day control’ test is to try to draw an important distinction about the nature of the investment that each investor is making. If the substance is that each investor is investing in a property whose management will be under his control, the arrangements should not be regarded as a collective investment scheme. On the other hand, if the substance is that each investor is getting rights under a scheme that provides for someone else to manage the property, the arrangements would be regarded as a collective investment scheme.

Day-to-day control is not defined and so must be given its ordinary meaning. In our view, this means you have the power, from day-to-day, to decide how the property is managed. You can delegate actual management so long as you still have day-to-day control over it.

Q7. The participants in my property investment club do not get involved in every single management decision, but appoint agents to take decisions for them in accordance with criteria agreed between them. Have the participants lost day-to-day control?

We do not consider that day-to-day control means that each participant would themselves need to be involved in each and every decision taken, so long as they retain day-to-day control over the management. For example, delegating rent collection, cleaning and management services in relation to a property, by appointing agents to carry out these tasks would not necessarily mean that the participants lose day-to-day control, so long as the participants retain day-to-day control over the management of the agency contracts.

Q8. Must each participant individually have day-to-day control for my property investment club not to be a collective investment scheme?

Yes, though this does not prevent two or more individuals having day-to-day control together. (This may happen, for example, where business partners buy several flats in a block and manage them jointly.) But the more distant any individual participant is from controlling the management of the property himself, the less likely it is that the individual participants can be said to have control which is ‘day-to-day’.

Q9. I run a property investment club where the participants have a right to be consulted on management decisions or at least give directions. Do they have day-to-day control?

Not by virtue of those rights alone. Simply having the right to be consulted or give directions is not enough to give a participant day-to-day control.

Also, if all management decisions are taken by the operator (or a person appointed by him) using generic mandates (for example, a power of attorney) from participants, then it is unlikely to be the case that the participants have day-to-day control. It is more likely in this case that the scheme is effectively one where management is devolved entirely to the operator, with participants only retaining a notional control over the decision-making of the operator – in essence amounting to a right to be consulted or give directions, rather than day-to-day control.

Q10. I have promoted or set up a property investment club such that the documents that each participant signs explicitly say that they have day-to-day control over the management of the property - does that mean it is not a collective investment scheme?

No. In our view, regardless of what rights or powers the documentation purports to give its participants, it is important to look at what happens in fact. It is the substance rather than the form that counts. So, if the participants are stated to have day-to-day control, simply as an attempt to avoid the property investment club amounting to a collective investment scheme, but they do not, in fact, have such day-to-day control, then the club may still amount to a collective investment scheme. In that case, its operation and promotion would be regulated by the FSA.

Q11. I run a property investment club where all of the major participants have day-to-day control over the management of the property but, by choice, one or two of the smaller participants do not. Does this mean that the club could still be a collective investment scheme?

Yes, if the other elements are present. In order for the arrangements not to be a collective investment scheme, all individual participants, regardless of their contribution or stated preferences, must have day-to-day control. So, if one participant does not have day-to-day control then the whole scheme could amount to a collective investment scheme.

Q12. I run a scheme where each person owns individual properties or parts of properties in the property investment club. Each person owns property either directly, or indirectly (for example, through a limited company or a limited liability partnership

of which he is the owner or through a limited partnership). Is this scheme likely to be a collective investment scheme?

No, unless the properties belonging to each person, company, limited liability partnership or limited partnership are managed as a whole by or on behalf of the operator of the scheme. So, the mere fact that the operator is managing a number of properties and achieves economies of scale in his management charges or in things such as insurance cover would not mean that the properties are being managed as a whole. Neither would the fact that the operator may be able to offer reductions in sale price because of bulk discounts negotiated with developers. This is provided the operator is managing each property on an individual basis.

As an example, if a managing agent manages a block of flats on the basis that the only profit or income each individual flat owner obtains is what arises from the management of his property, there is no management as a whole. However, if the managing agent managed the flats in such a way that each individual flat owner received an income from total lettings, regardless of whether that person's flat was let or not, the properties are managed as a whole and the arrangements are likely to be a collective investment scheme.

Q13. Does it make a difference if people participate through a corporate vehicle?

No. But it should be noted that a limited liability partnership or limited partnership, through which a person indirectly owns the property concerned, may amount to a collective investment scheme itself. This is if the partnership has more than one investor participant and subject to the considerations set out in this guidance.

Q14. I run a property investment club where the participants own their own individual properties which are rented out but the rental income is pooled and I decide on which property should be rented at any time and to whom. Is this likely to be a collective investment scheme?

Yes. This is because:

- the property in respect of which the arrangements are made is the property belonging to each of the participants;
- you are managing that property as a whole; and
- the participants do not have day-to-day control over the management of that property.

Q15. If my property investment club is not a collective investment scheme because participants acquire shares in a body corporate, does that mean that I do not need to be authorised?

Not necessarily. Depending on the circumstances, you may be involved in making arrangements for the participants to buy, sell or subscribe for their shares which is itself a regulated activity and may only be carried on by an authorised or exempt person.

Q16. Does the FSA regulate the mortgages that are used to finance property investment clubs?

No. The FSA only regulates the provision of mortgages on property where the borrower intends to use at least 40% of it as a dwelling for him or a close relative. This is typically not the case with properties purchased through property investment clubs.

Q17. What are the consequences of a property investment club being regulated by the FSA?

If a property investment club were considered to be a collective investment scheme, and therefore its operation and promotion regulated by the FSA, then any person operating the scheme in the *United Kingdom* or advising investors on the merits of participating or arranging for them to do so, must be an authorised or exempt person. If such a person was not authorised or exempt, he would be liable to commit a criminal offence. It is only the activities of such persons that would be regulated by the FSA. The property investment club itself would not be regulated by the FSA as a product in the way that authorised unit trusts or authorised open-ended investment companies (which are collective investment schemes) are. Also, agreements entered into by an unauthorised person in the course of their operating, advising on or arranging for persons to participate in a collective investment scheme are potentially unenforceable against the other party and the other party may be entitled to compensation from the unauthorised person.

Q18. Are there restrictions on the promotion of my property investment club?

Yes, if it is a collective investment scheme or involves investors acquiring securities issued by a body corporate – otherwise not. If your property investment club is a collective investment scheme, you would not be able to promote it to the general public and, unless exempt, any promotional material would need to comply with FSA rules. PERG 8 has guidance about the restrictions on all kinds of *financial promotion*.

Q19. Does the FSA or Treasury intend to regulate all property investment clubs?

We understand that, as at 6 March 2006, there is no current intention to change existing regulatory boundaries.

11.3 Guidance on land investment schemes involving planning permission arrangements

Q20. I run a business arranging for the sale of individual plots of development land to investors who are also required to use my services in obtaining planning permission for or disposing of the land as a whole (or both). Might I need to be authorised?

Yes, this is likely to be the case. This will be because the role you have in obtaining planning permission or in negotiating and effecting the sale of the land (or both) may mean that you are operating a collective investment scheme (see Q4). The purpose or effect of the arrangements would appear to be to enable investors, as owners of parts of the land, to receive profits arising from your services in obtaining planning permission or arranging disposal in respect of the land as a whole. If the planning or disposal process is such that individual investors do not have day-to-day control over it, the arrangements are likely to amount to a collective investment scheme, and to operate it you would need to be authorised

or exempt. The restrictions on financial promotions referred to in Q18 would also need to be considered.

Q21. I run a business which arranges for individual plots of land to be sold to potential investors and, whilst I refer to the possibility of obtaining planning permission as a way of increasing the value of the land, I don't, nor does anyone connected to me, have a role in pursuing any such permission nor any other control over the land as a whole. Do I need to be authorised?

No. If all of the participants have control over the obtaining of planning permission relevant to their individual plots of land the arrangements will not be a collective investment scheme. Arranging for investment in plots of land by itself is not a regulated activity as plots of land are not of themselves *specified investments*.

FEES PROVISIONS INSTRUMENT 2006

Powers exercised

- A. The Financial Services Authority ("FSA") makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 ("the Act"):
- (1) section 72 (The competent authority);
 - (2) section 74(4) (The official list);
 - (3) section 99(1) (Fees);
 - (4) section 101 (Listing rules: general provisions);
 - (5) section 138 (General rule-making power);
 - (6) section 156 (General supplementary powers);
 - (7) section 157(1) and (4) (Guidance);
 - (8) section 213 (The Compensation Scheme);
 - (9) section 223 (Management expenses);
 - (10) paragraph 17(1) of Schedule 1 (Fees); and
 - (11) paragraphs 1 (General), 4 (Rules), and 7 (Fees) of Schedule 7 (The Authority as Competent Authority for Part VI).
- B. The rule-making powers listed above are specified for the purpose of section 153(2) (Rule-making instruments) of the Act.

Commencement

- C. This instrument comes into force on 1 April 2006.

Amendments to the Handbook

- D. The Fees manual is amended in accordance with Annex A to this instrument.
- E. The Supervision manual is amended in accordance with Annex B to this instrument.
- F. The Credit Unions sourcebook is amended in accordance with Annex C to this instrument.

Citation

- G. This instrument may be cited as the Fees Provisions Instrument 2006.

By order of the Board
23 March 2006

Annex A

Amendments to the Fees manual

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

- 2.2.1 R If a *person* does not pay the total amount of a periodic fee (including fees relating to reportable transactions to the FSA using the FSA's Direct Reporting System or FSA's Transaction Reporting System (see SUP 17)), FOS levy or case fee, ...

...

FEES 3 Annex 4R

Application and tranche fees in relation to listing rules

Part 1

Fee type	Fee amount
Application Fees for the period 1 July 2005 to 31 March 2006	
Application for <i>listing</i>	<u>£225200 plus £100 per each additional issue of securities with its own International Securities Identification Number.</u>
...	

...

FEES 3 Annex 5R

Document vetting and approval fees in relation to listing and prospectus rules

...

Part 2

...

...	
Tranches — upfront fee per tranche for draw downs in the following 12 months. Payment in advance for more than 75 draw downs will attract a 10% discount.	£100

...

FEES 3 Annex 6R

Fees payable for guidance on the availability of a waiver (or concession) in connection with rules implementing Basel Capital Accord

Part 1

Fees payable other than applications for guidance on the availability of a waiver (or concession) to allow a firm to use the Effective Expected Potential Exposure estimates

Table 1

Application group	Description of group	Application fee 2005/2006 2006/07		
		Advanced IRB (£'000)	Foundation IRB (£'000)	AMA (£'000)
Group 1	Five or more significant overseas entities applying for <i>guidance</i> on the availability of a <i>waiver</i> or concession in connection with future <i>rules</i> implementing the revised Basel Capital Accord (including any amendments)	247219	214190	167148

...

Table 2

Application group	Description of group		Application fee 2005/2006 2006/07		
	Modified eligible liabilities (£m)	Number of traders as at 31 December 2004 2005	Advanced IRB (£'000)	Foundation IRB (£'000)	AMA (£'000)
Group 2	>40,000	>200	214190	183162	135120
Group 3	>5,000 - 40,000	26 - 200	8777	6659	4742
Group 4	0 - 5,000	0 - 25	3935	2825	2220
(1)	Advanced and Foundation IRB applications are applications for <i>guidance</i> regarding the Internal Ratings Based approach for credit risk. AMA applications are applications for guidance regarding the Advanced Measurement Approach for operational risk.				
(2)	For the purposes of Table 2, a <i>firm's</i> A.1 or A10 tariff data for the relevant period will be used to provide the value of modified eligible liabilities or number of traders.				

...

Part 2

Fees payable for applications for guidance on the availability of a waiver (or concession) to allow a firm to use the Effective Expected Potential Exposure estimates

£50,000

...

4.2.11 R Table of periodic fees

...			
<i>Sponsors</i>	<u>£10,000 per year for the period from 1 April to 31 March the following year (see Note)</u>	Within 30 <i>days</i> of the date of the invoice	Approval of <i>sponsor</i>
...			

Note: *Sponsors* on the list of approved *sponsors* as at 1 April each year will be liable for the full year's annual fee unless FEES 4.3.13R applies.

...

4.3.13 R (1) If:

- (a) a *firm* makes an application to vary its *permission* (by reducing its scope), or cancel it, in the way set out in SUP 6.3.15D(3) (Variation of permission) and SUP 6.4.5D (Cancellation of permission); an *issuer* makes an application for de-listing; or a *sponsor* notifies FSA of its intention to be removed from the list of approved *sponsors*; and
- (b) the *firm*, *issuer* or *sponsor* makes the application or notification referred to in (a) before the start of the period to which the fee relates;

FEES 4.2.1R applies to the *firm* as if the relevant variation or cancellation of the *firm's permission*, de-listing or removal from the list of approved *sponsors*, took effect immediately before the start of the period to which the fee relates.

- (2) But (1) does not apply if, due to the continuing nature of the business, the variation, ~~or~~ cancellation, de-listing or removal is not to take effect within three *months* of the start of the period to which the fee relates.

...

FEES 6 Annex 1R

Financial Services Compensation Scheme - Management Expenses Levy Limit

This table belongs to *FEES* 6.4.2R

Period	Limit on total of all management expenses levies attributable to that period (£)
1 December 2001 to 1 April 2002	£4,209,000
1 April 2002 to 31 March 2003	£13,228,000
1 April 2003 to 31 March 2004	£13,319,000
1 April 2004 to 31 March 2005	£17,590,000
1 April 2005 to 31 March 2006	£27,030,000
<u>1 April 2006 to 31 March 2007</u>	<u>£37,060,000</u>

Annex B

Amendments to the Supervision manual

In this Annex, underlining indicates new text.

...

16.3.14 R (1) If a *firm* does not submit a complete report by the date on which it is due in accordance with the *rules* in this chapter and any prescribed submission procedures, the *firm* must pay an administrative fee of £250.

(2) The administrative fee in (1) does not apply in respect of quarterly reports required to be submitted by *credit unions*.

...

Annex C

Amendments to the Credit Unions sourcebook

In this Annex, underlining indicates new text.

...

- 14.10.4D G If a *credit union* fails to submit a complete annual report by the date on which it is due in accordance with the *rules* in SUP 16.7 and any prescribed submission procedures, the *credit union* must pay an administrative fee of £250 (see SUP 16.3.14R). Failure to submit a report in accordance with the *rules* in SUP 16.7 may also lead to the imposition of a financial penalty and other disciplinary sanctions (see ENF 13.5 and CRED 15.5).

...

MARKET CONDUCT SOURCEBOOK (AMENDMENT NO 7) INSTRUMENT 2006

Powers exercised

- A. The Financial Services Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 ("the Act"):
- (1) section 119 (The code);
 - (2) section 138 (General rule-making power);
 - (3) section 149 (Evidential provisions); and
 - (4) section 157(1) (Guidance).

Commencement

- B. This instrument comes into force on 6 April 2006.

Amendment to the Glossary of definitions

- C. The Glossary of definitions is amended in accordance with Annex A to this instrument.

Amendment to the Market Conduct sourcebook

- D. The Market Conduct sourcebook is amended in accordance with Annex B to this instrument.

Citation

- E. This instrument may be cited as the Market Conduct Sourcebook (Amendment No 7) Instrument 2006.

By order of the Board
23 March 2006

Annex A

Amendment to the Glossary of definitions

In this Annex, underlining indicates new text.

Insert the following new definition in the appropriate alphabetical position:

metal market
aberrations regime

The practices set out in the London Metal Exchange's document "Market Aberrations: The Way Forward" published in October 1998 which govern the behaviour expected of long position holders, as clarified and explained by Schedule 1 to the Memorandum from the Executive Director, Regulation and Compliance, London Metal Exchange, to All Members of the London Metal Exchange dated 15 December 2005.

Annex B

Amendments to the Market Conduct sourcebook

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

1.6.14 E The following are accepted by the FSA as *accepted market practices* for the purposes of *market abuse (manipulating transactions)*:

- (1) ~~The practices set out in the London Metal Exchange's document "Market Aberrations: The Way Forward" published in October 1998~~ *metal market aberrations regime* ~~which govern the behaviour expected of long position holders (see MAR 1 Annex 2G).~~

...

1.9.3 C *Behaviour* that complies with the requirements imposed on long position holders in the ~~London Metal Exchange's document "Market Aberrations: The Way Forward" published in October 1998~~ *metal market aberrations regime* will not amount to *market abuse (distortion)*.

...

MAR 1 Annex 2 G

Accepted Market Practices

...

Table: Part 2 – Accepted Market Practice: Market aberrations on the London Metal Exchange

Description of the AMP:	
Behaviour conforming with the London Metal Exchange Document "Market Aberrations: the Way Forward" published in October 1998 <u><i>metal market aberrations regime</i></u> which governs the behaviour expected of long position holders in this market.	
Rationale for why the practice would constitute manipulation	
Behaviour which gives rise to the application of the London Metal Exchange Document "Market Aberrations: the Way Forward" published in October 1998 <u><i>metal market aberrations regime</i></u> may involve transactions or orders to trade which:	
(i)	give or are likely to give, false or misleading signals as to the supply of or demand for or price of <i>financial instruments</i> ;
(ii)	secure, by a person or persons acting in collaboration, the price of one or several <i>financial instruments</i> at an abnormal or artificial level.

List of Factors
The following factors were taken into account by the FSA when assessing behaviour conforming with the London Metal Exchange Document "Market Aberrations: the Way Forward" <i>metal market aberrations regime</i> as an accepted market practice:
<i>The level of transparency (to the rest of the market) of the practice in question</i>
The Metal Market Aberrations Regime <i>metal market aberrations regime</i> has been published to the market by the Exchange on which it applies. The transparency criterion is therefore met. Those who have long positions at or above the thresholds specified in the Market Aberrations Regime <i>metal market aberrations regime</i> are required to advertise to the market that they will be prepared to lend stock.
<i>The need to safeguard the operation of market forces and the proper interplay of the forces of supply and demand</i>
The Metal Market Aberrations Regime <i>metal market aberrations regime</i> is designed to facilitate the operation of supply and demand on the market by avoiding abusive squeezes or other circumstances which could result in or involve distortion of the market for the investment in question.
...
<i>The degree to which the practice takes into account the trading mechanism of the relevant market and enables market participants to react properly and in a timely manner to the new market situation created by the practice</i>
The practice in the London Metal Exchange Document "Market Aberrations: the Way Forward" <i>metal market aberrations regime</i> was developed taking into account the trading mechanism of the LME. The behaviour required of long position holders under the London Metal Exchange Document "Market Aberrations: the Way Forward" , <i>metal market aberrations regime</i> is monitored by the LME compliance department on a daily basis using public and confidential regulatory information available to it. ...
<i>The risk inherent in the practice for the integrity of directly or indirectly related markets in the financial instrument, including any market in the financial instrument which exists on an exchange (or other trading venue) and related markets in directly related financial instruments:</i>
The practices in the London Metal Exchange Document "Market Aberrations: the Way Forward" <i>metal market aberrations regime</i> were <i>was</i> developed to maintain the integrity of the markets in <i>financial instruments</i> traded in the LME. The practices have <i>regime has</i> been shown to be an aid in maintaining the integrity of those markets.
<i>The outcome of any investigation of the practice by any regulatory body, including the extent to which a practice breaches existing rules or regulations designed to prevent market manipulation on the market in question or on directly or indirectly related markets in the EU-</i>
The FSA <i>FSA</i> supports the regime outlined in the London Metal Exchange Document "Market Aberrations: the Way Forward" <i>metal market aberrations regime</i> and, under the

previous Code of Market Conduct applying to trading on the LME, provided a safe harbour for behaviour in conformity with the ~~practices outlined in the document~~ metal market aberrations regime.

...

Overriding Principles

The ~~FSA~~FSA had regard to the following overriding principles to ensure that the ~~practices outlined in the London Metal Exchange Document "Market Aberrations: the Way Forward"~~ metal market aberrations regime ~~do~~ does not undermine market integrity, while fostering innovation and the continued dynamic development of financial markets:

...

Conditions relating to legitimate reasons and proper execution:-

The ~~regime in the London Metal Exchange Document "Market Aberrations: the Way Forward"~~ metal market aberrations regime specifies the behaviour required in the circumstances where it is triggered and conduct in conformity with the ~~regime~~ metal market aberrations regime is for legitimate reasons.

PERIMETER GUIDANCE (PENSION ACTIVITIES) INSTRUMENT 2006

Powers exercised

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

Commencement

- B. This instrument comes into force on 6 May 2006.

Amendments to the Perimeter Guidance manual

- C. The Perimeter Guidance manual (PERG) is amended in accordance with the Annex to this instrument. The general guidance in PERG does not form part of the Handbook.

Citation

- D. This instrument may be cited as the Perimeter Guidance (Pension Activities) Instrument 2006.

By order of the Board
23 March 2006

Annex

Amendments to the Perimeter Guidance manual

In this Annex, underlining indicates new text and striking through indicates deleted text. This is with the exception of Chapter 10 which represents new text that is not underlined.

1.4.2 G Table: list of general guidance to be found in *PERG*

Chapter:	Applicable to:	About:
...		
<i>PERG</i> 10: Activities related to pension schemes	[to be added] <u>Any person who needs to know whether his activities in relation to pension schemes will amount to regulated activities or whether the restriction in section 21 of the Act will apply to any financial promotions he may make.</u>	<ul style="list-style-type: none"> • <u>the regulated activities that arise in connection with the establishment and operation of pension schemes and any exclusions that may be relevant</u> • <u>the circumstances in which financial promotions about pension schemes may be exempt from the restriction in section 21 of the Act</u>

1.5.1 G ...

(1) ...

<http://www.fsa.gov.uk/pages/doing/info/mgi/topics/risk.shtml>
;

http://www.fsa.gov.uk/Pages/Doing/small_firms/insurance/library/archive/risk.shtml;

(2) ...

<http://www.fsa.gov.uk/Pages/Doing/Info/MGI/FAQs/travel.shtml>;

http://www.fsa.gov.uk/pages/Doing/small_firms/insurance/faq/travel.shtml;

- (3) ...
<http://www.fsa.gov.uk/pages/Doing/Info/MGI/FAQs/freight.shtml>;
http://www.fsa.gov.uk/pages/Doing/small_firms/insurance/faq/freight.shtml;
- (4) ...
<http://www.fsa.gov.uk/Pages/Doing/Info/MGI/FAQs/property.shtml>;
http://www.fsa.gov.uk/pages/Doing/small_firms/insurance/faq/property.shtml;
- (5) ...
<http://www.fsa.gov.uk/pages/doing/info/mgi/faqs/exclusion.shtml>;
http://www.fsa.gov.uk/pages/Doing/small_firms/insurance/faq/exclusion.shtml;
- (6) ...
<http://www.fsa.gov.uk/Pages/Doing/Info/MGI/FAQs/insurers.shtml>;
http://www.fsa.gov.uk/pages/Doing/small_firms/insurance/faq/insurers.shtml;
- (7) ...
- (8) ...
http://www.fsa.gov.uk/pages/doing/info/mgi/pdf/property_guidance_note.pdf; and
http://www.fsa.gov.uk/pages/Doing/small_firms/insurance/library/imd.shtml; and
- (9) ...

...

New text to be added as Chapter 10

10 Guidance on activities related to pension schemes

10.1 Background

Q1. What is the purpose of these questions and answers (“Q&As”) and who should be reading them?

These Q&As are aimed at *persons* involved in the establishment or running of a pension scheme or in providing services to such persons and should be read, in particular, by:

- pension scheme trustees;
- those who provide services to pension schemes or their trustees; and
- employers or affinity groups who provide pension schemes for their employees or members.

They are intended to help such persons understand:

- whether they will be carrying on a *regulated activity* and so need to be an *authorised* or *exempt person* under section 19 of the Financial Services and Markets Act 2000; and
- whether their communications are *financial promotions* and, if so, whether they will be exempt from the restriction in section 21 of that Act.

The Q&As are primarily concerned with identifying the regulated activities (such as dealing or arranging deals in investments, managing investments or advising on investments) that may be carried on by persons (including trustees) who are involved with *occupational pension schemes* and personal pension schemes. They are also concerned, but only in relation to *stakeholder pension schemes*, with identifying when the regulated activity of operating such a scheme will be carried on (see Q26).

The Q&As complement the general *guidance* on regulated activities in Chapter 2 of our Perimeter Guidance Manual (“PERG”), the general guidance on insurance mediation activities in Chapter 5 of PERG (PERG 5) and the relevant legislation.

The Q&As that follow are set out in sections:

- general issues (PERG 10.2);
- issues for pension scheme trustees (PERG 10.3);
- issues for pension scheme service providers other than trustees (PERG 10.4); and
- issues for employers or affinity groups (PERG 10.5);

and are complemented by:

- Annex 1 : Flow chart showing the steps to be considered in deciding whether authorisation is needed;
- Annex 2: Flow chart showing the additional steps to be considered by trustees of occupational pension schemes and other persons in deciding whether authorisation is needed for managing the assets of such a scheme;
- Annex 3: Table summarising the regulatory position of pension scheme trustees and service providers;
- Annex 4: Table summarising the regulatory position of employers and affinity groups; and

- Annex 5: Table summarising the regulatory position concerning financial promotions by trustees, employers and affinity groups.

10.2 General issues

Q2. I propose to provide services to a pension scheme – in what circumstances will I need to be authorised by the FSA or be an exempt person?

You will need to be an *authorised* or *exempt person* if you will:

- be carrying on *regulated activities*;
- be doing so by way of business; and
- be doing so in the *United Kingdom*.

Q3. How will I know if my proposed activities are regulated?

Regulated activities are specified in the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (“the *Regulated Activities Order*”). They include:

- *dealing* (broadly, entering into a transaction as principal or agent to *buy* or *sell* certain investments);
- *arranging* (broadly, bringing about an investment transaction between other parties or making arrangements to assist other *persons* to enter into such transactions);
- *managing investments* (broadly, discretionary management of assets that include or may include certain investments);
- *assisting in the administration and performance of a contract of insurance* (broadly, notifying and providing evidence in support of or negotiating claims on behalf of policyholders);
- *safeguarding and administering investments*, being assets that include or may include certain investments (otherwise known as custody services);
- *advising on investments* (broadly, advising an investor on the merits of his *buying* or *selling* certain particular investments);
- *establishing, operating or winding up a stakeholder pension scheme*.

But some activities are specifically excluded from the FSA’s regulatory scope.

Q4. What kind of investments do these regulated activities relate to?

Securities, such as shares, debt securities, warrants or unit trusts, and *contractually based investments* such as options, futures and cash-settled instruments (contracts for differences) or long-term insurance policies with an investment element (such as unit-linked insurance or annuities). Some *regulated activities*, such as *arranging* and *advising on investments*, also relate to all *contracts of insurance*.

Q5. What exclusions are available?

There are various exclusions – some relate to a single activity and others relate to several. Further guidance on exclusions is given in the remaining questions.

Q6. How do I know if I am carrying on activities by way of business?

Whether a particular *person* will be carrying on a *regulated activity* by way of business (and so needs *authorisation* or exemption) will invariably depend on that person's individual circumstances. A number of factors need to be taken into account in determining whether the by-way-of-business test is met. These include:

- the degree of continuity;
- the existence of a commercial element;
- the scale of the activity;
- the proportion which the activity bears compared to other activities carried on by the same person which are not regulated; and
- the nature of the particular regulated activity that is carried on.

Corporate pension scheme trustees and other persons who provide professional services to pension schemes are likely to be carrying on their activities by way of business. Unpaid individuals who act as trustees are not likely to be. Neither are in-house trustee companies set up by an employer to operate its *occupational pension scheme* (“OPS”) or the employer if it acts as the trustee itself. In this respect, however, article 4 of the Financial Services and Markets Act 2000 (Carrying on Regulated Activities by Way of Business) Order 2001 (“the *Business Order*”) amends this test for trustees and other persons who manage the assets of an OPS. The effect of the amendment is that a trustee will need to be authorised if he is managing the investments of an OPS, whether or not he would normally be regarded as doing so by way of business. This is unless certain conditions are met (as explained in questions 7 to 22).

In addition, article 3(4) of the *Business Order* provides that any person who carries on an *insurance mediation activity* by way of business must be remunerated for doing so. Guidance on the application of the by-way-of-business test to insurance mediation activities is in Chapter 5.4 of PERG.

10.3 Pension scheme trustees

Q7. I am a trustee of an occupational pension scheme (“OPS”) – will I need to be authorised if I also manage the investments held under my scheme?

Only if you are involved in the day-to-day management of the assets and your scheme is not a *small self-administered scheme*.

Occupational pension scheme trustees are subject to special treatment when they manage investments held under their scheme. This means that they may need to be *authorised* even though they are not carrying on their managing activities by way of business in the normal sense (they may be unpaid individuals for example).

That aside, and broadly speaking, you will not need to be *authorised* if:

- you delegate day-to-day decision-making about *securities* or *contractually based investments* to an *authorised, exempt* or *overseas person* (typically a fund manager); or
- the only day-to-day decisions you take relate to pooled investment products and are only taken after you have obtained and considered advice from a regulated person; or
- your scheme is fully insured and you do not take or need to delegate any day-to-day decisions; or
- your scheme is a small self-administered scheme.

Q8. What decisions can I make, as a trustee of an OPS (other than a small-self administered scheme), if I am not authorised?

You can make:

(1) strategic decisions, such as decisions:

- about the adoption or revision of a statement of investment principles as required by relevant pensions legislation; or
- about the formulation of a general asset allocation policy; or
- about prescribing the method and frequency for rebalancing asset classes, and the permitted ranges of divergence, following the setting of the general asset allocation policy; or
- about the proportion of the assets that should constitute investments of particular kinds; or
- affecting the balance between income and growth; or
- about the appointment of fund managers; or
- as to which pooled investment products to make available for members to choose from under a money purchase scheme;

(2) decisions that are needed to be taken in exceptional circumstances, such as:

- in a take-over situation; or
- where the person managing the scheme's assets has a conflict of interest; or
- where the decision is sensitive (such as one relating to investments in the same market sector as the employer or in the employer's own securities); or
- where the decision raises sensitive policy considerations (such as investments in certain territories or markets or in ethical or green areas); or
- where the trustees are required to make decisions:
 - about investments acquired purely as a result of a demutualisation by an insurer or building society in which the scheme holds investments or deposits;or

- following a change in fund managers which results in the scheme holding investments which the new fund manager is unable or unwilling to take on;

(3) day-to-day decisions about investment in pooled investment products, namely:

- *collective investment schemes* such as unit trusts, limited partnerships, hedge funds or open-ended investment companies;
- shares or debt securities issued by an investment company such as an investment trust or a venture capital trust;
- contracts of insurance such as annuities or unit-linked investment policies;

(This is subject to the decisions being made only after you have taken and considered advice from an *authorised, exempt or overseas person* or an *exempt professional firm* (that is, a firm of solicitors, accountants or actuaries who can carry on incidental *regulated activities* without *authorisation*).);

and

(4) decisions of any kind about investing in assets that are not *securities* or *contractually based investments* – such as real property, cash or precious metals.

Q9. As an unauthorised OPS trustee, what decisions am I unable to make?

You will be unable to make most day-to-day decisions. Generally speaking, these will be:

- decisions to *buy, sell* or hold particular *securities* or *contractually based investments* such as a fund manager would be expected to make in his everyday management of a client's portfolio (other than day-to-day decisions about investment in pooled investment vehicles taken after obtaining advice as per Q8(3)); or
- decisions made as a result of regular or frequent interventions outside scheduled review meetings in the decision-making of external fund managers; or
- recommendations made to fund managers, on a regular basis, with a force amounting to direction relating to individual *securities* or *contractually based investments*.

Q10. As an OPS trustee, will I be making day-to-day decisions by implementing strategic decisions on a regular basis?

No. For example, you will not be making day-to-day decisions merely because the application of the method for rebalancing asset classes and permitted ranges of divergence result in mechanical changes being made regularly to the asset allocation policy. This is because the decisions are made at the time the method and frequency are set and not when those decisions result in a change to the policy.

Similarly, there may be occasions when you may determine that, in the absence of instructions from a member, his contributions will automatically be placed in a particular fund. Provided this follows a pre-determined procedure that is rigidly applied and not subject to frequent alteration, it may be regarded as the routine application of a strategic decision and not as a day-to-day decision in its own right.

Q11. As an OPS trustee, I need, from time to time, to sell investments to raise cash to meet obligations to scheme members. Is this likely to mean that I am making day-to-day decisions?

No, unless you are making regular decisions as to which particular investments to dispose of to release the necessary cash. This would not include situations where, in realising assets, you are merely applying pre-agreed strategic policy decisions with no element of discretion. In that situation, the decision is made at the time that the policy is set and is strategic.

Q12. Does the fact that, as an OPS trustee, I only infrequently make decisions about investments mean that the decisions I do make will not be regarded as day-to-day decisions?

No. The mere fact that a decision may be taken only infrequently does not, of itself, prevent that decision being a day-to-day decision. It is the nature of the decision that is important, not its frequency. For example, if you were responsible for the investment of scheme assets in a portfolio of Government stocks and debt securities, the fact that you might only occasionally need to make decisions about buying new, or selling existing, investments would not prevent those decisions being day-to-day decisions. Similarly, the fact that you may be the trustee of a small scheme where decisions about the investment of scheme assets arise only infrequently does not, of itself, prevent those decisions being day-to-day decisions.

Q13. As an OPS trustee, will I be making day-to-day decisions if I decide on the purchase of annuities to be held under the scheme?

Not in most circumstances. Typically, you may choose to select what you consider to be the most suitable annuity provider on each occasion that a decision has to be made. If this is the case, provided that you are not purchasing annuities on a frequent basis, it is unlikely that the decisions you make would be day-to-day decisions (on the basis that you are making strategic decisions about which provider to use rather than decisions about investment of the scheme assets). Less typically, your choice of annuity provider might be determined at the outset so that, each time an annuity has to be purchased, that chosen provider is used. If this occurs, you may be regarded as having made a strategic decision with regard to the most appropriate provider and then as carrying out that strategic decision on each occasion that an annuity is purchased.

But, even if your decision to purchase an annuity is a day-to-day decision, you can still make it. This is provided you meet the conditions for making decisions that involve taking and considering advice about investment in pooled investment vehicles (see Q8(3)).

Q14. As an OPS trustee, if I make decisions about the purchase of annuities on the winding-up of the scheme, am I making day-to-day decisions?

No. Decisions taken about annuities in such exceptional circumstances would not be regarded as day-to-day decisions. This also applies to decisions about annuities taken in the context of ensuring provision of benefits for a member's ex-spouse.

Q15. As an OPS trustee, I make investments on the instructions of members of the scheme. Does this mean that I have to be authorised as I have effectively delegated day-

to-day decision-making to persons who are not authorised, exempt or overseas persons? What about the member – is he then managing the assets of an OPS so as to need authorisation?

No, on both points. You will not be regarded as *managing investments* (so that issues about delegation of day-to-day decision-making do not arise) provided the investment is to be purchased solely for the benefit of the member and you, in practice, invariably seek to match the scheme's obligations to the member by purchasing those investments. This includes where the member instructs you to purchase a particular annuity. But the position may be different should you choose not to match the obligations that the scheme incurs through the members' instructions by purchasing the relevant investments. If you then make decisions about what alternative investments to make, you are likely to be *managing investments* and the decisions you make may be day-to-day decisions.

The member would be regarded as managing assets that belong beneficially to him rather than assets that belong to another. So, he would not be regarded as *managing investments* either.

Q16. Am I going to be managing investments by exercising voting rights conferred by investments that I hold as trustee under my OPS? If so, will this be viewed as my taking a day-to-day decision?

No, you will not be *managing investments* unless the exercise of the rights would result in your *buying, selling, subscribing for or underwriting securities or contractually based investments*. This will not usually be the case. For example, voting to support a take-over offer to be made by a company in which the scheme holds shares would not involve *managing investments* as it would not result in your acquiring or disposing of investments. Neither would voting on the re-appointment of company directors or auditors or on whether a company in whom the scheme holds shares should make a rights issue (although deciding to subscribe to the rights issue when it is made would amount to managing investments).

Deciding to accept an offer to buy company shares held by you under the scheme, in the context of a proposed take-over of that company, would involve *managing investments*. But the decision you make would be viewed as strategic and not a day-to-day decision.

Q17. When may a decision I make as an OPS trustee that results in my investing in a pooled investment vehicle other than an annuity be regarded as a strategic decision?

This will arise where the decision:

- represents the initial decision to invest the scheme wholly or to a substantial amount, and on an ongoing basis, in a particular vehicle such as a life policy or unit trust scheme (on the basis that an initial decision of this kind is of such importance to the scheme that it may be regarded as strategic); or
- may be seen to be a decision to appoint a discretionary fund manager.

Q18. When will a decision that I make as an OPS trustee be regarded as one to appoint a discretionary fund manager?

This will be the case when the decision:

- seeks to implement a strategic decision to invest part of the scheme assets in a particular area or asset class (such as venture capital or emerging markets);
- is based principally on the suitability of appointing the fund manager to manage that part of the scheme assets; and
- to use a pooled investment vehicle rather than a segregated portfolio is secondary to the decision to appoint the fund manager.

Where the circumstances surrounding the appointment of a fund manager suggest that the decision is day-to-day, you may still be able to make that decision. This is provided you meet the conditions for making decisions that involve taking and considering advice about investment in pooled investment vehicles (see Q8(3)).

Q19. As an unauthorised OPS trustee, I have made a decision to invest in an investment vehicle which allows me to switch between various sub-funds. Can I make decisions about switching between those sub-funds?

Yes. However, taking decisions of this kind other than to implement strategic decisions on asset allocation is likely to involve taking day-to-day decisions. So, you would need to meet the conditions for making decisions that involve taking and considering advice about investment in pooled investment vehicles (see Q8(3)).

Q20. I understand that, as an unauthorised trustee of a small self-administered scheme (a “SSAS”) I can make day-to-day investment decisions. What types of scheme qualify as a SSAS?

There are two kinds of scheme that qualify as a SSAS. These are:

(1) an “insured SSAS” - that is an OPS:

- that has no more than 50 members; and
- where:
 - the contributions made by or for each member are used in the acquisition of a contract of insurance or an annuity on the life of that member;
 - the only decision to be made is the selection of the relevant contract; and
 - each member has been given the opportunity to make that choice himself, whether or not he chooses to do so; and

(2) a “12 relevant member SSAS” – that is an OPS:

- with no more than 12 relevant members (broadly speaking, ‘relevant members’ are existing or former employees for whom contributions are being or have been made and for whom benefits under the scheme are or may become payable);
- that is established under an irrevocable trust;
- where all the relevant members are trustees of the scheme (except those who are unfit to act or incapable of acting as trustee); and
- where all day-to-day decisions relating to the management of the assets of the scheme which are *securities* or *contractually based investments* (other than decisions that satisfy the conditions involving taking and considering advice about investment in pooled investment vehicles – see Q8(3)) are required to be taken by:

- all or a majority of the relevant members who are trustees; or
- an *authorised person* or *exempt person*, in each case acting either alone or jointly with all or a majority of the relevant members.

Q21. My 12 relevant member SSAS requires that all day-to-day decisions are taken by the trustee beneficiaries. The SSAS has an independent trustee who is not a beneficiary or an authorised or exempt person. If the independent trustee takes a day-to-day decision in breach of the scheme’s requirement, what effect does that have on him and on the relevant members?

The independent trustee's actions will not cause the trustee beneficiaries any regulatory difficulties, even though he has acted in breach of the requirements of the SSAS. This is because it is the existence of the requirement about day-to-day decision-making that is important and not whether it may be breached. The independent trustee may, as a result of having taken the decision, be regarded as managing the SSAS’s investments. But whether or not this would be the case will depend on the particular circumstances in which the decision came to be made.

Q22. I am a trustee of a 12 relevant member SSAS but not a relevant member. My role requires me to monitor investments made by the scheme – won't I be drawn into making day-to-day decisions?

No. You should be able to perform your role in monitoring and, where necessary, objecting to particular transactions without needing authorisation. Merely operating a blocking vote where a certain proposed investment would, for whatever reason, be prohibited, would not be regarded as taking part in the decision to make, or to refrain from making, that investment. If you merely express a view as to whether or not a certain proposed investment would be permitted you would not, thereby, be making a decision to buy the investment. However, to reduce the risk of being drawn into making day-to-day decisions, you may wish to make a point of not participating in a vote except where the investment could not, in your view, be made without breaching the relevant requirements.

Q23. My company acts as the corporate trustee for a self-invested personal pension scheme (“SIPP”). Will it need to be authorised?

No, provided it is able to satisfy various exclusions. But note that, under government proposals for reforming the way in which personal pension schemes are permitted to be established and registered, it may need to be authorised by 6 April 2007 for operating a personal pension scheme – see HM Treasury’s Consultation Document entitled “Proposed changes to the eligibility rules for establishing a pension scheme - A consultation document, September 2005”. This is available on HM Treasury’s website at: http://www.hm-treasury.gov.uk/consultations_and_legislation/pension_scheme/consult_pensionscheme_index.cfm. The document sets out several options and indicates that the Treasury’s preferred option is to introduce a new regulated activity of establishing, operating or winding up a personal pension scheme other than a stakeholder pension scheme (where those activities are already regulated). The new regulated activity would come into force on 6 April 2007. At the same time, rights under a personal pension scheme would become an investment for the purposes of existing *regulated activities* such as *dealing, arranging, managing investments and advising on investments*. The FSA proposes to consult on further perimeter *guidance* about the changes to regulatory scope in this area during the course of 2006.

Your company's position until April 2007 will depend on a combination of the activities that it carries on and the availability of certain exclusions. These exclusions may also apply to trustees of pension schemes other than SIPPs with the exception of that for *managing investments* (which will not apply to a trustee of an OPS).

(1) Your company is likely to be *dealing in investments as principal* in entering into investment transactions on behalf of the trust. However, in general terms, it would avoid this if either:

- it is a bare trustee acting on the instructions of the member or his agent and it does not hold itself out as someone who provides a dealing service (see article 66(1) of the *Regulated Activities Order*); or
- it does not hold itself out to the public as someone who carries on business as a market maker or dealer in *securities* and, if it buys or sells *contractually based investments*, it only does so with or through a regulated person (see articles 15 and 16 of the *Regulated Activities Order*).

But you will not be *dealing in investments as agent* merely because you commit co-trustees to a transaction by entering into it on behalf of the scheme.

(2) Your company should not be *arranging* because this activity does not apply where a person arranges transactions to which he is to be a party (see articles 25 and 26 of the *Regulated Activities Order*).

(3) Your company is likely to be *managing investments* if it has discretionary control over the assets held under the trust. But it will not be managing investments if:

- it is acting solely on instructions from the members or from a fund manager or other agent appointed to instruct it on their behalf; or
- it is not holding itself out as an investment manager and is not remunerated for managing investments in addition to what it is paid for acting as trustee (see article 66(3) of the *Regulated Activities Order*).

(4) As trustee, your company is likely to be responsible for *safeguarding and administering investments* held as scheme assets. If it makes use of a specialist custodian it will be *arranging safeguarding and administration of assets*. These are potentially regulated activities. But they will not be if:

- your company is not holding itself out as a custodian and is not remunerated for providing custody services in addition to what it is paid for acting as trustee (see article 66(4) of the *Regulated Activities Order*); or
- (as respects arranging for another person to provide custody services) it delegates custody to a suitably *authorised* or *exempt person* (see article 66(4A) of the *Regulated Activities Order*).

(5) Your company will not be *advising on investments* unless it advises a prospective member on the merits of his *buying* or *selling* interests in *securities* or *relevant investments* to

be held under the trust. If it gives advice to its co-trustees about trust investments or to existing members about their interests under the trust, its advice will be excluded provided it is not remunerated for giving the advice in addition to what it is paid for acting as trustee (see article 66(6) of the Regulated Activities Order).

Q24. My company acts as corporate trustee of a trust-based stakeholder pension scheme. Does it need to be authorised?

This depends on the responsibilities that your company assumes as trustee. *Establishing, operating or winding up a stakeholder pension scheme* are regulated activities in their own right. These are functions that are often carried out by the trustees of a trust-based stakeholder pension scheme other than where the trustees are mere bare trustees. This is apart from establishing a scheme which is a function that may often be carried out by a third party such as a product provider. See Q25 to Q28 for further guidance on these activities.

Q25. What does establishing a stakeholder pension scheme involve?

The establisher of a personal pension scheme is the *person* responsible for putting in place the arrangements founding the scheme and registering it with HM Revenue & Customs. With a trust-based scheme, this will usually be the person who executes the trust as principal. In a scheme established by deed poll, it will usually be the person who enters into the deed poll. There will usually only be one person who establishes the scheme. Any professional firms that he may employ to act as his agent (such as solicitors) would not be establishing the scheme. The establisher may also be the operator but need not be. An employer will not be establishing a stakeholder pension scheme purely as a result of his having designated such a scheme to meet the statutory requirement to do so.

Q26. What does operating a stakeholder pension scheme involve?

The 'operator' is the *person* responsible, under the scheme's constitution, for ensuring continuing compliance with the management and administration requirements in respect of the assets and income of, and the benefits payable under, the scheme as imposed under relevant pensions and tax legislation. For example, with a trust-based scheme, the trustees will often be the operator by virtue of the responsibilities they assume under the trust deed. In situations where the trustees' role is merely to act as a bare trustee holding the scheme assets, it may be the case that there is a third party who has responsibility for the management and administration of the scheme and its assets and who will be the scheme's operator. The scheme may be established by an *authorised person* who acts as a provider of investment products or services to the scheme. This does not make that person the operator of the scheme if, as a matter of fact, he has appointed another person (such as a trustee) to carry out all of the operator's functions in his place.

Q27. What is my position as the operator of a stakeholder pension scheme if I delegate day-to-day functions such as administration of the scheme or management of the scheme assets to another person?

A *person* who accepts responsibility, and remains responsible, for carrying on a *regulated activity* is carrying on that activity even though he may delegate or outsource the day-to-day carrying out of the functions to another person. So, if the operator of a scheme delegates some or all of his functions to another person, he will still be the regulated operator of the

scheme. At the same time, none of the people to whom he delegates his activities will become an operator of the scheme. However, they may be carrying on other regulated activities in performing their delegated or outsourced tasks (such as *arranging* or *managing investments*), in which case they will be subject to regulation for those activities.

Q28. What does winding-up a stakeholder pension scheme involve?

The *person* who winds-up a *stakeholder pension scheme* will be the person who is responsible for putting in place the arrangements for bringing the scheme to an end in a way that complies with the relevant provisions of the instrument that established the scheme and any relevant rules under pensions or tax legislation. This will, more often than not, be the operator of the scheme.

Q29. I am one of several trustees of a pension scheme. Sometimes I arrange an investment transaction on behalf of all the trustees but another trustee actually signs the purchase agreement and becomes the registered owner of the trust asset – does this mean that I could be regarded as arranging deals in investments on behalf of my fellow trustee?

No. You will not be *arranging* in these circumstances. This is because the interest that you acquire as trustee in the investment means that you will be regarded as being a party to the transaction. Arrangements made by a person in relation to transactions of which he is to be a party as principal or agent are excluded from *arranging*.

Q30. As a professional trustee of a pension scheme, am I affected by the implementation of the Insurance Mediation Directive (IMD)?

No. A pension scheme trustee may perform tasks on behalf of the other trustees (such as signing proposal forms or giving dealing instructions to insurers or brokers or notifying claims on the death of a scheme member). But he will not be providing an insurance mediation service to them. This is because, under the policy, he will share equal rights and equal responsibility with his co-trustees and so may be regarded as acting solely in the capacity of policyholder rather than intermediary. Also, the pension scheme trustee will not be providing an insurance mediation service on behalf of the members as the members will not be policyholders.

10.4 Pension scheme service providers other than trustees

Q31. I provide administration services to pension schemes. Will I require authorisation or exemption?

Yes, if your services include any of the following activities and you cannot make use of an exclusion.

(1) Receiving instructions from the trustees or members about the *buying* or *selling* of trust investments (being *securities* or *relevant investments*) and then instructing a broker or product provider to effect the transaction. This is because you are likely to be *arranging*.

This will include arranging for investments such as units in a unit trust scheme or in a life policy managed fund to be realised or surrendered to raise cash.

(2) Entering into investment transactions concerning *securities* or *relevant investments* on behalf of the trustees. This is because you will be *dealing in investments as agent*.

(3) *Assisting in the administration and performance of contracts of insurance*. This will only be likely to apply if you handle claims under policies held by the scheme on behalf of the trustees or other policyholders. For example, if you were making a claim for benefits payable on the death of a member under the ‘death in service’ benefits provided by a pension scheme. To be carrying on this regulated activity you must be assisting the trustees in both the administration and performance. Whilst dealing with claims on the death of a scheme member is likely to involve assisting in the administration of the contract of insurance, it will only involve assisting in the performance if you assist the trustees, as policyholders, to satisfy a contractual obligation that they have under it. This will typically include assisting the trustees to notify the claim in the manner specified in the policy. Detailed guidance on this regulated activity is available in Chapter 5.7 of PERG.

(4) Arranging the appointment of a custodian on behalf of the trustees. This is because you will be *arranging safeguarding and administration of assets*. But you will not be doing so simply because you instruct a fund manager to buy investments which the fund manager will then safeguard and administer in accordance with pre-existing arrangements.

Services that typically will not involve any regulated activities include:

- maintaining records;
- liaising with tax authorities;
- arranging actuarial advice;
- paying over contributions to a product provider or fund manager for investment in line with pre-agreed instructions; and
- paying out benefits.

Q32. What are the exclusions that might apply to me as a pensions administration service provider?

One or more of the following exclusions might be available to you depending on the nature and scope of the services you provide:

- *dealing in investments as agent* and *arranging* with or through an *authorised person* (articles 22 and 29 of the *Regulated Activities Order*);
- *dealing in investments as agent, arranging and advising on investments* as a necessary part of providing other non-regulated services (article 67 of the *Regulated Activities Order*); and
- services provided to a member of your *group* (article 69 of the *Regulated Activities Order*).

Q33. How would the exclusions for dealing or arranging with or through an authorised person in articles 22 and 29 apply to me as a pensions administration service provider?

The exclusions will apply to you if:

- you are an *unauthorised person*;
- you are *dealing in investments as agent* or *arranging* on behalf of the pension scheme trustee or member (your ‘client’);
- the transaction into which you are entering or which you are arranging is either with an authorised product provider such as a unit trust manager or is effected by an authorised intermediary such as a stockbroker;
- you do not advise your client on the merits of his entering into the transaction;
- you are not paid by anyone other than your client; and
- the transaction does not involve *contracts of insurance*.

So, the exclusions can apply to a transaction involving any investment other than rights under a contract of insurance. Given that many pension schemes invest wholly or partly in contracts of insurance, there may be limited occasions where articles 22 or 29 will exclude all dealing or arranging activity of this kind.

The requirement that you do not receive any payment other than from your client does not prevent you receiving payment from the *authorised person* but you must then treat the sums paid to you as belonging to your client. There is nothing to prevent you then using the sums to offset payments due to you from your client for services rendered to him. This is provided that you have your client’s agreement to do so.

Q34. When will regulated activities form a necessary part of my pension administration services so that I can use the exclusion in article 67?

Broadly speaking, a regulated activity will form a necessary part of your pension administration service if you could not reasonably expect to be able to provide your non-regulated administration services to the scheme trustee or member without conducting the regulated activity. This may apply where you are simply arranging for the payment of regular contributions that the broker or product provider will apply in line with standing instructions. This would, for example, apply to you if you were to be providing payroll services.

There are further conditions that must be met for the exclusion to apply:

- you must not be remunerated for the regulated activity separately from the remuneration you get from providing pension administration services; and
- you must not be a person who is required to be regulated by the *Insurance Mediation Directive*.

So, the exclusion cannot apply to you if you are providing a service that involves assisting in the conclusion or the administration and performance of *contracts of insurance*. But it may apply where you are providing other services relating to contracts of insurance (for example, arranging post-conclusion transactions such as surrenders or switches) or to other investments such as shares or unit trusts.

Q35. I provide pension administration services to a corporate pension scheme trustee who is a member of the same group as me. Does this mean that the exclusion for services provided to other group members in article 69 will apply to me?

Yes, provided the services:

- may properly be regarded as being provided solely to the trustee (as will be the case where the trustee has delegated or outsourced the carrying out of regulated activities to you but remains responsible to the members for the performance of those activities) and not to the members; and
- do not relate to *contracts of insurance*.

If the services do relate to contracts of insurance, you are still unlikely to need authorisation because you will only be carrying out *insurance mediation activities* by way of business if you are remunerated for providing services to third parties. Members of your *group* are not considered to be third parties.

Q36. As an administration service provider, I have authority over the pension scheme trustees' bank account. Does this mean I have to be authorised?

No. Holding or controlling money belonging to a client is not, of itself, a regulated activity. It is only if you are holding or controlling the money in connection with performing a *regulated activity* that you will need to be *authorised*. This may arise, for example, if you are arranging investment transactions on behalf of the trustees and have authority to settle the transaction using funds in the trustees' bank account.

Q37. The trustees authorise me, as administration service provider, to determine how much money should be transferred for investment each month to ensure that the scheme has enough cash available to meet its obligations. Does this have regulatory implications for me?

No, unless it results in your concluding that there is a need to realise funds and instructing a broker or product provider to liquidate investments to do so. Should that happen, you are likely to be *dealing in investments as agent* or *arranging* subject to the possible availability of an exclusion such as that in article 29 of the *Regulated Activities Order* (see Q33). If you are able to exercise delegated powers to determine, on the trustees' behalf, which particular investments should be sold or surrendered, you are likely to be *managing investments* and need to be an *authorised* or *exempt person*.

Q38. My services to the pension trustees include advising them on investments and investment strategy. Is this likely to be regulated advice and mean that I must be authorised or exempt?

Yes, if the advice:

- relates to a particular *security* or *relevant investment* such as the ABC unit trust scheme or the XYZ unit-linked insurance policy – advice on investment strategy or the choice of fund managers or brokers is not regulated advice;
- is advice and not simply information – so, there must be a recommendation to *buy*, *sell* or hold on to the particular investments;
- relates to the merits (that is the pros or cons) of buying or selling the particular investment; and
- is given to a *person* who is acting as an investor or who would enter into transactions as agent for the investor – so, advice to trustees about scheme investments will be given to them in their capacity as investors.

Q39. I give advice to the members of a pension scheme. Is this likely to be regulated advice and mean that I must be authorised or exempt?

It may be if the advice concerns a personal pension scheme but probably not if it concerns an OPS. The same factors apply to advice given to a member as apply to advice given to trustees (see Q38). But a particular factor is likely to be whether the member is himself *buying* or *selling* a *security* or *relevant investment* (a “regulated investment”).

With a trust-based pension scheme, the trustees will usually hold the legal title to the scheme’s investments with the members having a beneficial interest in those investments. These beneficial interests may themselves be regulated investments (under article 89 of the *Regulated Activities Order*) that can be bought or sold by the member.

So, for example, the interests which a member may acquire in *units* or *life policies* held under a SIPP will amount to a regulated investment held by the investor, even though the legal title to the investments is held by the trustees on the member’s behalf. Advice to the member on the merits of acquiring or disposing of those interests will then be regulated advice. But advice on the merits of acquiring or disposing of interests in other assets such as real property or cash will not be regulated advice.

Where an OPS is concerned, the interests obtained by members are specifically excluded from being regulated investments (see article 89(2) of the *Regulated Activities Order*). This means that a member of an OPS does not acquire a regulated investment simply through having additional voluntary contributions held under the trust for his benefit. So, advice to the member on the merits of his making additional voluntary contributions will not be regulated advice.

The position with *stakeholder pension schemes* is different. The rights under such a scheme (whether it is trust-based or contractual) are a specific type of regulated investment. So, advice on the merits of joining or leaving a stakeholder pension scheme will be regulated advice. This is the case even if the scheme is also an OPS.

The rights or interests that a person acquires under free-standing additional voluntary contribution arrangements will be regulated investments if and to the extent that the underlying investments are *securities* or *contractually based investments*. Where this is the case, advice on the merits of making free-standing additional voluntary contributions will be regulated advice.

If operating a personal pension scheme becomes a regulated activity in line with the government’s proposals (see Q23), the rights that a member obtains under any such scheme (including a SIPP) will become regulated investments in their own right and so advice on the merits of *buying* or *selling* such rights would be regulated.

Q40. I provide administration services to the providers of pension products such as insurers. Is my position any different to that of a person who provides administration services to pension scheme trustees?

Potentially, yes. This is because:

- you are unlikely to be *assisting in the administration and performance of a contract of insurance* because of the exclusion in article 39B of the *Regulated Activities Order* for persons who manage claims on behalf of a regulated insurer; and
- although you are likely to be carrying on *dealing* or *arranging* activities if you handle such things as arranging new policies, additional payments, surrenders, switches or assignments, some of the exclusions may not apply to you, for example:
 - the exclusions in articles 22 and 29 of the *Regulated Activities Order* (see Q33) will not apply because you will be remunerated by the authorised person rather than by the trustee; and
 - the exclusion in article 69 of the *Regulated Activities Order* (see Q35) will not apply because, as a group company of the insurer, you will not be providing services solely to it but also providing services directly to the trustees on behalf of the insurer.

Q41. Does the fact that I provide administration services to the providers of pension products such as insurers on an outsourced basis and act in their name affect my position?

No. The need for *authorisation* or exemption depends on the nature of the activities that you carry on. The mere fact that you may carry on the services under your authorised client's name does not, of itself, remove the need for you to be authorised or exempt in your own right if the services you perform involve *regulated activities*.

10.5 Employers and affinity groups (such as trade unions)

Q42. Will I, as an employer, ever need to be regulated for providing pension benefits to my staff?

No, unless you are carrying on a *regulated activity* and, if so, satisfy the by-way-of-business test (see Q44).

Q43. When am I, as an employer, likely to be carrying on a regulated activity?

You are unlikely to be carrying on a *regulated activity* in the case of an OPS (other than one that is also a *stakeholder pension scheme*) unless you provide services that involve *regulated activity* to the trustees (such as giving them advice or arranging trust transactions). Any service that you might provide to your employees concerning their rights under the OPS will not be a regulated activity. But if you provide your staff with the opportunity to participate in a *group personal pension scheme* or a *stakeholder pension scheme*, you are likely to be *arranging*. You may also be *advising on investments* if you provide your employees with advice on the merits of their joining the scheme (see Q39).

Q44. As an employer, I am offering staff a personal pension scheme. Will I satisfy the by-way-of-business test?

Most probably not. To need *authorisation* you would need to be carrying on the *arranging* activity on commercial lines. This means that you would need to be expecting to obtain some form of commercial benefit from providing your staff, or a third party such as the

intermediary who sets up the scheme for you, with services. This also applies if you were to be advising your employees on the merits of joining the scheme. However, giving advice also brings into play the restriction on making *financial promotions* (see Q47 to Q50).

As an employer, you are likely to be obtaining a commercial benefit from providing a pension scheme for your staff if you receive a direct benefit such as a commission or introduction fee. Or the commercial benefit may be indirect, for example, a reduction in premiums payable on another product such as key man or buildings insurance as an alternative to a direct fee.

But you would not gain a commercial benefit purely because:

- you negotiate special terms for your employees or for your own contributions or for both; or
- you hope to acquire or retain a more satisfied or happier or efficient workforce; or
- you recover the actual costs of arranging for your staff to be able to participate in the scheme.

In addition, if your scheme is an insurance-based scheme, such as a *group personal pension scheme*, your activity will potentially involve *insurance mediation activity*. If so, to satisfy the by-way-of-business test, you would also need to be remunerated.

The vast majority of employers or affinity groups do not set out to make a regular profit from arranging pension benefits for their staff or members and so will not satisfy the by-way-of-business test and will not need to be an *authorised or exempt person*.

Q45. As an employer, administration services that involve regulated activities are provided to my OPS in-house by my staff. Does this mean that I or my staff will need to be authorised or exempt?

No, on the basis that neither you nor they are likely to satisfy the by-way-of-business test. This is unless you are providing the services on a commercial basis (see Q44). This would arise if you provide the service in return for a reward that goes beyond the mere recovery of the costs you incur in doing so.

Q46. As an employer, I have designated a stakeholder pension scheme for my employees in accordance with the statutory requirement to do so. Does this mean that I am carrying on the regulated activity of establishing a stakeholder pension scheme?

No. The scheme has already been established by another person and you are merely choosing it as the stakeholder pension scheme which is to be offered by you to your employees.

Q47. As an employer, are there restrictions on my providing staff with details of pension schemes?

Yes, but in most circumstances you should be able to make use of an exemption.

If you make an invitation or inducement to your staff to join a *personal pension scheme* or a nominated *stakeholder pension scheme*, you are likely to be making a *financial promotion*. This is prohibited under section 21 of the Financial Services and Markets Act 2000 unless:

- you are an authorised person; or
- its contents are approved by an *authorised person*; or
- it falls within a relevant exemption.

It should be noted that the prohibition applies to financial promotions made in the course of business. It is our view that employers who promote their chosen pension schemes to their employees will be doing so in the course of business.

There are no restrictions on your promoting a non-stakeholder OPS to your employees. This is because neither rights under an OPS nor interests in any investments held under it (such as interests in additional voluntary contributions schemes) are treated as regulated investments.

Q48. What are the exemptions that are available to employers?

Where an employer is obliged by law to offer its employees a *stakeholder pension scheme*, any *financial promotion* made for that purpose will be exempt under article 29 of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (“the *Financial Promotion Order*”).

There is also a specific exemption for employers who make financial promotions to their staff in article 71 of the Financial Promotion Order. This applies, broadly speaking, where:

- the promotion is about a *group personal pension scheme* or a *stakeholder pension scheme*;
- the employer contributes to the pension scheme and discloses details of its contribution to the employee;
- the employer does not obtain any direct commercial benefit from promoting the scheme to its employees; and
- the employer informs the employee in any written promotion of his right to seek independent financial advice from a regulated person.

Q49. Are there any other exemptions available to employers or any that apply to affinity groups?

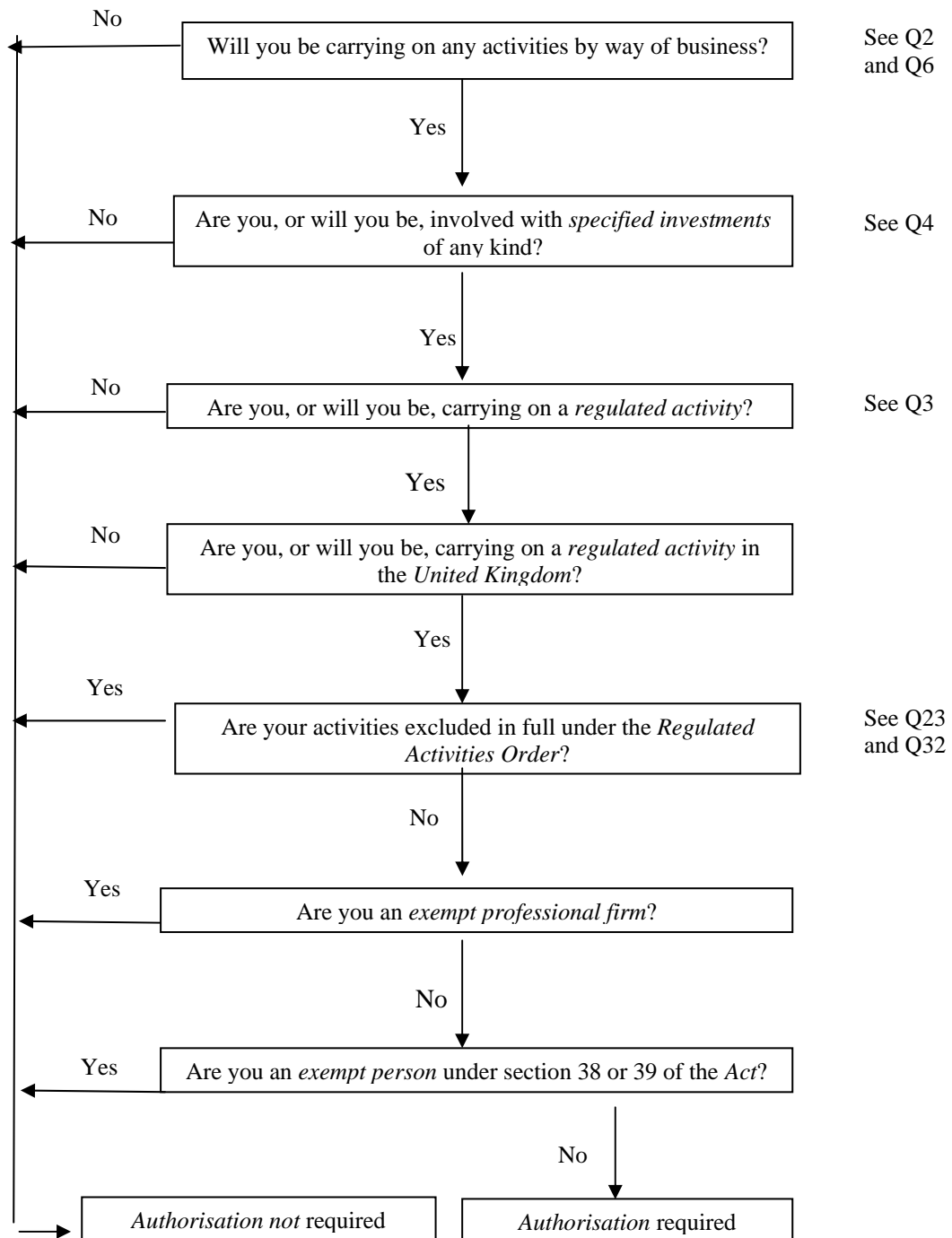
There are a few exemptions that may be relevant. For example:

- follow-up promotions, such as may be made after the employer has made a promotion under article 71 of the Financial Promotion Order – see article 14 of the Financial Promotion Order; and
- one-off promotions (that is, promotions that take account of the personal circumstances of the recipient) – see articles 28 and 28A of the Financial Promotion Order.

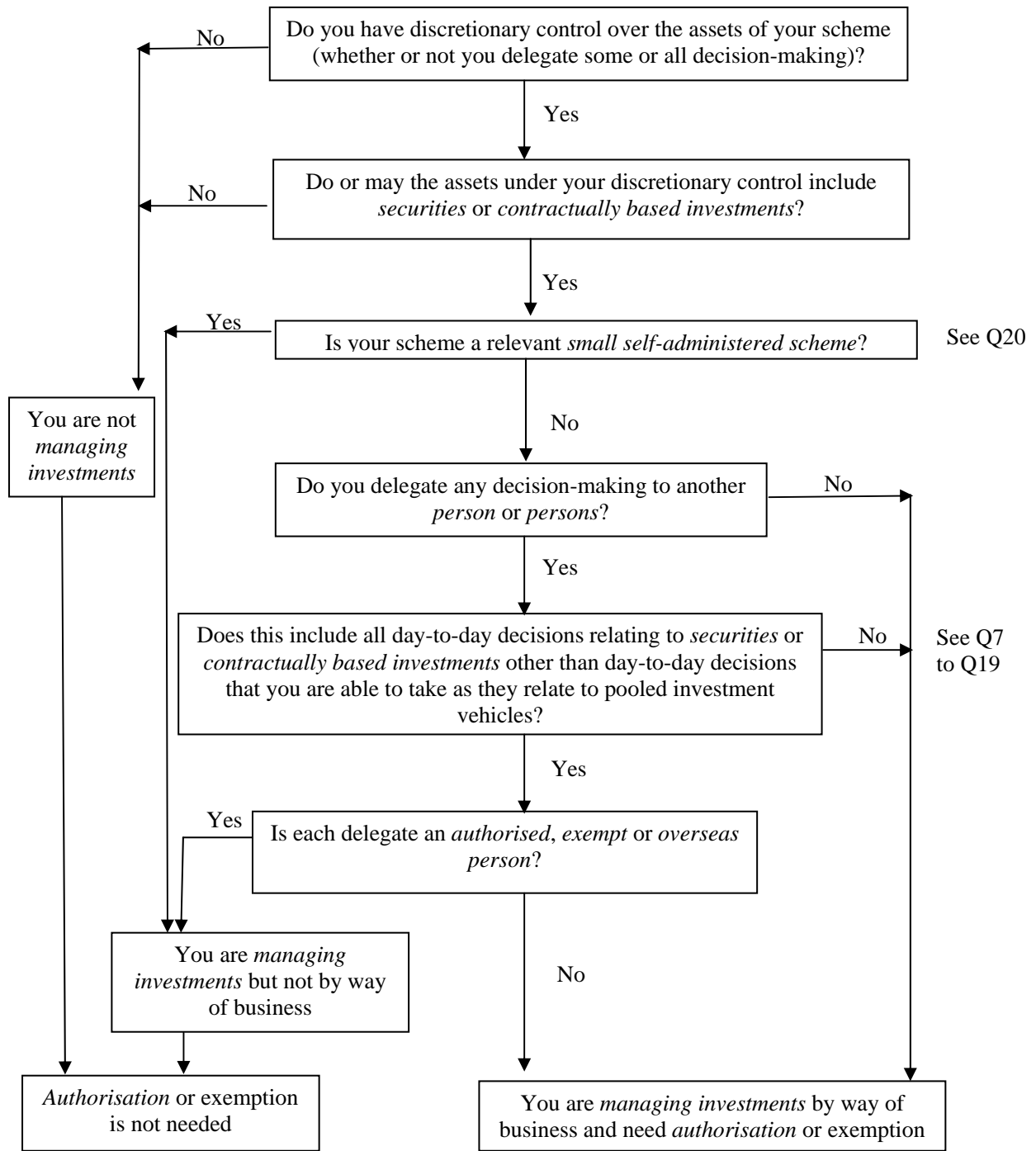
Q50. Can I find out more about the financial promotion restriction?

Yes. Chapter 8 of PERG has detailed *guidance* about the scope of the financial promotion restriction and the exemptions that are available.

10 Annex 1: Flow chart showing the steps to be considered in deciding whether authorisation is needed.



10 Annex 2: Flow chart showing the additional steps to be considered by trustees of occupational pension schemes and other persons in deciding whether authorisation is needed for managing the assets of such a scheme



10 Annex 3: Table summarising regulatory position of pension scheme trustees and service providers

Potential regulated activity	When will such regulated activities be carried on?
<i>Dealing in investments as principal</i> (article 14 of the <i>Regulated Activities Order</i>)	Pension scheme trustees will be entering into investment transactions as principal but should be able to rely on the exclusions in articles 15, 16 or 66(1) of the Regulated Activities Order (see Q23(1)).
<i>Dealing in investments as agent</i> (article 21 of the <i>Regulated Activities Order</i>)	<p>Service providers who enter into investment transactions under delegated authority from pension scheme trustees or members are likely to be dealing in investments as agent (see Q31(2)).</p> <p>Pension scheme trustees are not dealing in investments as agent simply because their actions result in co-trustees acquiring or disposing of interests in trust assets. This is because they will be acting as principals (see Q23(1)).</p> <p>Article 22 of the Regulated Activities Order excludes from its scope, subject to certain conditions, an <i>unauthorised person</i> who deals in investments as agent with or through an <i>authorised person</i>. This exclusion is disapplied where the arrangements relate to a contract of insurance (such as a unit-linked policy, an annuity, term assurance or any general insurance contract). Service providers may be able to make limited use of this exclusion (see Q33).</p> <p>Article 67 of the Regulated Activities Order provides an exclusion for persons whose profession or business does not otherwise consist of regulated activities and who deal in investments as agent as a necessary part of their profession or business without being separately remunerated for doing so. This exclusion does not apply, in broad terms, where a</p>

	<p>person is carrying on <i>insurance mediation</i>. Service providers may be able to make limited use of this exclusion – for instance, where providing payroll services (see Q34).</p> <p>Article 69 of the Regulated Activities Order excludes persons who are dealing in investments other than contracts of insurance as agent for other members of their <i>group</i>.</p> <p>However, service providers who are carrying on <i>insurance mediation activities</i> solely for, and are remunerated solely by, another group member will not satisfy the by-way-of-business test (see Q35).</p>
<p><i>Arranging (bringing about) deals in investments and making arrangements with a view to transactions in investments</i> (article 25 of the Regulated Activities Order)</p>	<p>Service providers who arrange transactions involving <i>securities</i> or <i>relevant investments</i> for pension scheme trustees or members are likely to be carrying on one or both of the <i>arranging</i> activities (see Q31(1)).</p> <p>Pension scheme trustees are not arranging simply because their actions result in co-trustees acquiring or disposing of interests in trust assets. This is because they will be acting as principal (see Q29).</p> <p>Service providers should be able to make good use of the exclusion in article 29 of the Regulated Activities Order for arranging deals with or through an <i>authorised person</i>.</p> <p>However, this exclusion does not apply where the arrangements relate to a contract of insurance (such as a unit-linked policy, an annuity, term assurance or any general insurance contract). This may affect the position of service providers where they are involved with such things as:</p> <ul style="list-style-type: none"> (1) arranging trust investments for the trustees; (2) arranging for employees to participate in a personal pension scheme; or (3) arranging for employees to participate in a <i>stakeholder pension scheme</i>.

	<p>Where such activities relate to a contract of insurance, the service provider is likely to need to be an authorised or exempt person provided he satisfies the by-way-of-business test (see Q33).</p> <p>Article 67 of the Regulated Activities Order provides an exclusion for persons whose profession or business does not otherwise consist of regulated activities and who are arranging as a necessary part of their profession or business without being separately remunerated for doing so. This exclusion does not apply, in broad terms, where a <i>person</i> is carrying on <i>insurance mediation</i>. Service providers may be able to make limited use of this exclusion – for instance, where providing payroll services (see Q34).</p> <p>Article 69 of the Regulated Activities Order provides an exclusion for persons who are arranging on behalf of other members of their <i>group</i>. This exclusion does not apply where the transaction involves a contract of insurance. However, service providers who are carrying on <i>insurance mediation activities</i> solely for, and are remunerated solely by, another group member will not satisfy the by-way-of-business test (see Q35).</p>
<p><i>Managing investments</i> (article 37 of the Regulated Activities Order)</p>	<p>Trustees of occupational pension schemes (whether or not they would otherwise be regarded as acting by way of business) will need authorisation or exemption for managing investments unless:</p> <ul style="list-style-type: none"> • the scheme is a small self-administered scheme that meets certain requirements; or • they do not need to take any day-to-day decisions about investing the scheme’s assets; or • they delegate the taking of all day-to-day decisions to an authorised, exempt or overseas person; or

	<ul style="list-style-type: none"> the only day-to-day decisions that they take relate to pooled investment vehicles and they obtain and consider advice from an expert (see Q7 to Q22). <p>The flow chart in Annex B sets out the steps that an OPS trustee will need to go through to determine whether he will need authorisation or exemption for managing investments. This also applies to any other person who may be managing the assets of an OPS.</p> <p>A personal pension scheme trustee will not need authorisation if he is unpaid. Other trustees who manage the investments of a personal pension scheme will not be managing investments provided they do not:</p> <ul style="list-style-type: none"> hold themselves out as providing a service of managing investments; or receive additional remuneration for managing investments (see Q23(3)).
<p><i>Assisting in the administration and performance of a contract of insurance</i> (article 39A of the Regulated Activities Order)</p>	<p>Pension scheme trustees will not be regarded as carrying on this activity simply because they make claims on behalf of their co-trustees as well as on their own behalf. This is where the trustees are acting jointly and share the same rights and obligations as policyholders (see Q30).</p> <p>Service providers are likely to carry on this activity if they notify a claim under the ‘death in service’ benefits under a scheme in conjunction with handling the claim on behalf of the pension scheme trustees. This is because such services involve assisting in both administration and performance. But they will not be carrying on this activity provided they do not assist the trustees to perform any contractual obligation that they may have under the relevant policy. For example, the trustees may notify the claim themselves in</p>

	<p>accordance with the policy leaving the service provider to deal with administration only. Redeeming units under a unit-linked contract of insurance with a view to funding benefits or assigning benefits for any reason will not involve making a claim or otherwise assisting in performance (see Q31(3)).</p> <p>The exclusion in article 67 of the Regulated Activities Order extends to persons whose profession or business does not otherwise consist of carrying on a regulated activity and who are assisting in the administration and performance of a contract of insurance as a necessary part of their profession or business without being separately remunerated for doing so. The exclusion only applies where a person is not required to be regulated by the Insurance Mediation Directive. This means, in effect, that service providers will only be able to use the exclusion in connection with assisting in the administration and performance of a contract of insurance if they are merely providing information (see Q34).</p> <p>Where a person is assisting in the administration and performance of a contract of insurance solely for, and is remunerated solely by, another <i>group</i> member, he will not satisfy the by-way-of-business test because he is not carrying on <i>insurance mediation activities</i> for a third party and so does not require to be authorised or exempt (see Q35).</p>
<p><i>Safeguarding and administering investments or arranging safeguarding and administration of assets</i> (article 40 of the Regulated</p>	<p>Some pension scheme trustees will not be carrying on this activity by way of business. For example, individuals who act as unpaid trustees of an occupational pension scheme (see Q6).</p>

<p>Activities Order).</p>	<p>Other trustees will not be carrying on this activity provided they do not :</p> <ul style="list-style-type: none"> • hold themselves out as providing a service of safeguarding and administering investments or arranging safeguarding and administration of investments; or • receive additional remuneration for safeguarding and administering investments or arranging safeguarding and administration of investments. <p>In addition, trustees will not be arranging safeguarding and administration of investments where they arrange for this to be done by a regulated person or a person acting on his behalf (see Q23(4)).</p> <p>Service providers would be arranging safeguarding and administration of investments if they arrange for the appointment of a custodian on behalf of the trustees. But they will not be arranging for another person to safeguard and administer simply by virtue of instructing a fund manager to buy investments which the fund manager will then safeguard and administer in accordance with pre-existing arrangements (see Q31(4)).</p>
<p><i>Establishing, operating or winding-up a stakeholder pension scheme</i> (article 52 of the Regulated Activities Order)</p>	<p>The trustee of a trust-based stakeholder pension scheme will often be its operator. This is where the trustee is responsible under the instruments establishing the scheme for complying with the management and administration requirements in respect of the assets and income of, and the benefits payable under, the scheme as imposed under relevant pensions and tax legislation (see Q26).</p>
<p><i>Advising on investments</i> (article 53 of the Regulated Activities Order)</p>	<p>Trustees of pension schemes will not be advising on investments provided the advice is given only:</p> <ul style="list-style-type: none"> • to a fellow trustee for the purposes of the trust; or

	<ul style="list-style-type: none"> • to a member about his interest in the trust fund, and provided that the trustee: • does not receive additional remuneration for advising on investments; and • is not required to be regulated under the Insurance Mediation Directive (which should not be the case either because he does not provide mediation services to his co-trustees or because he is not remunerated specifically for giving advice) (see Q23(5) and Q30). <p>Service providers would be advising on investments if they provide advice to the trustees on the merits of the trust making particular investments (see Q39 and Q40).</p> <p>Article 67 of the Regulated Activities Order provides an exclusion for persons whose profession or business does not otherwise consist of regulated activities and who are advising on investments as a necessary part of their profession or business without being separately remunerated for doing so. This exclusion does not apply, in broad terms, where a person is carrying on <i>insurance mediation</i>. Service providers may be able to make limited use of this exclusion – for instance, where providing actuarial advice to the trustees of an occupational pension scheme (see Q34).</p>
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10 Annex 4: Table summarising regulatory position of employers and affinity groups.

Activity carried on by employer or affinity group	Potential implications in terms of regulated activities and the need for authorisation
Establishing or setting up an <i>occupational pension scheme</i> or a <i>group personal pension scheme</i> or a <i>stakeholder pension scheme</i> .	Establishing an occupational pension scheme is not a regulated activity. Setting up a group personal pension scheme is likely to involve <i>arranging</i> (see Q43).

	<p>Establishing a stakeholder pension scheme is a regulated activity in its own right. But an employer who is designating a stakeholder pension scheme as required by law is not, as a result of that fact alone, establishing the scheme (see Q46).</p> <p>In any event, the employer or affinity group will only need to be authorised or exempt if they are carrying on regulated activity by way of business which, in most instances, should not be the case (see Q6, Q44 and Q45).</p>
<p>Acting as trustee of a trust-based stakeholder pension scheme.</p>	<p>This will be a regulated activity if the trustee is operating the stakeholder pension scheme. But the employer or affinity group will only need to be authorised or exempt if, as trustee, they are acting by way of business which, in most instances, should not be the case (see Q6, Q44 and Q45).</p>
<p>Arranging for employees to participate in an occupational pension scheme or a group personal pension scheme or a stakeholder pension scheme.</p>	<p>Arranging for employees to participate in an occupational pension scheme (other than one that is also a stakeholder pension scheme) is not a regulated activity as the employees are not acquiring investments. Arranging for employees to participate in a group personal pension scheme is likely to involve <i>arranging</i> as is arranging for employees to participate in a stakeholder pension scheme. But the employer or affinity group will only need to be authorised or exempt if they are acting by way of business which, in most instances, should not be the case (see Q6, Q44 and Q45).</p>

<p>Advising employees on the merits of participating in an occupational pension scheme or a group personal pension scheme or a stakeholder pension scheme, including advising employees against joining a personal pension scheme or advising them to transfer from a personal pension scheme.</p>	<p>Advice on the merits of participating in an occupational pension scheme (other than one that is also a stakeholder pension scheme) is not a regulated activity as the employees are not acquiring investments. Advice on the merits of participating in a group personal pension scheme or a stakeholder pension scheme will be a regulated activity. Advice against joining or to transfer from a personal pension scheme will be a regulated activity if the advice relates to a particular security or relevant investment that is or is to be held under the scheme or if the scheme is a stakeholder pension scheme. If the advice relates to personal pension schemes generally but not one in particular it will not be a regulated activity (see Q39 and Q40).</p> <p>But the employer or affinity group will only need to be authorised or exempt if they are acting by way of business which, in most instances, should not be the case (see Q6, Q44 and Q45).</p>
<p>Assisting in the administration of an occupational pension scheme or a group personal pension scheme or a stakeholder pension scheme.</p>	<p>Any of these could involve regulated activity (see Q31). But the employer or affinity group will only need to be authorised or exempt if they are acting by way of business which, in most instances, should not be the case (see Q6, Q44 and Q45).</p>
<p>Providing in-house administration services to the trustee of the employer's OPS and safekeeping services for documents of title such as bearer certificates.</p>	<p>This may amount to <i>safeguarding and administering investments</i> if the employer undertakes both activities.</p> <p>But the employer or affinity group will only</p>

	need to be authorised or exempt if they are acting by way of business which, in most instances, should not be the case (see Q6, Q44 and Q45).
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10 Annex 5: Table summarising regulatory position concerning financial promotions by trustees, employers and affinity groups.

Person communicating	Subject or purpose of communication	Need for approval or exemption available
Employer, affinity group or trustee	To provide information on any aspect or type of pension arrangements without seeking to persuade the recipient to take a particular course of action.	Approval or exemption not needed. Mere information will not be a <i>financial promotion</i> .
Employer, affinity group or trustee	To persuade employees or members to join an <i>occupational pension scheme</i> which is not a <i>stakeholder pension scheme</i> .	Approval or exemption not needed as interests arising under the trusts of an occupational pension scheme which is not a stakeholder pension scheme are not investments and so the communication will not be a financial promotion (see Q47).
Employer, affinity group or trustee	To persuade employees or members to join a stakeholder pension scheme or a <i>group personal pension scheme</i> .	Approval or exemption needed as rights under a stakeholder pension scheme will be, and rights under a group personal pension scheme are likely to be or to include, investments. Promotions about stakeholder pension schemes will be exempt where employers are

		<p>making them in order to meet their statutory obligation to provide a stakeholder pension scheme for their employees.</p> <p>Employers may be able to use the specific exemption for promotions made to employees if the conditions in the exemption are satisfied (see Q48).</p> <p>Individuals who act as unpaid trustees will not be making promotions in the course of business, so approval or exemption will not be required.</p> <p>Affinity groups may or may not be promoting in the course of business depending primarily on whether they are carrying on their main activities as a business.</p>
Employer or affinity group	To persuade employees or members to make free-standing additional voluntary contributions (FSAVCs) or to take out any other type of personal pension scheme (other than a stakeholder pension scheme or a group personal pension scheme).	Approval or exemption is likely to be needed as rights under FSAVCs and other personal pension schemes are likely to be or to include investments.
Employer, affinity group or trustee	To persuade employees or members to take out additional voluntary contributions (AVCs) or	Approval or exemption not needed as interests in AVCs or annuities arising under the trusts of an occupational pension scheme which is not a stakeholder pension scheme

	<p>an annuity to be held under an occupational pension scheme which is not a stakeholder pension scheme.</p>	<p>are not investments and so the communication will not be a financial promotion (see Q47).</p>
<p>Employer, affinity group or trustee</p>	<p>To persuade employees or members not to join, or not to leave the occupational pension scheme to join, a stakeholder pension scheme or a group personal pension scheme or not to switch funds by reference to which their benefits are calculated.</p>	<p>Approval or exemption not needed as persuading persons not to acquire, or not to dispose of, investments is not a financial promotion.</p>
<p>Employer, affinity group or trustee</p>	<p>To persuade members of a pension scheme to switch funds by reference to which their benefits are calculated.</p>	<p>Approval or exemption not needed when the scheme is an occupational pension scheme which is not a stakeholder pension scheme as the rights being switched are not investments and so the communication will not be a financial promotion (see Q47).</p> <p>Where the switching rights occur under a stakeholder pension scheme or a group personal pension scheme, approval or exemption will be needed as the rights are investments.</p> <p>Employers may be able to use the specific exemption for promotions made to employees where the promotion relates to switching rights under a group personal</p>

		<p>pension scheme or a stakeholder pension scheme and the other conditions in the exemption are satisfied (see Q48).</p> <p>Trustees will be exempt as they are making the promotion to a member and it relates to the management or distribution of the trust fund.</p>
Trustee	To persuade co-trustees to enter into an investment transaction.	Trustees will be exempt as they are making the promotion to a fellow trustee and it is made for the purposes of the trust fund.

FEES PROVISIONS (AMENDMENT) INSTRUMENT 2006

Powers exercised

- A. The Financial Services Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):
- (1) section 72 (The competent authority);
 - (2) section 74(4) (The official list);
 - (3) section 99(1) (Fees);
 - (4) section 101 (Listing rules: general provisions);
 - (5) section 138 (General rule-making power);
 - (6) section 156 (General supplementary powers);
 - (7) paragraph 17(1) of Schedule 1 (Fees); and
 - (8) paragraphs 1 (General), 4 (Rules), and 7 (Fees) of Schedule 7 (The Authority as Competent Authority for Part VI).
- B. The rule-making powers listed above are specified for the purpose of section 153(2) (Rule-making instruments) of the Act.

Commencement

- C. This instrument comes into force on 1 May 2006.

Amendments to the Handbook

- D. The Fees manual (FEES) is amended in accordance with Annex A to this instrument.
- E. The Supervision manual (SUP) is amended in accordance with Annex B to this instrument.

Citation

- F. This instrument may be cited as the Fees Provisions (Amendment) Instrument 2006.

By order of the Board
27 April 2006

Annex A

Amendments to the Fees manual

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

FEES 3 Annex 4R

Application and tranche fees in relation to listing rules

Part 1

Fee type	Fee amount
Application Fees	
Application for <i>listing</i>	£ 200 <u>225</u> ...
...	

Part 2

Sponsor Application Fees for the period 1 July 2005 to 31 March 2006	
...	

FEES 3 Annex 5R

Part 1

...	
Transaction vetting fees for the period 1 July 2005 to 31 March 2006	

Part 2

~~Fees for the period 1 July 2005 to 31 March 2006~~

Annex B

Amendments to the Supervision manual

In this Annex, underlining indicates new text.

...

16.3.14 R ...

- (2) The administrative fee in (1) does not apply in respect of quarterly reports required to be submitted by *credit unions* whose liability to pay a periodic fee under FEES 4.2.1 R in respect of the A.1 activity group in FEES 4 Annex 1R, for the financial year prior to the due date for submission of the report, was limited to the payment of the minimum fee.

...

**STAKEHOLDER PENSION DECISION TREES
AMENDMENT INSTRUMENT 2006**

Powers exercised

- A. The Financial Services Authority makes this instrument in the exercise of the following powers and related provisions of the Financial Services and Market Act 2000 (“the Act”):
- (1) section 138 (General rule making power);
 - (2) section 155(7) (Consultation); and
 - (3) section 156 (General supplementary powers).
- B. The rule-making powers listed above are specified for the purpose of section 153(2) of the Act (Rule-making instruments).

Commencement

- C. This instrument comes into force on 28 April 2006.

Amendments to the Handbook

- D. The Conduct of Business sourcebook (COB) is amended in accordance with the Annex to this instrument.

Citation

- E. This instrument may be cited as the Stakeholder Pension Decision Trees Amendment Instrument 2006.

By order of the Board
27 April 2006

Annex

Amendments to the Conduct of Business sourcebook

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

COB 6 Annex 1R Decision trees for stakeholder pension schemes (as required in COB 6.5.8R): text, content and format (R)

STAKEHOLDER PENSION DECISION TREES

Decision trees provide information and help you to answer the question: “Would a stakeholder pension be a good choice for me as part of my financial planning for retirement?”

Decision trees are intended to help you make your own choice about your pension arrangements. They do not give you financial or professional advice and you should not regard them as doing so.



[Insert current tax year]

You need to read the following notes before using the decision tree

flowcharts. There is also more information starting on page [insert page number] that you can refer to at any stage.

What is a stakeholder pension?

A stakeholder pension is a *private pension* - it's *not a State pension*. It must meet minimum standards laid down by the Government about charges, flexibility and the regular information you must be given. The standards are designed to help ensure that all stakeholder pensions give good basic value. There's more about this in the "Further information" section on page [insert page number].

With a stakeholder pension, you can pay regular contributions, and you can also make lump-sum contributions whenever you like. Your employer can also make contributions. You will benefit from tax relief on your own contributions – there's more about the tax advantages in the "Further information" section on page [insert page number].

Your contributions are invested to build up your own pension fund. The amount of your fund when you come to retire is not guaranteed and depends on how much has been paid in, the type of investment fund you choose, how those investments perform, and the level of charges. A stakeholder pension scheme will usually offer you a range of investment funds, with differing degrees of investment risk and potential investment growth.

You do not need to ~~can~~ retire to and draw your stakeholder pension benefits. You can take benefits at any time ~~between~~ from a certain minimum ages. The minimum age is currently increasing from 50 to 55, and this will happen ~~but~~ by April 2010 at the latest ~~it will be increased to 55~~. The precise timing of this increase may vary between different stakeholder pension schemes. ~~However, you must start to draw your benefits by age 75~~. You will need to bear this in mind when deciding on your retirement plans. You can't withdraw any money from your pension fund before you reach the minimum retirement age ~~retire and take your pension~~.

When you ~~retire~~ take benefits, you can choose to take up to 25% (a quarter) of your pension fund as a tax-free lump sum. And you can use the rest of your pension fund (or all of it, if you decide against a tax-free lump sum) to buy an "annuity". ~~The~~ An annuity will pay you a regular income during your retirement. That income will depend on the size of your pension fund and annuity rates at the time you take your pension. You may have to pay tax on your annuity income.

Is a stakeholder pension a good choice for me?

You can contribute to a stakeholder pension whether you are in employment, a fixed-contract worker, self-employed, or even not working. You can get one from a range of providers including a bank, building society, insurance company, investment company, or through a financial adviser.

Stakeholder pensions suit a wide range of people. But they are likely to be particularly attractive to people who have no existing pension provision apart from the State pensions, such as the self-employed or any employee whose employer does not contribute to a workplace-based pension scheme. ~~In some cases,~~ stakeholder pensions can be used to top up the benefits provided by an employer's own scheme. But if your employer offers to match any additional voluntary contributions (AVCs) that you choose to make to his scheme, this is likely to be a better way of topping-up than through your own separate stakeholder pension.

Stakeholder pensions have many advantages for many people, but they may not be the right choice for everyone. These decision trees are intended to help you decide what would be a good choice for you.

Do I need to save for my retirement through a stakeholder pension?

To answer this question, you must make your own judgment. Will your State pensions, any existing private pensions, any employer-sponsored pensions and any other sources of income be enough for you to live on when you retire? You need to think about the standard of living you want to enjoy when you retire and the income you'll need to support it.

Ask yourself these seven questions:

- ***Roughly how much will I need to live on when I retire?***

Try to work out how much money you will need to live on when you have retired to afford the things you'll want and the things you'll want to do.

- ***Will I qualify for the full basic State Pension?***

You cannot get your basic State Pension until you reach State pension age (currently 65 for men and 60 for women). Details of how the State Pension age for women is changing are on page [insert page number].

You can get a basic State Pension by building up enough qualifying years before State Pension age. A qualifying year is a tax year in which you have enough earnings on which you have paid, are treated as having paid or have been credited with, National Insurance (NI) contributions. Men normally need 44 qualifying years to get the full basic State Pension; women currently normally need 39 qualifying years to get the full basic State Pension. In 2020, when State Pension age for women is raised from 60 to 65, the normal requirement will increase to 44 qualifying years for the full basic State Pension.

To check the amount you will receive, you can get a State Pension forecast – see the details on page [insert page number].

The Government reviews the amount of the basic State Pension every year. The current rates are shown in a table under “Further information” on page [insert page number].

- ***Will I qualify for an additional pension through the State Second Pension (formerly State Earnings Related Pension Scheme – SERPS)?***

The State Second Pension is payable when you reach State Pension age, on top of the basic State Pension. The amount depends on your earnings while you were in employment and the National Insurance contributions you paid. Since April 2002, you may also qualify for an additional State Pension if you are a carer or have a long-term illness or disability.

Self-employed people do not qualify for the State Second Pension (formerly SERPS).

Those employees who were “contracted-out” of the State Second Pension will not qualify for the additional pension for the period when they were contracted out. Some people will be contracted out through an employer’s occupational pension scheme and some through private pension arrangements. Check with your employer or pension provider if you are not sure.

- ***Does my current employer provide a pension scheme and how much will that give me?***

Check with your employer if you are not sure about membership. If you are a member of an employer's scheme, you should get regular statements setting out what your benefits may be when you retire. If you cannot find these statements, check with your employer.

- ***Am I already contributing to a personal pension scheme or a stakeholder pension? If so, how much income will they give me?***

If you are already contributing to a personal pension or stakeholder pension, you need to find out what retirement income they might provide. Look at the most recent benefit statements you have been sent, or check with your pension plan provider.

- ***Have I any old pensions, maybe from previous employers' schemes or from personal pension schemes? If so, how much income will they give me?***

Check on the pension plans you have contributed to in the past but no longer pay into today. You need to have some idea of the retirement income you may get from them.

To check on the value of old pension plans, look at the most recent benefit statements you have been sent. If you cannot find any statements, contact your pension plan provider, for example the insurance company or the employer that offered the pension to you.

- ***Will the Government's Pension Credit make a difference to me?***

Pension Credit is designed to make sure that people aged 60 and over have a minimum income, and that those aged 65 and over with modest savings get some credit for having saved. These savings could, for example, be in the form of an employer's pension, a stakeholder or other personal pension, or the State Second Pension. This is not a complete list, and you could have other savings that will count.

~~Pension Credit means that, f~~For most people, ~~most of the time,~~ it will pay to save in a pension or some other vehicle, even with the effect of Pensions Credit. For a limited group of people, however, the decision will not be so clear-cut, and these people will have to think carefully about their personal circumstances. In particular, people in their fifties and over who have not been able to save much and have only a limited ability to save as they approach retirement should seek expert advice before they take out a stakeholder pension. See "Where to get more help" on page [insert page number].

You need to bear in mind that governments can change the rules for State pensions and benefits at any time. So it may be unwise to rely on any particular type or level of benefit being available when you retire.

There's more information about getting a forecast of your State pensions (page [insert page number]) and how to track down pensions provided by any former employers² or personal pensions (page [insert page number]).

If the income you expect in retirement is less than you want, you need to think about saving more to make up the difference. A stakeholder pension is one of your options. But before you decide anything, you need to think about your priorities.

What else should I think about before contributing to a stakeholder pension?

You may have other financial commitments that will affect what you can afford to contribute to a stakeholder pension. Or you may feel that other financial needs must come first. For example, ask yourself:

- ***What are my other financial commitments?***

For example, mortgage repayments, rent, life assurance, and credit cards. Make sure you do your sums before thinking about a stakeholder scheme and that you would still be able to afford your other commitments.

- ***Would I be prepared, if necessary, to give up anything so that I can pay into a stakeholder pension?***

Remember that saving through a pension scheme is a long-term commitment. Any change in how you spend your money may need to last for a long time.

- ***Should I be thinking of other things first?***

For example, you may want to consider life assurance protection for you and your family, or building up some “rainy-day” cash savings before thinking about a stakeholder pension.

If you are a member of your current employer’s pension scheme, it may make sense to pay additional voluntary contributions to that scheme rather than contribute to a stakeholder scheme. And if you are currently contributing to a personal pension or stakeholder pension, it may make sense to increase your contributions to that scheme rather than start a separate stakeholder pension, especially if you have a stakeholder pension that has kept to the original 1% limit on charges. There's more about charges under “Further information” on page [insert page number].

How much should I contribute to my stakeholder pension?

Contributions to stakeholder pensions can be as low as £20. But, even a regular monthly contribution of £20 over several years will not give you a large pension when you retire. And the older you are when you start saving, the less time there is for your pension fund to grow to something worthwhile.

Estimated pensions in the Pension Table

The Pension Table later on will give you a fair idea of the pension income you could get, depending on your age and contributions. **But please remember that the figures in the table are only estimates and are not guaranteed. You may get less, or you may get more.**

The pension figures are also shown before income tax. When you receive your pension during retirement you may be taxed on it.

The estimated pensions are based on the ~~new~~ stakeholder pension charge limit of 1.5% for the first 10 years– (if the stakeholder pension scheme has kept to the original 1% charge limit on the fund, then the estimated pension figures in the Pensions Table will be higher). There's more about charges under “Further information” on page [insert page number].

The figures in the table are calculated on the basis of the following assumptions:

Before you retire

Your monthly contributions increase in line with inflation.....2.5% a year.
Before charges, your fund grows by.....7% a year.
Charges deducted from your fund.....1.5% of fund a year for 10 years,then reducing to 1%.

When you retire

Your entire fund is used to buy an annuity, and you do not take any tax-free lump sum.
Annuity rates assume that the investment return after retirement is.....4.2 ~~0.6~~% a year in excess of inflation.
Your pension increases in line with inflation.
Your spouse will receive half your pension on your death.

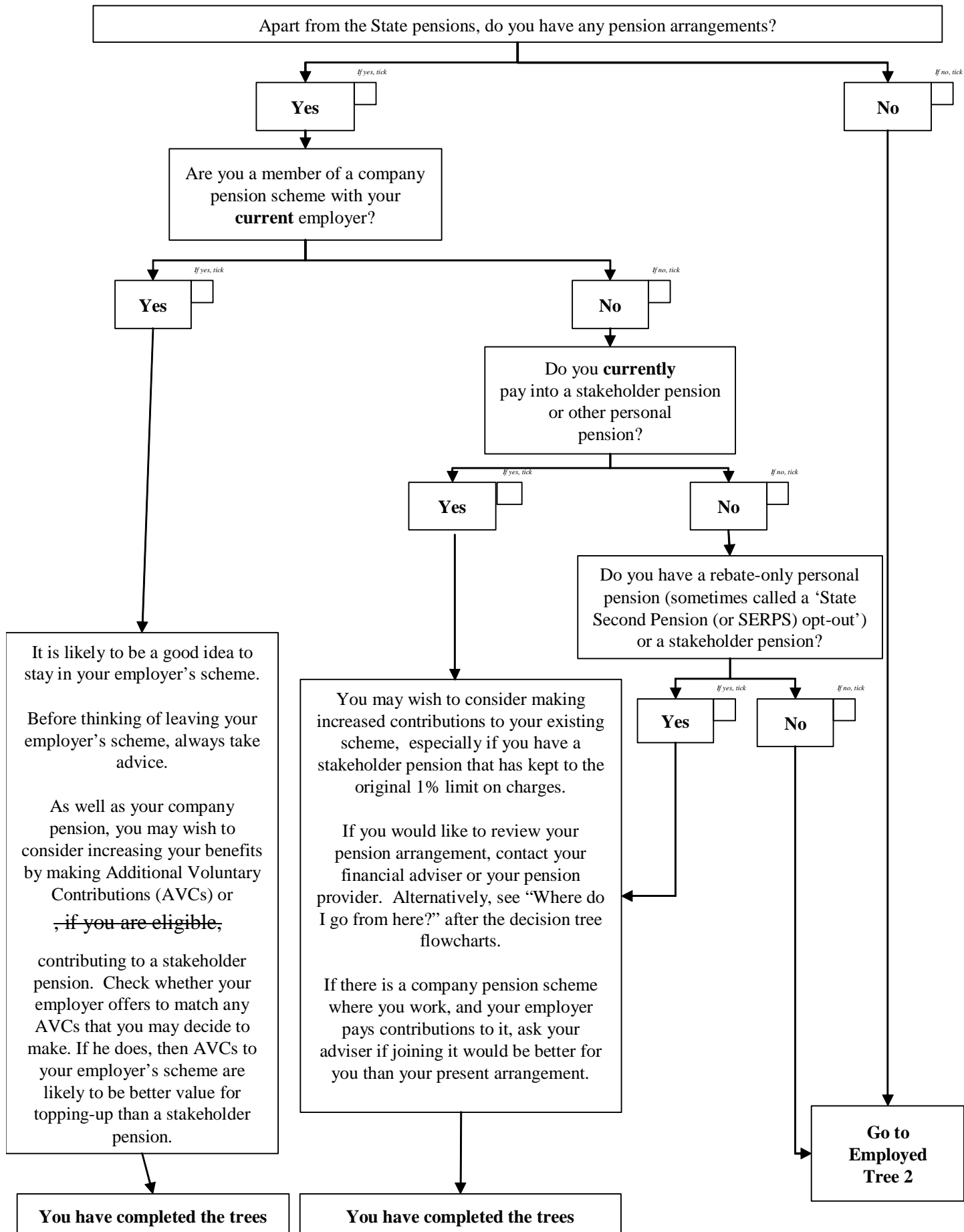
How do I use the decision trees?

- **These decision trees have been designed to help you decide whether a stakeholder pension would be a good choice for you. Please take the time to read and use them carefully, giving accurate answers to the questions. Because the decision trees do not give personalised advice, any decision you take is your own responsibility.**
- **There are separate decision trees for:**
 - **Employed people**
 - **Self-employed people**
 - **People who are not employed**
- **When you have found the right decision tree, work through the questions from the top of the page and tick the box for each question you answer.**
- **If the tree asks you about your present pension arrangements and you are not sure of the correct answer, find out the right information – don't guess.**
- **If the tree recommends you take advice, or if you are not sure what is right for you, then you should seek advice. You may have to pay for this advice.**
- **After the decision trees, you'll find further information about what to do next.**

Some of the information used in these materials comes from sources outside the FSA. The FSA does not guarantee or warrant the accuracy of the information included in these materials, and does not accept any liability for errors or omissions. The FSA shall not be liable for any damages arising from any action or decision taken as a result of using any of these materials.

This information is intended to help you make your own choice about your pension arrangements. It does not give you financial or professional advice and you should not regard it as doing so. You should get help if you require advice.

Employed Tree 1 – Current pensions



Employed Tree 2 – No current pensions

...

Self-employed Tree

...

Not employed Tree

...

This information is intended to help you make your own choice about your pension arrangements. It does not give you financial or professional advice and you should not regard it as doing so. You should get help if you require advice.

Pension Table

How much should I save towards a pension?

THIS IS AN IMPORTANT DECISION

Most people save every month. It is better if you can keep up your monthly contributions.

The following table shows the **estimated monthly pension**, at today's prices, that you would get for different **regular monthly contributions**. The contribution shown is assumed to **increase each year in line with inflation**. The government will also add tax rebates to increase the actual amounts paid into your stakeholder pension (although all tax breaks are subject to change). The estimated pension figures include this tax rebate. They also assume that your pension will increase in line with inflation.

**Remember: these estimates are not guaranteed – you could get more or less than the amounts shown.
A stakeholder pension would be on top of any State pensions you are entitled to.**

The table gives you an idea of how much you need to pay now – as a regular monthly contribution – to receive the monthly pension you want when you retire. First look down the left-hand column to find the age closest to your age now. Then look across to find the monthly contribution you want to pay and the age at which you want to retire.

Your approximate age now	What you pay per month for the first year (tax rebates will be added to this amount)							
	£ 20		£ 50		£ 100		£ 200	
	Initial monthly pension if you retire at 65	Initial monthly pension if you retire at 60	Initial monthly pension if you retire at 65	Initial monthly pension if you retire at 60	Initial monthly pension if you retire at 65	Initial monthly pension if you retire at 60	Initial monthly pension if you retire at 65	Initial monthly pension if you retire at 60
20	<u>£ 98</u>	<u>£ 67</u>	<u>£ 245</u>	<u>£ 169</u>	<u>£ 490</u>	<u>£ 339</u>	<u>£ 980</u>	<u>£ 679</u>
25	<u>£ 79</u>	<u>£ 54</u>	<u>£ 197</u>	<u>£ 135</u>	<u>£ 395</u>	<u>£ 270</u>	<u>£ 790</u>	<u>£ 540</u>
30	<u>£ 62</u>	<u>£ 42</u>	<u>£ 157</u>	<u>£ 105</u>	<u>£ 314</u>	<u>£ 210</u>	<u>£ 628</u>	<u>£ 421</u>
35	<u>£ 49</u>	<u>£ 32</u>	<u>£ 122</u>	<u>£ 80</u>	<u>£ 245</u>	<u>£ 160</u>	<u>£ 490</u>	<u>£ 320</u>
40	<u>£ 40</u>	<u>£ 23</u>	<u>£ 101</u>	<u>£ 58</u>	<u>£ 202</u>	<u>£ 117</u>	<u>£ 404</u>	<u>£ 234</u>
45	<u>£ 27</u>	<u>£ 16</u>	<u>£ 68</u>	<u>£ 40</u>	<u>£ 136</u>	<u>£ 80</u>	<u>£ 273</u>	<u>£ 161</u>
50	<u>£ 18</u>	<u>£ 9</u>	<u>£ 47</u>	<u>£ 24</u>	<u>£ 94</u>	<u>£ 49</u>	<u>£ 188</u>	<u>£ 98</u>
55	<u>£ 11</u>	<u>£ 4</u>	<u>£ 28</u>	<u>£ 11</u>	<u>£ 57</u>	<u>£ 23</u>	<u>£ 114</u>	<u>£ 46</u>
60	<u>£ 5</u>		<u>£ 13</u>		<u>£ 26</u>		<u>£ 53</u>	

Have you found the level of monthly pension that you need in the table and can you afford the monthly contribution?

If yes, tick

Yes, I've found the pension I need and can afford the monthly contribution

Consider starting a stakeholder pension or restart making contributions to a stakeholder pension. If you are employed, check if your employer offers workplace access to a particular stakeholder pension and if he offers a contribution to it.
If in doubt seek help from an expert adviser.
See "Where do I go from here?" on the next page.

You have completed the trees

If no, tick

No, I can't find the pension I need or I can't afford the contribution

For details of where to get further help, see "Where do I go from here?" on the next page.

[Insert current tax year]

Where do I go from here?

You've worked your way through the decision trees and now need to make some decisions. You may be confident that contributing to a stakeholder pension would be a good choice for you, or you may want more help before reaching a decision on what to do.

Have you decided that a stakeholder pension is a good choice for you:

If so, it is a good idea to contact several firms selling stakeholder pensions and ask them for a brochure or a Key Features Document, so that you can compare products. The Key Features Document sets out important details about that particular firm's stakeholder pension product.

You can compare different stakeholder pension and personal pension schemes by using the FSA's *Comparative Tables*, which you can find at www.fsa.gov.uk/tables. You can also look at a register of stakeholder schemes published by The Pensions Regulator at www.thepensionsregulator.gov.uk/stakeholderpensions/ (~~The Pensions Regulator replaced the Occupational Pensions Regulatory Authority in April 2005~~).

You can also contact an adviser to help you choose a particular stakeholder provider. See ~~the list~~ [Where to get more help](#) below ~~of useful contacts~~.

Do you need more help?

You may need to get more help before making a decision, particularly if you are in one or more of the following situations:

- You already have a pension arrangement but want to know if you should save more.
- Your personal circumstances do not seem to fit the questions in the decision trees.
- You wish to get advice that takes account of all your personal circumstances.
- You are not sure how to answer some of the questions in the decision trees.
- You are not sure if you are making the right decision.
- You feel you cannot afford to save for retirement.

You should consider getting advice if:

- you are not sure that saving through a pension plan is a good idea for you; or
- you want to look at other ways of saving and investing for the long term.

Some organisations that may be able to help you are listed below.

Where to get more help

You could contact the Pensions Advisory Service helpline on 0845 6012923. Their information is free but call charges may vary.

You can also visit their website at www.stakeholderhelpline.org.uk

If you already have a financial adviser, you may want to speak to them about your retirement needs. If you do not have a financial adviser but want to talk to one, the following organisations can help:

- IFA Promotions: 0800 085 3250 or at www.unbiased.co.uk
- Institute of Financial Planning: 0117 945 2470 or at www.financialplanning.org.uk
- The Personal Finance Society: at www.thepfs.org/findanadviser
- Solicitors for Independent Financial Advice: 01372 721172 or at www.sifa.co.uk

Alternatively, contact the pension provider of your choice.

Remember that advisers may charge for any help or advice they give you, so check first on how much you would have to pay.

The next section gives further detailed information about stakeholder pensions, State pensions and how to track down old pension schemes.

Further information

The minimum standards

Stakeholder pensions must meet the standards laid down by the Government.

The standards include:

v **Charges**

Providers of stakeholder pensions usually charge for managing your money. There is an upper limit of 1.5% of the value of your fund each year for the first 10 years (so on a fund value of £10,000, the maximum charge is £150 a year), which then reduces to 1%.

But if you started your stakeholder pension before 6 April 2005, the maximum that you can be charged is ~~still~~ 1%. If you took out a stakeholder pension before 6 April 2005, it may be cheaper to continue contributing to it rather than take out a new stakeholder pension.

v **Flexibility**

You can contribute regularly or occasionally. It is always best to make regular weekly or monthly contributions but you can change the amount. You can pay in as little as £20, and you can stop paying in without having to pay any penalty, and restart later.

If you are employed and your employers provide a stakeholder pension, they may, if you wish, deduct your contributions direct from your pay and put them into your pension fund.

You can take your stakeholder pension with you when you change jobs. You can switch to another stakeholder pension at any time if you want to, without having to pay any charges for the transfer.

v **Information**

Your stakeholder pension provider must give you regular information about your fund. This will include an annual statement to let you know how much you have paid in and how your fund is growing. It will also include a forecast of how much your pension could be in today's prices. Look out for this forecast – it's called a Statutory Money Purchase Illustration – which is updated each year and will help you decide whether you are making enough provision for your retirement.

v **Investments**

But one thing you must understand is that **the minimum standards do not necessarily mean that your money is protected**. The performance of your stakeholder pension depends on the type of investment fund you choose and how those investments perform. Remember that investments linked to the stock market can fall as well as rise.

You don't have to make decisions about how your contributions are to be invested. Stakeholder pensions must provide what is called "**lifestyling**" for anyone who does not want to make a choice. Lifestyling means that at least five years before retirement your pension savings will start to be moved into less risky investments. This will help to guard against falls in investment value as retirement approaches. You can, however, choose to turn off the lifestyling before it begins.

Tax relief

Everybody who contributes to a stakeholder pension will get tax relief on their contributions.

Under present tax arrangements, for each £1 you pay into your stakeholder pension fund, HM Revenue and Customs will pay an extra 28p into your fund, even if you don't normally pay income tax.

Example

If you pay in £50 a month, income tax relief will increase your contribution to £64.10.

The Government has simplified the tax rules for pensions since April 2006. Under the new tax rules, you can pay as much as you like into a stakeholder pension, **but there are limits on the amount of tax relief given.** You will receive tax relief on yearly contributions made by and for you in any year up to:

- £2,808; or
- 100% of your UK earnings;

whichever is more.

~~Because of the tax advantages, there are limits on how much you can contribute to a stakeholder pension. These limits are set by HM Revenue and Customs and depend on your taxable earnings and your age. There are also special limits for people without any earnings and those who are members of employers' occupational pension schemes.~~

Most people can contribute up to £3,600 to a stakeholder pension in any tax year, including basic-rate tax relief. This means you could pay in £2,808 and the income tax relief would increase your contribution to £3,600.

~~If you are self-employed or in non-pensionable employment you may be able to contribute more than £3,600 and still get income tax relief, depending on your age and earnings. For example, up to age 35 you can contribute up to 17.5% of your earnings in any tax year. If you are over 35, there is a scale that allows you to contribute higher percentages of your earnings.~~

If you pay income tax at the higher rate, you will be able to claim back the extra tax from HM Revenue and Customs at the end of each tax year.

Even if you have no form of paid employment, you can set up a stakeholder pension. You can then benefit from tax relief on your contributions, even if you don't pay any income tax.

There is however a maximum "annual allowance" – set at £215,000 for tax year 2006/07 – which applies to all contributions made by you and on your behalf (including from an employer). If the contributions made by and for you in any year exceed the annual allowance, the contributions above the annual allowance will still attract tax relief, but you will have to pay a 40% tax charge on any contributions which exceed the annual allowance.

There is also an overall "lifetime allowance" on the total amount of money you can save in your pension free of any tax charge when you come to draw your benefits. This is set at £1.5 million for tax year 2006/07, rising in stages to £1.8 million by tax year 2010/11. It includes the value of all the other current or old pension schemes you may have from previous jobs. There is information on how to get details of your old pension plans on page [insert page number].

The Government is simplifying the tax rules for pensions from April 2006. From then on, you will be able to contribute as much of your taxable earnings to your pension as you want – up to a maximum limit set at £215,000 for tax year 2006/07 – and still benefit from tax relief.

~~There will also be an overall "lifetime allowance" on the total amount of money you can save in your pension and still benefit from tax relief. This is set at £1.5 million for tax year 2006/07 and also includes the value of old pensions from previous jobs. There is information on how to get details of your old pension plans on page [insert page number].~~

State pensions

Rates of State pensions and benefits change every year. The following table shows the current rates of basic State Pension (assuming a full National Insurance contribution record) and the minimum income provided by Pension Credit.

THE BASIC STATE PENSION AND PENSION CREDIT RATES GIVEN HERE ARE THOSE ANNOUNCED BY THE GOVERNMENT AS APPLYING IN THE TAX YEAR [Insert current tax year].

	Weekly	Monthly equivalent
BASIC STATE PENSION from age 65 (men) or 60 (women)		
One person with a full NI contribution record	[...]	[...]
Full rate based on a spouse's NI contribution record	[...]	[...]
Couples who have <i>both</i> paid full National Insurance contribution	[...] each	[...] each
PENSION CREDIT guarantees a minimum income from age 60 of at least:		
Single person	[...]	[...]
Couple	[...]	[...]

You can get a forecast of your State pensions by calling the Retirement Pension Forecasting Team on 0845 3000 168, or if you have hearing or speech difficulties and have a textphone, on textphone 0845

3000 169. Lines are open from 8am to 8pm Monday to Friday and 9am to 1pm on Saturday. You can complete an application form over the phone or ask for the forecast form BR19 to be sent to you. Or you can write to:

Retirement Pension Forecasting Team
The Pension Service
Room TB001
Tyneview Park
Whitley Road
Newcastle upon Tyne
NE98 1BA

You can also complete the form on the Internet using the Pension Service website, www.thepensionsservice.gov.uk/resourcecentre/e-services/home.asp then print it out and post it in the normal way.

There are changes to the State Pension age which affect women born on or after 6 April 1950. The State Pension age for women will be increased gradually over a ten-year period from 2010 so that by 2020 women born on or after 6 April 1955 will not get a State Pension until age 65. For more information on these changes, see the Pension Service guide *Pensions for women – Your guide* (PM6) or by using the State Pension age calculator on The Pension Service website:

http://www.thepensionsservice.gov.uk/resource_centre/calc.asp.

<http://www.thepensionsservice.gov.uk/resourcecentre/home/statepensioncalc.asp>

The DWP produces a series of guides that give basic information on pensions. You can get copies by calling the DWP on 0845 731 3233. The line is open 24 hours a day and call charges may vary. A textphone service is available on 0845 604 0210. You can also order copies of these information guides on the Internet at www.thepensionsservice.gov.uk/resourcecentre/home/downloads.asp

You can get more information about Pension Credit on the Pension Service's website at www.thepensionsservice.gov.uk/pensioncredit/home.asp or by telephoning 0800 99 1234.

Old pension plans

To check on the value of old pension plans, look at the most recent benefit statements you have been sent. If you cannot find any statements, contact the pension plan provider, for example the insurance company or the employer that offered the pension to you.

Alternatively, the Pension Tracing Service can help you identify pension schemes you have belonged to in the past. The Pension Tracing Service is free and you can phone them on 0845 6002 537 and ask for a tracing request form or write to them at:

Pension Tracing Service
The Pension Service
Whitley Road
Newcastle upon Tyne
NE98 1BA

There is also an online form available at www.thepensionsservice.gov.uk.

Using a stakeholder pension to contract out of the State Second Pension

You can use a stakeholder pension to contract-out of the State Second Pension (S2P), but it's not an easy decision.

Everyone in employment earning above the lower earnings limit (a minimum level of earnings set by the Government for State benefit purposes) is automatically included in the ~~State Second Pension S2P~~ S2P unless they decide to leave it or are contracted-out through an employer's occupational pension scheme. Leaving the ~~State Second Pension S2P~~ S2P is called 'contracting-out'. If you contract-out, you give up your ~~State Second Pension S2P~~ S2P entitlement and instead build up a replacement for it in your own private pension arrangement, such as a stakeholder pension.

Whether you would be better off contracting-out of the ~~State Second Pension S2P~~ S2P or staying in it depends on your own personal circumstances and attitude to investment risk.

An independent report written for the FSA in August 2005 says that, in purely financial terms, most people who contract-out or stay contracted-out this year are likely to get a lower pension than if they were in S2P. The report looks at recent trends and makes assumptions about future investment returns and interest rates. It also assumes that S2P will stay in its current form. The government is currently looking at pensions reform and it is difficult to predict what will happen to S2P in the future.

If you have already contracted-out through a personal or stakeholder pension, you should review your decision now. Your decision is about the future but you should review it every year. It does not affect past years in which you were contracted-out.

You may wish need to get advice on what may be the best thing for you to do. See the "where to get more help" section page [insert page number]. The FSA publishes information on its website at www.fsa.gov.uk, designed to help you understand the issues, but it's not intended to replace professional advice.

For more information about contracting out, read the **FSA Factsheet: The State Second Pension and contracting out**. You can view or order this factsheet online at www.fsa.gov.uk/consumer or from the FSA Consumer Helpline on 0845 606 1234.

Deciding to contract out in one tax year does not commit you to do the same in later years. In fact, it's important to review your decision regularly.

**SIGNIFICANT MANAGEMENT FUNCTION REPORTING REQUIREMENT
AMENDMENT INSTRUMENT 2006**

Powers exercised

- A. The Financial Services Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):
- (1) section 138 (General rule-making power); and
 - (2) section 157(1) (Guidance).
- B. The rule-making power listed above is specified for the purpose of section 153(2) of the Act (Rule-making instruments).

Commencement

- C. This instrument comes into force on 6 May 2006.

Amendments to the Handbook

- D. The Supervision manual (SUP) is amended in accordance with Annex A to this instrument.
- E. The Enforcement manual (ENF) is amended in accordance with Annex B to this instrument.

Citation

- F. This instrument may be cited as the Significant Management Function Reporting Requirement Amendment Instrument 2006.

By order of the Board
27 April 2006

Annex A

Amendments to the Supervision manual

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

10.9.8 R Reporting requirement

~~A firm must, by no later than 31 July each year, provide the FSA with:~~

- ~~(1) the name of every individual who is approved to perform any of its significant management functions; and~~
- ~~(2) brief details of the job performed by that individual, as at 30 June of that year;~~

~~unless it has, within the 12 months preceding 30 June, already provided the FSA with that information. [deleted]~~

- 10.9.9 G The broad description of each *significant management function* means that an individual may perform a different function within the *significant management function* without needing prior approval. However, the FSA does require a notification of the job performed by such people once a year. Typically, a *firm* will give this information to the FSA as a matter of routine during the year but, if not, SUP 10.9.8 R requires it to do so by 31 July. The *rule* requires the *firm* to provide a report only in respect of individuals performing a *significant management function*: if there are none, there is no need to provide a report. [deleted]

10 Ann 4D

Form A Application to perform controlled functions under the approved persons regime

...

Section 3 ARRANGEMENTS AND CONTROLLED FUNCTIONS

...

Unless the *firm* indicates otherwise, the *FSA* assumes that the *arrangement* given on the application form includes all of the activities that fall within the description of the *controlled function*. This means that a *firm* may alter a *candidate's* responsibilities within the broad description of a *controlled function* without needing further approval from the *FSA*. ~~However, in relation to the significant management functions, firms must comply with the reporting requirements in SUP 10.9.8R and SUP 10.9.9G.~~

Notification requirements

Sch 2.2 G ...
...

SUP 10.9.8R	<i>Approved persons-significant management functions</i>	Name of every individual who is approved to perform any of its significant management functions; and brief details of the job performed by that individual as at 30 June each year.	Annual requirement	By 31 July each year
------------------------	----------------------------------------------------------	------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------	--------------------	----------------------

...

Annex B

Amendments to the Enforcement manual

In this Annex, striking through indicates deleted text.

13.5 Financial penalties for late submission of reports

13.5.1 G The following is a list of the main periodic reporting *rules* (the list may not be comprehensive) and those other provisions:

- (1) the *rules* set out in ~~SUP 10.9.8R (Significant management functions)~~ and SUP 16 (Reporting requirements);

...

**SUPERVISION MANUAL (RETAIL MEDIATION ACTIVITIES RETURN)
INSTRUMENT 2006**

Powers exercised

- A. The Financial Services Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):
- (1) section 138 (General rule-making power);
 - (2) section 156 (General supplementary powers); and
 - (3) section 157(1) (Guidance).
- B. The rule-making powers listed above are specified for the purpose of section 153(2) (Rule-making instruments) of the Act.

Commencement

- C. This instrument comes into force on 6 October 2006.

Amendments to the Handbook

- D. The Supervision manual (SUP) is amended in accordance with the Annex to this instrument.

Citation

- E. This instrument may be cited as the Supervision Manual (Retail Mediation Activities Return) Instrument 2006.

By order of the Board
27 April 2006

Annex

Amendments to the Supervision manual

In this Annex, underlining indicates new text and striking through indicates deleted text; new entry fields on Forms are shown in shading.

SUP 16 Annex 18A Retail Mediation Activities Return (RMAR)

SECTION E: Professional Indemnity Insurance (PII) Self-Certification

Is the firm exempt from the PII requirements in respect of any regulated activities? (tick as appropriate)
 Does your firm hold a comparable guarantee or equivalent cover in lieu of PII or is it otherwise exempt from holding PII in respect of any regulated activities? (tick as appropriate)
 If the firm does not hold a comparable guarantee or equivalent cover and is not exempt if not exempt has the firm renewed its PII cover since the last reporting date? does the firm currently hold PII?
 Has the firm renewed its PII cover since the last reporting date?

Mortgage advising/arranging	Non-inv insurance advising/arranging/dealing/assisting	Retail investment advising/arranging

Please complete the following section as appropriate, in relation to each applicable PII policy:
 What activities are covered by the policy?

Mortgage advising/arranging	
Non-inv insurance advising/arranging/dealing/assisting	
Retail investment advising/arranging	

Is the cover compliant? If your policy excludes all business activities carried on prior to a particular date (i.e. a retroactive start date), then insert the date here, if not please insert 'n/a'

Annual premium

Those firms subject to the Insurance Mediation Directive (IMD) should state their limit in Euros, those that are not subject to the IMD should select Sterling.

- a) Limit of Indemnity - single claim Firms with unlimited indemnity should enter "unlimited" (lower case)
 - b) Limit of Indemnity - aggregate. Firms with unlimited indemnity should enter "unlimited" (lower case)
- Policy excess

Please select
 Euros (€)
 Sterling (£)

Amount of additional capital required for increased excess(es) (where applicable, total amount for all PII policies)

Personal investment firms only:
 Total amount of additional own funds required for policy exclusion(s)

Total of additional own funds required

Total of readily realisable own funds

Excess/deficit of readily realisable own funds

Increased excess(es) for specific business types (only in relation to business you have undertaken in the past or will undertake during the period covered by the policy)

business type	amount	
		add row
		add row

Policy exclusion(s) for specific business types (only in relation to business you have undertaken in the past or will undertake during the period covered by the policy)

Renewal date-Start Date
 End Date

Insurer name (please select from the drop down list)

(Drop down list) (other)

Annual income as stated on the most recent proposal form

--

Does the firm have any other PII policies?

Drop down list

[Please Select]

1. Abacus Syndicate (Lloyds Syndicate)
2. Ace
3. ALEA London Ltd
4. American International Group
5. American Insurance Company
6. Amlin Insurance Services
7. Aon Professional Risks
8. Beazley (Lloyds Syndicate or Limited Company)
9. Brit (Lloyds Syndicate or Limited Company)
10. Canopus Managing Agents (previously Trenwick)
11. Catlin Insurance Company Ltd
12. CBC UK Ltd
13. Chaucer Syndicates Ltd (Lloyds Syndicate)
14. China
15. Chubb Insurance Company of Europe SA
16. CNA Insurance
17. Collegiate
18. D A Constable (Lloyds Syndicate)
19. Griffen
20. HCC (Lloyds syndicate)
21. Hiscox (Lloyds Syndicate or Limited Company)
22. Interpolis (SimplyBiz)
23. Magian Underwriting
24. Markel (Lloyds Syndicate)
25. Mitsui Sumitomo (Lloyds Syndicate)
26. Newline Underwriting (Lloyds Syndicate)
27. PI Direct
28. QBE International Insurance Limited
29. Royal & Sun Alliance
30. St Paul International Insurance Co Ltd
31. SVB (Lloyds Syndicate)
32. Towergate Lifestyle Underwriting
33. Trilley
34. W R Berkley
35. Other (please state)
36. Multiple (please state all the insurance undertakings)

SUP 16 Annex 18B Notes for completion of the Retail Mediation Activities Return (RMAR)

...

Section E: Professional Indemnity Insurance

Data is required in relation to all PII policies that a *firm* has in place, up to a limit of ten (~~the firm will be prompted~~ the system will prompt you to submit data ...

...to the full requirements of *PRU* 9.2.

Firms which are subject to the requirements in both *PRU* and *IPRU* must apply the PII rules outlined in *IPRU(INV)*13.1.4 (1), not *PRU* 9.2

Section E: guide for completion of individual fields

Part 1

<p><u>Is the firm exempt from the PII requirements in respect of any regulated activities? Does your firm hold a comparable guarantee or equivalent cover in lieu of PII, or is it otherwise exempt from holding PII in respect of any regulated activities (tick as appropriate)?</u></p>	<p><u>This question will establish whether a <i>firm</i> is exempt from the requirements and so is not required to hold PII.</u></p> <p>The conditions for <u>comparable guarantees and exemptions from the PII requirements ...</u></p> <p>... applies in respect of comparable guarantees)_</p> <p><u>If the <i>firm</i> is required to hold PII – i.e. is not exempt from holding PII – you should enter 'no' in the data field.</u></p> <p><u>A <i>firm</i> is NOT exempt from holding PII if:</u></p> <ul style="list-style-type: none"> • <u>the <i>firm</i> has a group policy with an insurer; or</u> • <u>the <i>firm</i> has permission for the regulated business that requires PII, but does not currently carry it out; or</u> • <u>it is a <i>personal investment firm</i> meeting the exemption requirements for <i>mortgage intermediaries</i> and <i>insurance intermediaries</i> in <i>PRU</i> 9.2.</u>
<p><u>If the firm does not hold a comparable guarantee or equivalent cover and is not exempt, has the firm renewed its PII cover since the last reporting date? does the firm currently hold PII?</u></p>	<p>The purpose of this question is to ensure that <i>firms</i> do not have to fill in the same information each time they report when the information only changes annually.</p> <p><u>If the <i>firm</i> is reporting for the first time, you should enter 'yes' here and complete the data fields below.</u></p>

	<p><u>Firms</u> are required to take out and maintain PII at all times.</p> <p>You should only enter 'n/a' if the <i>firm</i> is exempt from the PII requirements in respect of <u>for all of the regulated activities</u> forming part of the RMAR.</p>
<p><u>Has the firm renewed its PII cover since the last reporting date?</u></p>	<p><u>This question will ensure that a firm does not fill in Part 2 of the PII section of the RMAR each time it reports, if the information only changes annually.</u></p> <p><u>If the firm is reporting for the first time, you should enter 'yes' here and complete the data fields.</u></p> <p><u>You should only enter 'n/a' if the firm is exempt from the PII requirements for all the regulated activities forming part of the RMAR.</u></p>

Part 2

At this point, if the firm has PII policy details to report, it should do so by clicking on the 'add PII policy' button in the summary screen. This will then prompt you to name the sub-section, e.g. 'policy1'. You may also add further sub-sections if the firm has two or more policies (up to a maximum of ten).

<p>What activities are covered by the policy(ies)?</p>	<p>...</p>
<p>Is the cover compliant?</p> <p><u>If your policy excludes all business activities carried on prior to a particular date (i.e. a retroactive start date), then insert the date here, if not please insert 'n/a'</u></p>	<p>The required terms for PII cover are set out in the Prudential Sourcebooks as follow:</p> <p>Insurance intermediaries and mortgage intermediaries – PRU 9.2.</p> <p>Personal investment firms – IPRU(INV) 13.1</p> <p>Authorised professional firms that carry on retail investment activities should note that by ticking this box they are providing confirmation that they are in compliance with IPRU(INV) 2.3.2E, which requires them to have PII cover that is at least equivalent to the requirements of their designated professional body.</p> <p><u>Required terms of PII are set out for personal investment firms in IPRU(INV) 13.1.4 and for mortgage intermediaries and general insurance intermediaries in PRU 9.2.10.</u></p> <p><u>Examples of a retroactive start date:</u></p>

	<p><u>(1) A firm has a retroactive start date of 01/01/2005 on its policy if:</u></p> <ul style="list-style-type: none"> • <u>A client is advised by the firm to purchase an XYZ policy on 01/03/2004 (i.e. before the retroactive date).</u> • <u>The client makes a formal complaint about the sale of the XYZ policy to the firm on 01/04/2006 (i.e. while this PII cover is still in place).</u> • <u>The complaint is upheld, but the firm's current PII Insurer will not pay out any redress for this claim as the transaction took place before 01/01/2005, the retroactive date in the policy.</u> <p><u>Insert '01/01/05' for this question on the RMAR.</u></p> <p><u>(2) A firm does not have a retroactive start date if:</u></p> <ul style="list-style-type: none"> • <u>A client is advised by the firm to purchase an XYZ policy on 01/03/2006.</u> • <u>The client makes a formal complaint about the sale of the XYZ policy to the firm on 01/04/2006 (i.e. while this PII cover is still in place).</u> • <u>The complaint is upheld, and the firm's current PII Insurer will pay out any redress owed by the firm to the client over any prescribed excess, and to the limit of indemnity provided for. There is no date in the policy before which any business transacted may not give rise to a valid claim.</u> <p><u>Insert 'n/a' for this question on the RMAR.</u></p>
Annual premium	This should be the annual premium that is paid by the firm, net of tax and any other add-ons.
Limit of indemnity	<p>You should record ... in aggregate.</p> <p><u>Those firms subject to Insurance Mediation Directive (IMD) requirements should state their limit in Euros; those that are not subject to the IMD should select 'Sterling' from the drop-down list.</u></p> <p><u>For Insurance insurance intermediaries, see PRU 9.2.13R and select either 'Euros' or 'Sterling' as applicable.</u></p>

	<p>For Mortgage <u>mortgage-intermediaries</u>, should state their limits in Sterling (see PRU 9.2.15R).</p> <p>For <i>personal investment firms</i>, see IPRU(INV) 13.1.4(2)R and 13.1.4(5)E and select either 'Euros' or 'Sterling' as applicable.</p> <p>... the policy documentation. <u>If there is more than one limit, only the highest needs to be recorded in this field.</u></p> <p><u>If the firm's PII policy has an unlimited limit of indemnity for either single claims or in the aggregate, then they should enter 'unlimited' (lower case) in the relevant data field.</u></p>
...	...
Increased excess(es) for specific business types <u>(only in relation to business you have undertaken in the past or will undertake during the period covered by the policy)</u>	<p>If the prescribed excess limit is exceeded in respect of <u>for</u> a type ...</p> <p>...</p>
Policy exclusion(s) for specific business types <u>(only in relation to business you have undertaken in the past or will undertake during the period covered by the policy)</u>	<p>If there are any exclusions in the <i>firm's</i> PII policy, the business type(s) to which they relate should be entered here <u>which relate to any types of businesses or activities that the firm has carried out either in the past or during the lifetime of the policy, enter the business type(s) to which the exclusions relate should be entered here.</u></p> <p>...</p>
Renewal date <u>Start Date</u>	The next date by which the current cover needs to be renewed. <u>The date the current cover began.</u>
<u>End Date</u>	<u>The date the current cover expires.</u>
Insurer name <u>(please select from the drop down list)</u>	<p>The name of the insurance undertaking providing cover. If cover is provided by a Lloyd's syndicate, the name of the syndicate should be stated.</p> <p><u>The firm should select the name of the insurance undertaking or Lloyd's syndicate providing cover. If the PII provider is not listed you should select 'other' and enter the name of the insurance undertaking or Lloyd's syndicate providing cover in the free-text box.</u></p> <p>If a policy is underwritten by more than one <i>insurance undertaking or Lloyd's syndicate</i>, you should state <u>select 'multiple' along</u> and state with the number <u>names of all the insurance undertakings or Lloyd's syndicates</u></p>

	<u>in the free-text box.</u>
<u>Annual income as stated on the most recent proposal form</u>	<u>This should be the income as stated on the <i>firm's</i> most recent PII proposal form. For a <i>personal investment firm</i>, this is relevant income arising from all of the <i>firm's</i> activities for the last accounting year before the policy began or was renewed (IPRU(INV) 13.1.3(3)R). For <i>insurance intermediaries</i> and <i>mortgage intermediaries</i> this is the annual income given in the <i>firm's</i> most recent annual financial statement from the relevant <i>regulated activity</i> or activities (PRU 9.3.42R to 44R).</u>
...	...
Amount of additional own funds required for policy exclusion(s)	<i>Personal investment firms</i> only - this should be calculated in accordance <u>line</u> with ...
Total of additional own funds required	<i>Personal investment firms</i> only - this is the same figure as in section D1, representing the total of additional own funds that are required under IPRU(INV) 13.1.4(8)R to 13.1.4(13)G for all of-the <i>firm's</i> PII policies.
...	
Excess/deficit...	...readily realisable own funds'.

PERIODIC FEES (2006/2007) INSTRUMENT 2006

Powers exercised

- A. The Financial Services Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):
- (1) section 72 (The competent authority);
 - (2) section 74(4) (The official list);
 - (3) section 99(1) (Fees);
 - (4) section 101 (Listing rules: general provisions);
 - (5) section 138 (General rule-making power);
 - (6) section 156 (General supplementary powers);
 - (7) section 157(1) and (4) (Guidance);
 - (8) section 234 (Industry funding);
 - (9) paragraph 17(1) of Schedule 1 (Fees) and
 - (10) paragraphs 1 (General), 4 (Rules), and 7 (Fees) of Schedule 7 (The Authority as Competent Authority for Part VI).
- B. The rule-making powers listed above are specified for the purpose of section 153(2) (Rule-making instruments) of the Act.

Commencement

- C. This instrument comes into force on 1 June 2006.

Amendments to the Handbook

- D. The Fees manual (FEES) is amended in accordance with Annex A to this instrument.
- E. The Supervision manual (SUP) is amended in accordance with Annex B to this instrument.

Citation

- F. This instrument may be cited as the Periodic Fees (2006/2007) Instrument 2006.

By order of the Board
25 May 2006

Annex A

Amendments to the Fees manual

In this Annex, underlining indicates new text and striking through indicates deleted text, save that where an entire new section is being inserted or deleted, the instructions are described and the text is not underlined or struck through.

...

3.2.7 R Table of application, notification and vetting fees

(1) Fee payer	(2) fee payable	Due date
(a) Any applicant for <i>Part IV permission</i> (including an <i>incoming firm</i> applying for <i>top-up permission</i>)	<p><u>(1) Unless (2) applies, in respect of a particular application, the highest of the tariffs set out in FEES 3 Annex 1R part 1 which apply to that application</u></p> <p><u>(2) In respect of a particular application which is:</u></p> <p><u>(i) a straightforward or moderately complex case for the purposes of FEES 3 Annex 1R part 1, and</u></p> <p><u>(ii) only involves a simple change of legal status as set out in FEES 3 Annex 1R part 6,</u></p> <p><u>the fee payable is 50% of the tariff that would otherwise be payable in FEES 3 Annex 1R part 1</u></p>	On or before the application is made
...		
(o) A <i>firm</i> applying for guidance on the availability of a <i>waiver</i> or concession <u>(or guidance on the availability of either)</u> in connection with future rules <u>(or future rules)</u> implementing ...	<p><u>(2) (a) Unless (b) applies A a firm submitting a second application for a waiver or concession or guidance ...</u></p> <p><u>(b) No fee is payable by a firm in relation to a successful application for a waiver or a concession based on a minded to grant decision in respect of the same matter following a complete application for guidance in accordance with prescribed</u></p>	

	<u>submission requirements.</u>	
(p) A <i>firm</i> applying for a variation of its <i>Part IV permission</i>	<p>(1) Unless (2) applies, if the <u>proposed new</u> business of the <i>firm</i> will<u>would</u> fall within one or more activity groups specified in Part 1 of <i>FEES</i> 4 Annex 1R not applicable before the <u>application</u> grant of the variation (if the variation is granted), the fee is 50% of the highest of the tariffs set out in <i>FEES</i> 3 Annex 1R which apply to that application</p> <p>(2) If the <u>only change is that the</u> A.12 activity group tariff applied to the <i>firm's</i> business before the variation and the A.13 activity group will apply after variation, no fee is payable.</p> <p>(3) <u>In all other cases, other than applications by credit unions, the fee payable is £250, unless the variation involves only the reduction (and no other increases) in the scope of a Part IV permission in which case no fee is payable.</u></p>	On or before the date the application is made

FEES 3 Annex 1R
Authorisation fees payable

...

Part 5 – Activity Groupings R

The activity group definitions are set out in ~~SUP 20~~ FEES 4 Ann 1R.

Part 6 - ~~Application for a certificate under article 54 of the Regulated Activities Order~~
~~The amount payable in relation to each application is £2,000.~~ Change of legal status

An application involving only a simple change of legal status for the purposes of FEES 3.2.7R(a) is from an applicant:

- (1) which is a new legal entity intending to carry on the business, using the same business plan, of an existing firm with no outstanding regulatory obligations cancelling its Part IV permission, and
(2) which is to:

- (a) have the same or narrower permission, and the same branches (if any), as the firm;
(b) assume all of the rights and obligations in connection with the regulated activities carried on by the firm;

(c) continue the same compliance arrangements and compliant client asset and *client money* procedures, as the *firm*, subject to any changes required only as a result of the change of legal status;

(d) continue with a risk profile and arrangements for controlling and monitoring risk which will not be materially different from those of the *firm*; and

(e) have the individuals within the *firm* that are responsible for *insurance mediation activity* perform the same role for the applicant.

...

FEES 3 Annex 6R

Fees payable for ~~guidance on the availability of~~ a waiver (or concession) or guidance on the availability of either in connection with rules implementing Basel Capital Accord

Part 1

Fees payable other than applications for ~~guidance on the availability of~~ a waiver (or concession) or guidance on the availability of either to allow a firm to use the ~~Effective Expected Potential Exposure estimates~~ counterparty credit risk internal model method.

For *firms* falling into a group ...

...

Part 2

Fees payable for applications for ~~guidance on the availability of~~ a waiver (or concession) or guidance on the availability of either to allow a firm to use the ~~Effective Expected Potential Exposure estimates~~ counterparty credit risk internal model method.

£50,000

...

Method of payment

- 4.2.4 R (1) Unless (2) applies, a periodic fee must be paid using either direct debit, credit transfer (BACS/CHAPS), cheque, switch or by credit card (Visa/Mastercard only). Any payment by permitted credit card must include an additional 2% of the sum paid. ~~one of the payment methods specified in the table below and must include the additional amounts or apply the discounts set out in that table.~~

Payment method	Additional amount or discount applicable
Direct debit	Discount of £20
Credit transfer (BACS/CHAPS)	Discount of £10
Cheque	None
Switch	None

Credit card (Visa/Mastercard only)	Additional 2% of sum paid
------------------------------------	---------------------------

(2) The FSA does not specify a method of payment for a *recognised body* or a *designated professional body*.

...

4.2.7 R ...

4.2.7A G Projected valuations for a *firm's* first year will be collected for the 12 month period beginning with the date a *firm* becomes authorised, or the date *permission* is extended. That information will be used to calculate the periodic fee for the remainder of the financial year in which the firm was authorised or its *permission* was extended (adjusted in accordance with FEES 4.2.7R) and to calculate the periodic fee for the following financial year.

...

FEES 4 Annex 1R

Activity groups, tariff bases and valuation dates applicable

Part 1

...	
A12 ...	<ul style="list-style-type: none"> • ...regulated collective investment scheme; • a <i>firm</i> activities;
...	

Part 2

...

A2	<p>...</p> <p>The number of mortgage contracts being administered, multiplied by <u>0.05 for mortgage outsourcing <i>firms</i></u> and by <u>0.5 for all other firms</u>.</p> <p>Notes:</p> <p>(1) For 2004/05 and 2005/06 <i>firms</i> have supplied this data on their 'HSF1' or 'variation of permission' application form. Mortgage outsourcing <i>firms</i> are <i>firms</i> with <i>permission</i> for administering regulated mortgage contracts, but not to enter the contract as lender.</p> <p>...</p>
...	
A4	<p>...</p> <p>For each of the above, business transacted through independent practitioners <u>or tied agents (either single or multi-tie)</u> will be divided by two in calculating the</p>

	adjusted gross premium income;
...	
A18	<p>ANNUAL INCOME</p> <p>...</p> <p>Plus</p> <p>(c) if the <i>firm</i> is a <i>mortgage lender</i>, the value of all new mortgage advances which are or would be <i>regulated mortgage contracts</i> if they had been made after 30 October 2004 (other than those made as a result of <i>mortgage mediation activity</i> by another <i>firm</i>), multiplied by 0.004.</p> <p><u>For mortgage outsourcing firms whose permission does not include <i>advising on regulated mortgage contracts</i> the relevant amounts are multiplied by 0.15.</u></p> <p>...</p> <p>(4) Reference to a "<i>firm</i>" above also includes reference to any <i>person</i> who carried out activities which would be <i>mortgage mediation activity</i> if they had been carried out after 30 October 2004.</p> <p><u>(5) Mortgage outsourcing firms are firms whose permission includes <i>administering regulated mortgage contracts</i>, but not <i>entering into a regulated mortgage contract</i>.</u></p>

In the following sections existing text is deleted in its entirety and is not struck through and replacement text is entirely new and is not underlined.

FEES 4 Annex 2R

Delete existing annex save the above heading and replace with the following text:

4 Annex 2R Fee tariff rates, permitted deductions and EEA/Treaty firm modifications for the period from 1 April 2006 to 31 March 2007

R	Part 1	
	This table shows the tariff rates applicable to each fee block.	
	(1)	For each activity group specified in the table below, the fee is the total of the sums payable for each of the tariff bands applicable to the <i>firm's</i> business, calculated as follows:
	(a)	the relevant minimum fee; plus
	(b)	an additional fee calculated by multiplying the <i>firm's</i> tariff base by the appropriate rates applying to each tranche of the tariff base, as indicated.
(2)	A <i>firm</i> may apply the relevant tariff bases and rates to non-UK business, as well as to its UK business, if:	

	(a)	it has reasonable grounds for believing that the costs of identifying the <i>firm's UK</i> business separately from its non-UK business in the way described in Part 2 of <i>FEES</i> 4 Annex 1R are disproportionate to the difference in fees payable; and
	(b)	it notifies the <i>FSA</i> in writing at the same time as it provides the information concerned under <i>FEES</i> 4.4 (Information on which fees are calculated), or, if earlier, at the time it pays the fees concerned.
(3)	For a <i>firm</i> which has not complied with <i>FEES</i> 4.4.2 R (Information on which fees are calculated) for this period:	
	(a)	the fee is calculated using (where relevant) the valuation or valuations of business applicable to the previous period, multiplied by the factor of 1.10;
	(b)	an additional administrative fee of £250 is payable; and
	(c)	the minimum total fee (including the administrative fee in (b)) is £400.
Activity group	Fee payable	
A.1	Minimum fee (£)	150
	£ million of Modified Eligible Liabilities (MELs)	Fee (£/£m or part £m of MELs)
	0 - 0.5	0
	>0.5 - 2	additional flat fee of £360
	>2 - 10	additional flat fee of £510
	>10 - 200	30.96
	>200 - 2,000	30.93
	>2,000 - 10,000	30.88
	>10,000 - 20,000	30.76
	>20,000	30.52
	For a <i>firm</i> in A.1 which has a limitation on its <i>permission</i> to the effect that it may <i>accept deposits</i> from <i>wholesale depositors</i> only, the fee is calculated as above less 30%. In addition, the fee specified below is payable by <i>UK banks</i> and <i>building societies</i> . The <i>wholesale depositors</i> discount and permitted deductions in Part 2 of <i>FEES</i> 4 Annex 2 do not apply to this fee.	
Minimum fee (£m of MELs)	Fee (£)	
if 0 - 2,000	0	

	if >2,000	2,000
	£ million of MELs	Fee (£/£m or part £m of MELs)
	0 - 5,000	0
	>5,000 - 10,000	0.69
	>10,000 - 20,000	0.63
	>20,000	0.59
A.2	Minimum fee (£)	450
	No. of mortgages	Fee (£/mortgage)
	0 - 50	0
	51 - 500	4.36
	501 - 1,000	1.75
	1,001 - 50,000	1.32
	50,001 - 500,000	0.44
	>500,000	0.09
A.3	Gross premium income (GPI)	
	Minimum fee (£)	410
	£ million of GPI	Fee (£/£m or part £m of GPI)
	0 - 0.5	0
	>0.5 - 2	1,778.54
	>2 - 5	1,652.58
	>5 - 20	1,550.19
	>20 - 75	493.49
	>75 - 150	432.61
	>150	60.98
	PLUS	
	Gross technical liabilities (GTL)	
	Minimum fee (£)	0
	£ million of GTL	Fee (£/£m or part £m of GTL)
	0 - 1	0

	>1 - 5	43.55
	>5 - 50	40.36
	>50 - 100	37.46
	>100 - 1,000	11.80
	>1,000	4.73
A.4	Adjusted annual gross premium income (AGPI)	
	Minimum fee (£)	205
	£ million of AGPI	Fee (£/£m or part £m of AGPI)
	0 - 1	0
	>1 - 50	756.42
	>50 - 1,000	705.19
	>1,000 - 2,000	484.07
	>2,000	332.35
	PLUS	
	Mathematical reserves (MR)	
	Minimum fee (£)	205
	£ million of MR	Fee (£/£m or part £m of MR)
	0 - 1	0
	>1 - 10	37.70
	>10 - 100	34.51
	>100 - 1,000	23.37
	>1,000 - 5,000	16.43
	>5,000 - 15,000	12.78
	>15,000	9.93
A.5	Minimum fee (£)	550
	£ million of Active Capacity (AC)	Fee (£/£m or part £m of AC)
	0 - 50	0
	>50 - 150	99.36
	>150 - 250	83.62
	>250	24.53
A.6		£1,068,000
A.7	For class 1(C), (2) and (3) <i>firms</i> :	
	Minimum fee (£)	1,150

	£ million of Funds under Management (FuM)	Fee (£/£m or part £m of FuM)
	0 - 10	0
	>10 - 100	52.68
	>100 - 2,500	16.94
	>2,500 - 10,000	9.43
	>10,000	1.06
	<p>For class 1(B) <i>firms</i>: the fee calculated as for class 1(C) <i>firms</i> above, less 15%.</p> <p>For class 1(A) <i>firms</i>: the fee calculated as for class 1(C) <i>firms</i> above, less 50%.</p>	
A.8	This activity group does not apply for this period.	
A.9	Minimum fee (£)	1,800
	£ million of Gross Income (GI)	Fee (£/£m or part £m of GI)
	0 – 1	0
	>1 – 5	1,074.59
	>5 - 15	1,056.41
	>15 – 40	1,045.94
	>40	1,031.68
A.10	Minimum fee (£)	2,200
	No. of traders	Fee (£/trader)
	0 - 2	0
	3 - 5	2,069
	6 - 10	1,495
	11 - 50	1,382
	51 - 200	1,196
	>200	965
	<p>In addition, the fee specified below is payable by <i>UK domestic firms</i>. The permitted deductions in Part 2 of <i>FEES 4 Annex 2</i> do not apply to this fee.</p>	
	Minimum fee (No. of traders)	Fee (£)
	if 0 - 100	0
	if >100	1,000
	No. of traders	Fee (£/trader)

	0 -125	0
	126 - 250	72.71
	>250	52.84
A.11	This activity group does not apply for this period.	
A.12	Minimum fee (£)	1,715
	No. of persons	Fee (£/person)
	0 – 1	0
	2 - 4	1,018
	5 - 10	515
	11 – 25	377
	26 – 150	205
	151 – 1,500	156
	>1,500	104
	For a <i>professional firm</i> in A.12 the fee is calculated as above less 10%.	
A.13	For class (2) <i>firms</i> :	
	Minimum fee (£)	1,605
	No. of persons	Fee (£/person)
	0 - 1	0
	2 - 4	878
	5 – 10	856
	11 – 25	821
	26 – 500	757
	501 – 4,000	696
	>4000	657
For class (1) <i>firms</i> : £1,605		
For a <i>professional firm</i> in A.13 the fee is calculated as above less 10%.		
A.14	Minimum fee (£)	1,220
	No. of persons	Fee (£/person)
	0 - 1	0
	2	1,101
	3 - 4	1,030
	5 - 10	947
	11 - 100	899
	101 - 200	629
	>200	378
A.15	This activity group does not apply for this period.	
A.16	0	

A.17	This activity group does not apply for this period.	
A.18	Minimum fee (£)	635
	£ thousands of Annual Income (AI)	Fee (£/£ thousand or part £ thousand of AI)
	0 - 100	0
	>100 - 1,000	5.38
	>1,000 - 5,000	4.48
	>5,000 - 10,000	3.59
	>10,000 - 20,000	2.69
	>20,000	2.25
A.19	Minimum fee (£)	400
	£ thousands of Annual Income (AI)	Fee (£/£ thousand or part £ thousand of AI)
	0 - 100	0
	>100 - 1,000	3.80
	>1,000 - 5,000	3.32
	>5,000 - 15,000	2.40
	>15,000 - 100,000	0.96
	>100,000	0.39
B. Market operators	£20,000	
B. Service companies	Bloomberg LP	£31,500
	EMX Co Ltd	£21,000
	LIFFE Services Ltd	£21,000
	Ofex plc	£70,000
	OMGEO Ltd	£21,000
	Reuters Ltd	£31,500
	Swapswire Ltd	£21,000
	Thomson Financial Ltd	£21,000

Part 2		
This table shows the permitted deductions that apply:		
Activity group	Nature of deduction	Amount of deduction
A.3	Financial penalties received	1.2% of the fee payable by the <i>firm</i> for the activity group (see Part 1)
A.4	Financial penalties received	3.1% of the fee payable by the <i>firm</i> for the activity group (see Part 1)
A.5	Financial penalties received	1.2% of the fee payable by the <i>firm</i> for the activity group (see Part 1)
A.6	Financial penalties received	1.2% of the fee payable by the <i>firm</i> for the activity group (see Part 1)
A.10	Financial penalties received	100% of the fee payable by the <i>firm</i> for the activity group (see Part 1)
A.12	Financial penalties received	5.6% of the fee payable by the <i>firm</i> for then activity group (see Part 1)
A.13	Financial penalties received	0.9% of the fee payable by the <i>firm</i> for the activity group (see Part 1)
A.14	Financial penalties received	1.8% of the fee payable by the <i>firm</i> for the activity group (see Part 1)
E.	Financial penalties received	3% of the fee payable by the <i>firm</i> for the activity group (see Part 1)
Part 3		
This table shows the modifications to fee tariffs that apply to <i>incoming EEA firms</i> and <i>incoming Treaty firms</i> .		
Activity group	Percentage of tariff payable under Part 1 applicable to the firm subject to a minimum amount payable of £100 (unless specified below)	
A.1	20% (for a <i>firm</i> operating on cross-border services basis only, 0% and the minimum sum is not applicable)	
A.3	0% and the minimum sum is not applicable	
A.4	75%	
A.7 and A.9	95%	

A.10, A.12, A.13 and A.19	90%
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FEES 4 Annex 3R

Delete existing annex save the above heading and replace with the following text:

4 Annex Transaction reporting fees
3R

R Transaction reporting fees for the period from 1 April 2006 to 31 March 2007

This table shows the fees payable for transaction reporting.

Fee type	Fee amount (including VAT)	
Transaction charge	Number of transactions per annum	Fee per transaction (inc. VAT)
	For the first 1,000	0p
	1,001 - 1,000,000	3p
	1,000,001 - 4,000,000	2.75p
	4,000,001 - 8,000,000	2.5p
	8,000,001 - 13,000,000	2.25p
	13,000,001 - 20,000,000	2p
	>20,000,000	1.75p
Firms using the Direct Reporting System software or the Transaction Reporting System will be additionally invoiced for:		
(a)	an initial software licence fee of £587.50 (including VAT) for users of the Direct Reporting System;	
(b)	an annual enrolment fee of £235 (including VAT) per licence held on 1 April each year for users of the Direct Reporting System; and	
(c)	an annual enrolment fee of £235 (including VAT) per registration held on 1 April each year for users of the Transaction Reporting System.	

FEES 4 Annex 4R

Delete existing annex save the above heading and replace with the following text:

4 Annex 4R Periodic fees in relation to collective investment schemes payable for the period 1 April 2006 to 31 March 2007

R Part 1 - Periodic fees payable

Scheme type	Basic fee (£)	Total funds/sub-funds aggregate	Fund factor	Fee (£)
ICVC AUT Section 264 of the <i>Act</i> Section 270 of the <i>Act</i>	620	1-2	1	620
		3-6	2.5	1,550
		7-15	5	3,100
		16-50	11	6,820
		>50	22	13,640
Section 272 of the <i>Act</i>	2,540	1-2	1	2,540
		3-6	2.5	6,350
		7-15	5	12,700
		16-50	11	27,940
		>50	22	55,880

Fees are charged according to the number of funds or sub-funds operated by a *firm* as at 31 March 2006. Where a new *collective investment scheme* becomes authorised during a year, fees are charged according to the number of funds or sub-funds operated by a firm as at the date of authorisation. Where more than one fund or sub-fund is operated the number of funds (not including the umbrella or parent fund) produces a 'fund factor' in accordance with the table above which is then applied to a basic fee to produce one total fee per operator. Fund factors are applied per operator rather than per scheme so that the fees relate to the number of funds rather than the number of schemes. This means that, for example, an authorised fund manager of three schemes pays the same as an operator or authorised fund manager of one scheme with three sub-funds (as only the sub-funds are counted).

Delete existing annex save the above heading and replace with the following text:

4 Annex Periodic fees for designated professional bodies payable in relation to the period 1
5R April 2006 to 31 March 2007

R Table. Fees payable by Designated Professional Bodies

Name of Designated Professional Body	Amount payable	Due date
The Law Society of England & Wales	£62,860	30 April 2006
	£38,500	1 September 2006
The Law Society of Scotland	£16,090	1 July 2006
The Law Society of Northern Ireland	£14,500	1 July 2006
The Institute of Actuaries	£10,190	1 July 2006
The Institute of Chartered Accountants in England and Wales	£36,150	1 July 2006
The Institute of Chartered Accountants of Scotland	£12,290	1 July 2006
The Institute of Chartered Accountants in Ireland	£11,050	1 July 2006
The Association of Chartered Certified Accountants	£21,160	1 July 2006
The Council for Licensed Conveyancers	£11,890	1 July 2006
Royal Institution of Chartered Surveyors	£12,320	1 July 2006

Notes

(1) The *FSA register* includes details of *exempt professional firms* carrying out *insurance mediation activity*.

(2) In addition to the periodic fees shown above, the sum of £31,400 will be due from the *designated professional bodies*, divided between the bodies in proportion to the number of *exempt professional firms* each has on the *FSA register* on 14 January 2006. This is a contribution towards the costs of developing this part of the *FSA register*.

(3) Each of the *designated professional bodies* will be invoiced for the appropriate amount in January 2006. The invoices must be paid on or before 28 February 2006.

FEES 4 Annex 6R

Delete existing annex save the above heading and replace with the following text:

4 Annex 6R Periodic fees for recognised investment exchanges and recognised clearing houses payable in relation to the period 1 April 2006 to 31 March 2007

R	<p>In this Annex:</p> <p>- the term <i>recognised body</i> includes a body which was a recognised investment exchange or a recognised clearing house recognised under the Financial Services Act 1986 and which is a <i>recognised body</i> as a result of Regulation 9 of the <i>Recognition Requirements Regulations</i>; and</p> <p>- the term recognition order includes a recognition order made by the <i>FSA</i> under section 37 or section 39 of the Financial Services Act 1986 or a recognition order made by the Treasury under section 40 of the Financial Services Act 1986.</p>
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Part 1 - Periodic fees for UK recognised bodies

Name of UK recognised body	Amount payable	Due date
CRESTCo Limited	£282,500	30 April 2006
	£175,500	1 September 2006
The International Petroleum Exchange of London Limited	£162,500	30 April 2006
	£134,500	1 September 2006
LIFFE Administration and Management	£400,000	30 April 2006
	£105,000	1 September 2006
LCH.Clearnet Limited	£352,500	30 April 2006
	£228,500	1 September 2006
The London Metal Exchange Limited	£230,000	30 April 2006
	£103,000	1 September 2006
London Stock Exchange plc	£367,500	30 April 2006
	£296,500	1 September 2006
virt-x Exchange Ltd	£105,000	30 April 2006
	(£25,000)	1 September

		2006
EDX London Ltd	£80,000	30 April 2006
	(£16,000)	1 September 2006
NYMEX Europe Limited	£75,000	30 April 2006
	£60,000	1 September 2006
Any other <i>UK recognised investment exchange</i> recognised as such by a <i>recognition order</i> made in the period	£150,000	30 days after the date on which the <i>recognition order</i> is made
Any other <i>UK recognised clearing house</i> recognised as such by a <i>recognition order</i> made in the period	£250,000	30 days after the date on which the <i>recognition order</i> is made

Part 2 - Periodic fees for overseas recognised bodies

Name of overseas recognised body	Amount payable	Due date
Cantor Financial Futures Exchange	£11,000	1 July 2006
The Chicago Mercantile Exchange	£11,000	1 July 2006
Chicago Board of Trade	£11,000	1 July 2006
EUREX (Zurich)	£11,000	1 July 2006
National Association of Securities and Dealers Automated Quotations (NASDAQ)	£11,000	1 July 2006
NQLX LLC	£11,000	1 July 2006
New York Mercantile Exchange Inc.	£11,000	1 July 2006
The Swiss Stock Exchange	£11,000	1 July 2006
Sydney Futures Exchange Limited	£11,000	1 July 2006
Warenterminbourse Hannover	£11,000	1 July 2006
US Futures Exchange LLC	£11,000	1 July 2006
SIS x-clear AG	£37,000	1 July 2006

Any other <i>overseas investment exchange</i> recognised as such by a <i>recognition order</i> made in the period	£11,000	30 days after the date on which the <i>recognition order</i> is made
Any other <i>overseas clearing house</i> recognised as such by a <i>recognition order</i> made in the period	£37,000	30 days after the date on which the <i>recognition order</i> is made

FEES 4 Annex 7R

Delete existing annex save the above heading and replace with the following text:

4 Annex 7R Periodic fees in relation to the Listing Rules for the period 1 April 2006 to 31 March 2007

Fee type	Fee amount
Annual fees for the period 1 April 2006 to 31 March 2007	
Annual Issuer Fees - all <i>listed issuers</i> of <i>shares</i> , <i>depository receipts</i> and <i>securitised derivatives</i> . This fee represents the total annual fee for a <i>listed issuer</i> - no additional annual fee is due under the <i>disclosure rules</i> .	<p>(1) For all <i>issuers</i> of <i>securitised derivatives</i>, <i>depository receipts</i> and <i>global depository receipts</i> the fees payable are set out in Table 1.</p> <p>(2) For all other <i>issuers</i>, fees to be determined according to market capitalisation as set out in Table 2. The fee is calculated as follows:</p> <p>(a) the relevant minimum fee; plus</p> <p>(b) the cumulative total of the sums payable for each of the bands calculated by multiplying each relevant tranche of the <i>firm's</i> market capitalisation by the rate indicated for that tranche. Where <i>issuers</i> have more than one type of <i>share</i> in issue, the highest market capitalisation of all of its securities in issue is used.</p> <p>(3) Notwithstanding (2), <i>overseas issuers</i> with a <i>listing of equity securities</i> which is not a <i>primary listing</i> will only pay 80% of</p>

	the fee otherwise payable under (2).
Annual fees are charged in annual cycles beginning on 1 April of a year and ending on 31 March of the following year. For fees purposes <i>issuers</i> should take into account only equity ordinary <i>shares</i> , including those issued by suspended <i>issuers</i> .	

Table 1
Annual fees for issuers of *securitised derivatives*, depositary receipts and global depositary receipts

Issuer	Fee amount
<i>Issuers of securitised derivatives</i>	£3,075
Issuers of depositary receipts and global depositary receipts	£3,690

Table 2
Tiered annual fees for all other issuers

Fee payable	
Minimum fee (£)	3,075
£ million of Market Capitalisation	Fee (£/£m or part £m of Market Capitalisation)
0 – 100	0
>100 – 250	12.40
>250 – 1,000	4.96
>1,000 – 5,000	1.65
>5,000 – 25,000	0.031
>25,000	0.0083

Delete existing annex save the above heading and replace with the following text:

4 Annex 8R Periodic fees in relation to the disclosure rules for the period 1 April 2006 to 31 March 2007

Annual fees for the period 1 April 2006 to 31 March 2007	
All non-listed <i>issuers</i> of <i>shares</i> , depositary receipts and securitised derivatives. Annual fees for listed <i>issuers</i> in respect of Disclosure Rules obligations are incorporated in the annual fee for listed <i>issuers</i> under the Listing Rules.	(1) For all non-listed <i>issuers</i> of securitised derivatives, depositary receipts and global depositary receipts the fees payable are set out in Table 1.
	(2) For all other non-listed <i>issuers</i> , fees to be determined according to market capitalisation as set out in Table 2. The fee is calculated as follows:
	(a) the relevant minimum fee; plus
	(b) the cumulative total of the sums payable for each of the bands calculated by multiplying each relevant tranche of the <i>firm's</i> market capitalisation by the rate indicated for that tranche.
Fees from other fee schedules contained in other sections of the sourcebook may be applicable to a single submission.	

Table 1

Annual fees for non-listed issuers of securitised derivatives, depositary receipts and global depositary receipts

Issuer	Fee amount
<i>Issuers of securitised derivatives</i>	£2,460
<i>Issuers of depositary receipts and global depositary receipts</i>	£2,952

Table 2

Fee payable	
Minimum fee (£)	2,460
£ million of Market Capitalisation	Fee (£/£m or part £m of Market Capitalisation)
0 – 100	0
>100 – 250	9.92

>250 – 1,000	3.968
>1,000 – 5,000	1.32
>5,000 – 25,000	0.0248
>25,000	0.00664

FEES 5 Annex 1R

Delete the Introduction and Parts 1 and 2 of existing annex and replace with the following text:

5 Annex Annual Fees Payable in Relation to 2006/07

1R

R

Introduction: annual budget		
1.	The <i>annual budget</i> for 2006/07 approved by the <i>FSA</i> is £59.2m.	
Part 1: General levy and supplementary levy		
2.	The total amount expected to be raised through the <i>general levy</i> in 2006/07 will be £15.8m.	
Part 2: Fee tariffs for general levy and supplementary levy		
3.	No <i>establishment costs</i> will be raised in 2006/07 by the <i>supplementary levy</i> .	
Industry block	Tariff base	General levy payable by firm
1-Deposit acceptors, <i>mortgage lenders</i> and <i>administrators</i> (excluding <i>firms</i> in block 14)	Number of accounts relevant to the activities in DISP 2.6.1 R	£0.0059 per relevant account, subject to a minimum levy of £100
2-Insurers - general (excluding <i>firms</i> in blocks 13 & 15)	Relevant annual gross premium income	£0.055 per £1,000 of relevant annual gross premium income, subject to a minimum levy of £100
3-The <i>Society</i> (of Lloyd's)	Not applicable	£28,000 to be allocated by the <i>Society</i>
4-Insurers - life (excluding <i>firms</i> in block 15)	Relevant adjusted annual gross premium income	£0.124 per £1,000 of relevant adjusted annual gross premium income, subject to a minimum levy of £100

5-Fund managers (including those holding <i>client money/assets</i> and not holding <i>client money/assets</i>)	Relevant funds under management	£0.0007 per £1,000 of relevant funds under management, subject to a minimum levy of £100
6-Operators, trustees and depositaries of collective investment schemes	Flat fee	Levy of £75
7-Dealers as principal	Flat fee	Levy of £50
8-Advisory arrangers, dealers or brokers holding and controlling <i>client money</i> and/or assets	Number of relevant approved persons (<i>controlled functions</i> 21, 22, 24, 25, 26)	£160 per relevant approved person (<i>controlled functions</i> 21, 22, 24, 25, 26), subject to a minimum levy of £160
9-Advisory arrangers, dealers or brokers not holding and controlling <i>client money</i> and/or assets	Number of relevant approved persons (<i>controlled functions</i> 21, 22, 24, 25, 26)	£45 per relevant approved person (<i>controlled functions</i> 21, 22, 24, 25, 26), subject to a minimum levy of £50
10-Corporate finance advisers	Flat fee	Levy of £50
11-	N/A for 2006/07	
12-	N/A for 2006/07	
13-Cash plan health providers	Flat fee	Levy of £50
14-Credit unions	Flat fee	Levy of £50
15-Friendly societies whose tax-exempt business represents 95% or more of their total relevant business	Flat fee	Levy of £50
16 - Mortgage	Flat fee	Levy of £50

lenders, advisers and <i>arrangers</i> (excluding <i>firms</i> in blocks 13, 14 & 15)		
17 - General insurance mediation (excluding <i>firms</i> in blocks 13, 14 & 15)	Flat fee	Levy of £50
4	[not used]	
5	The <i>industry blocks</i> in the table are based on the equivalent activity groups set out in Part 1 of <i>FEES 4 Annex 1R</i> .	
6	Where the tariff base in the table is defined in similar terms as that for the equivalent activity group in Part 2 of <i>FEES 4 Annex 1R</i> , it must be calculated in the same way as that tariff base - taking into account only the <i>firm's relevant business</i> .	

Annex B

Amendments to the Supervision manual

In this Annex underlining indicates new text.

16.3.14 R (1) If a *firm* does not submit a complete report by the date on which it is due in accordance with the *rules in, or referred to in, this chapter or the provisions of relevant legislation* and any prescribed submission procedures, the *firm* must pay an administrative fee of £250.

...

16.3.14A G Failure to submit a report in accordance with the *rules in, or referred to in, this chapter or the provisions of relevant legislation* may also lead to the imposition of a financial penalty and other disciplinary sanctions (see *ENF* 13.5). *A firm may be subject to reporting requirements under relevant legislation other than the Act, not referred to in this chapter. An example of this is reporting to the FSA by building societies under those parts of the Building Societies Act 1986 which have not been repealed (see SUP 16.1.4G).* If it appears to the *FSA* that, in the exceptional circumstances of a particular case, the payment of any fee would be inequitable, the *FSA* may reduce or remit all or part of the fee in question which would otherwise be payable (see *FEES* 2.3).

SUP 16 Ann 18BG Notes for completion of the Retail Mediation Activities Return ('RMAR')

...

Section J: data required for calculation of fees

Firms with an *accounting reference date* of between 1 February and 31 August (inclusive) must report the information required in this section solely in their half year end *RMAR*. All other *firms* must report the information in their year end *RMAR*. *Firms which do not yet have data for a full 12 months ending on their accounting reference date (for example if they have not traded for a complete financial year by the time of the accounting reference date) should complete Section J with an 'annualised' figure based on the actual income up to their accounting reference date. That is, such firms should pro-rate the actual figure as if the firm had been trading for 12 months up to the accounting reference date. So for a firm with 2 months of actual income of £5000 as at its accounting reference date, the 'annualised' figure that the firm should report is £30,000.*

...

SUP 16 Ann 19BG Notes for completion of the Mortgage Lending and Administration Return ('MLAR')

...

SECTION J: FEE TARIFF MEASURES

J1 Introduction

...

* Refer to *FEES 4* Annex 1R of the *FSA Handbook* for the *FSA* fee tariff*

*Refer to *FEES 5* Annex 1R of the *FSA Handbook* for the *FOS* fee tariff*

To the extent that the *FOS* fee tariff measure requires other relevant activities that the *firm* carries out to be taken into account, these should be included in J1.3.

**INTERIM PRUDENTIAL SOURCEBOOKS (MISCELLANEOUS AMENDMENTS)
INSTRUMENT 2006**

Powers exercised

- A. The Financial Services Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):
- (1) section 138 (General rule-making power);
 - (2) section 156 (General supplementary powers); and
 - (3) section 157(1) (Guidance).
- B. The rule-making powers listed above are specified for the purpose of section 153(2) (Rule-making instruments) of the Act.

Commencement

- C. This instrument comes into force on 6 June 2006.

Amendments to the Handbook

- D. The modules of the FSA’s Handbook of rules and guidance listed in column (1) below are amended in accordance with the Annexes to this instrument listed in column (2).

(1)	(2)
Interim Prudential sourcebook for Banks (IPRU(BANK))	Annex A
Interim Prudential sourcebook for Building Societies (IPRU(BSOC))	Annex B
Interim Prudential sourcebook for Investment Businesses (IPRU(INV))	Annex C
Supervision manual (SUP)	Annex D

Citation

- E. This instrument may be cited as the Interim Prudential Sourcebooks (Miscellaneous Amendments) Instrument 2006.

By order of the Board
25 May 2006

Annex A

Amendments to Interim Prudential sourcebook for Banks

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

Amend Volume 1, CA (Definition of Capital) as follows:

4 ELEMENTS OF A BANK'S CAPITAL BASE

...

4.3 Tier 2 - supplementary capital

5 Tier 2 (or supplementary) capital consists of:

- (a) Reserves arising from the revaluation of tangible fixed assets and fixed asset investments, including any net unrealised gains for the fair valuation of equities held in the available-for-sale financial assets category and any unrealised gains on investment property.

...

5 TIER 1 CAPITAL

...

5.2 Reserves

6 *Reserves* are accumulated profits retained by the bank after the payment of all dividends and tax, and other reserves created by appropriations of share premia and other surpluses.

- a) Dividends should be deducted from reserves as soon as they are declared.

(a) For the purposes of calculating prudential capital a bank should:

- (i) deduct unrealised gains or, where applicable, add back in unrealised losses, on cash flow hedges of financial instruments measured at cost or amortised cost;
- (ii) deduct unrealised gains or, where applicable, add back in unrealised losses, on debt instruments held in the available-for-sale financial assets category;
- (iii) deduct unrealised gains or, where applicable, add back in unrealised losses, which are not attributable to changes in a benchmark interest rate, arising when a bank, upon initial recognition, designates its financial liabilities as at fair value through profit or loss;
- (iv) deduct unrealised gains on investment property;

...

6 UPPER TIER 2 CAPITAL

This section provides detail on the constituent elements of Upper Tier 2 capital.

6.1 Reserves arising from the revaluation of tangible fixed assets and fixed asset investments

1 *Reserves arising from the revaluation of tangible fixed assets*, or fixed asset investments, are reserves created when such assets are revalued to bring them in line with replacement costs. This category also includes any unrealised gains arising on revaluing investment property which is ineligible for inclusion in Tier 1 capital. These reserves are eligible for inclusion in Upper Tier 2 capital.

- a) *Fixed assets* are assets such as land, buildings, plant, equipment and other assets acquired for carrying on the business of a company.
- b) Where *negative goodwill* is required to be identified under the adopted accounting framework it will be included in reserves. *Negative goodwill* arises when a company/ portfolio is purchased below the value of its assets. The difference is called negative goodwill.
- c) For the definition of *goodwill* see the section on deductions from capital.
- d) Unrealised gains may arise on revaluing investment property, where applicable.

...

Amend Volume 1, BC (Credit risk in the banking book) as follows:

3 RISK WEIGHTING FRAMEWORK: ON BALANCE SHEET

...

3.2 Counterparty weights

...

3.2.2 Zero weighting

4 The following types of asset may attract a zero weighting:

...

- (g) certificates of tax deposit; ~~and~~

- (h) items in suspense where they represent position risk; and
- (i) a defined benefit asset.

Amend Volume 2, VA (Valuation) as follows:

2 GENERAL POLICY ON VALUATION

...

- 4 Unless a different practice has been agreed in writing with the FSA, non - CAD bank should value both its trading and its banking books on an *accruals* basis rather than on a cash basis; and a CAD bank should value its trading book on a *mark-to-market* basis and its banking book on an *accruals* basis.

...

- f) For risk-weighting purposes a bank should deduct unrealised gains or, where applicable, add back in unrealised losses on debt instruments held in the available-for-sale financial assets category.

...

Annex B

Amendments to Interim Prudential sourcebook for Building Societies

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

Amend Volume 1 (Prudential Standards), Chapter 1 Solvency, as follows:

1.8 DEDUCTIONS

...

1.8.4 G

...

- (4) a "defined benefit asset" is the excess of the value of the assets in a defined benefit occupational pension scheme over the present value of the scheme liabilities, to the extent that a society, as employer, should recognise that excess as a ~~liability~~ an asset in its balance sheet.

Amend Volume 1 (Prudential Standards), Chapter 1 Solvency, Annex 1A as follows:

CALCULATION OF "OWN FUNDS"

G

1A.1 Tier 1 Capital

1A.1.1 Reserves as disclosed in the latest year end balance sheet;

plus

cumulative interim profits for the year to date which have been verified by the society's external auditors (see Annex 1E); or

less

cumulative losses (if any) for the year to date and any unrealised gains on investment property reported in retained earnings (these should be reported as part of the revaluation reserve (see 1A.4)).

...

1A.4 Revaluation Reserves

1A.4.1 Societies may include revaluation reserves arising out of the differences between book values and the current market value of property fixed assets and unrealised gains on investment property but only if:

....

Amend Volume 1 (Prudential Standards), Chapter 1 Solvency, Annex 1B as follows:

RISK ASSET WEIGHTS

G

1B.1 General

1B.1.1 Risk weights should be applied net of any specific or individual provision. Items subject to deduction from Own Funds should be zero weighted (this includes unrealised gains or losses held in the available-for-sale financial assets category (see 1A.1.5(2) and any defined benefit asset)). Assets held by a subsidiary undertaking are weighted on the same basis as if held by the parent society.

Amend Volume 1 (Prudential Standards), Chapter 10 Securitisation to insert a new paragraph 10.3.4AG after 10.3.4G as follows:

10.3.4AG The adoption of International Accounting Standards by some societies changes the accounting treatment of securitised assets for those societies from 1 January 2005. The Building Societies Act 1986 (Modification of the Lending Limit and Funding Limit Calculations) Order 2004 (S.I. 2004/3200) amends the Building Societies Act 1986 so that securitised assets and related liabilities may continue to be excluded from nature limit calculations, regardless of how they are included in the accounts of a society. Therefore societies which use International Accounting Standards to prepare their accounts will not be disadvantaged in relation to the nature limits.

Annex C

Amendments to Interim Prudential sourcebook for Investment Businesses

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

Amend IPRU(INV) Chapter 3 (Financial resources for Securities and Futures Firms which are not Investment Firms) as follows:

Insert a new rule 3-62(8)R after 3-62(7)G as follows:

3-62(8) R Where applicable, a *firm* must deduct any asset in respect of deferred acquisition costs and add back in any liability in respect of deferred income (but excluding from the deduction or addition any asset or liability which will give rise to future cash flows), together with any associated deferred tax.

Amend IPRU(INV) 3-75 (Liquidity adjustment) as follows:

3-75 Liquidity adjustment

...

Intangible assets

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

...

Other assets

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

Amend IPRU(INV) Chapter 5 (Financial Resources) as follows:

Amend IPRU(INV) Table 5.2.2(1) (Calculation of own funds and liquid capital) as follows:

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

...

PART II
DETAILED REQUIREMENTS

...

2A Audited reserves

For the calculation of *own funds* and *liquid capital* the following adjustments apply to the audited reserves figure:

- (a) a *firm* must deduct any unrealised gains or, where applicable, add back in any unrealised losses on cash flow hedges of financial instruments measured at cost or amortised cost;
- (b) in respect of a *defined benefit occupational pension scheme*, a *firm* must derecognise any *defined benefit asset*;
- (c) a *firm* may substitute for a *defined benefit liability* the *firm's deficit reduction amount*. The election must be applied consistently in respect of any one financial year.

Note

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

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

Note

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

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

3 Intangible assets

Intangible assets comprise:...

(Item 6)

- (a) ...
- (b) ...
- (c) ...

	<u>Intangible assets do not include a deferred acquisition cost asset.</u>
...	
10 Illiquid assets	Illiquid assets comprise:...
(Item 16)	(a) ...
	...
	(i) ...
	<u>Illiquid assets do not include a <i>defined benefit asset</i> or a deferred acquisition cost asset.</u>

Amend IPRU(INV) Table 5.2.3(5)(e) (Other assets requirement) as follows:

TABLE 5.2.3(5)(e) OTHER ASSETS REQUIREMENT	
...	
	PART II RISK FACTORS
...	
<u>Defined benefit asset</u>	<u>NIL</u>
<u>Deferred acquisition cost asset</u>	<u>NIL</u>
All other assets ...	

Amend IPRU(INV) Chapter 7 (UCITS Management Companies), Table belonging to rule 7.2.1R(1) as follows:

7.3 METHOD OF CALCULATION OF FINANCIAL RESOURCES

7.3.1R This table belongs to *rule 7.2.1R(1)*

PART II DETAILED REQUIREMENTS
...

2A Audited reserves

For the calculation of financial resources, the following adjustments apply to the audited reserves figure:

- (a) a *firm* must deduct any unrealised gains or, where applicable, add back in any unrealised losses on cash flow hedges of financial instruments measured at cost or amortised cost;
- (b) in respect of a *defined benefit occupational pension scheme*, a *firm* must derecognise any *defined benefit asset*;
- (c) a *firm* may substitute for a *defined benefit liability* the *firm's deficit reduction amount*. The election must be applied consistently in respect of any one financial year.

Note

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

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

Note

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

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

3 Intangible assets (Item 6)

Intangible assets comprise:...

- (a) ...
- (b) ...
- (c) ...

Intangible assets do not include a deferred acquisition cost asset.

...

10 Illiquid assets (Item 14) Illiquid assets comprise:...

(a) ...

...

(i) ...

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

...

Amend IPRU(INV) Chapter 10 (Financial Resources for Securities and Futures Firms which are Investment Firms) as follows:

Amend IPRU(INV) 10-61R (Initial capital) as follows:

10-61(3A) R When calculating *initial capital*, a *firm* may include its audited retained earnings only after making the following adjustments:

- (a) a *firm* must deduct any unrealised gains or, where applicable, add back in any unrealised losses on cash flow hedges of financial instruments measured at cost or amortised cost;
- (b) in respect of a *defined benefit occupational pension scheme*, a *firm* must derecognise any *defined benefit asset*;
- (c) a *firm* must not include any unrealised gains from investment property (these should be reported as part of revaluation reserves);
- (d) where applicable, a *firm* must deduct any asset in respect of deferred acquisition costs and add back in any liability in respect of deferred income (but exclude from the deduction or addition any asset or liability which will give rise to future cash flows), together with any associated deferred tax.

Externally-verified interim net profits or current account

10-61(4A) R When calculating *initial capital*, a *firm* may include its partners' current accounts figure only after making the following adjustments:

- (a) a *firm* must deduct any unrealised gains or, where applicable add back in any unrealised losses on cash flow hedges of financial instruments measured at cost or amortised cost;

- (b) in respect of a *defined benefit occupational pension scheme*, a *firm* must derecognise any *defined benefit asset*;
- (c) where applicable, a *firm* must deduct any asset in respect of deferred acquisition costs and add back in any liability in respect of deferred income (but exclude from the deduction or addition any asset or liability which will give rise to future cash flows), together with any associated deferred tax.

...

Intangible assets

- 10-61(5) R A *firm* must deduct from *initial capital*, when calculating *original own funds*, the full balance sheet value of intangible assets including goodwill, capitalised development costs, licences, exchange seats held as part of its trading requirement, trademark and similar rights etc. Intangible assets do not include a deferred acquisition cost asset.

Amend IPRU(INV) 10-65(11)R (Liquidity adjustment on illiquid assets: Other assets) as follows:

Other assets

- 10-65(11) The liquidity adjustment for assets other than those specifically stated above where the asset is not due to be repaid within 90 days, is either 8% multiplied by the appropriate counterparty weight, or 100% of the balance sheet value, except that there is no liquidity adjustment for amounts due which are secured by *acceptable collateral*. Other assets do not include a *defined benefit asset* or a deferred acquisition cost asset.

Amend IPRU(INV) Chapter 13 (Calculation of own funds) as follows:

Amend IPRU(INV) 13.3.2AR as follows:

- 13.3.2A R For the purpose of calculating a *Category A firm's own funds*, the following adjustments apply to audited reserves or, (for non-corporate entities), current accounts figures.
- (1) a *Category A firm* must deduct any unrealised gains or, where applicable, add back in any unrealised losses on cash flow hedges of financial instruments measured at cost or amortised cost;
 - (2) a *Category A firm* must derecognise any *defined benefit asset*;

- (3) a *Category A firm* may substitute for a *defined benefit liability* its *deficit reduction amount*. The election must be applied consistently in respect of any one financial year;
- (4) a *Category A firm* must deduct any unrealised gains on investment property and include these within revaluation reserves;
- (5) where applicable, a *Category A firm* must deduct any asset in respect of deferred acquisition costs and add back in any liability in respect of deferred income (but excluding from the deduction or addition any asset or liability which will give rise to future cash flows), together with any associated deferred tax.

Amend IPRU(INV) 13.4.1R (Financial Resources Test 1A - Adjusted net current assets) as follows:

13.4.1 R A *Category A firm* must adjust its *net current assets* as follows:

exclude assets which cannot be realised or recovered within twelve months;

exclude amounts receivable from *connected persons* to the extent that they are not *properly secured*, except amounts that are *deposits* referred to at item (11) in Part I of table 13.5.4(1) or at item (11) in Part I of table 13.5.4(2);

value *investments* at current *market value*, using the *bid price* for a *net long position* in an investment and the *offer price* for a *net short position* in an investment-;

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

Amend IPRU(INV) 13.5.4R (Calculation of financial resources to meet tests 1, 1A or 2) as follows:

13.5.4 R A *Category A firm* must be able to calculate its financial resources at any time on the basis of the balance sheet it could draw up at that time. For this purpose:

a *Category A1 firm* ...

a *Category A2 or A3 firm*,...

- (3) the assets and liabilities in the balance sheet are also subject to the following adjustments:

- (a) a *firm* must deduct any unrealised gains, or where applicable, back in any unrealised losses on cash flow hedges of financial instruments measured at cost or amortised cost;
- (b) in respect of a *defined benefit occupational pension scheme*, a *firm* must derecognise any *defined benefit asset*;
- (c) a *firm* may substitute for a *defined benefit liability* the *firm's deficit reduction amount*. The election must be applied consistently in respect of any one financial year;
- (d) where applicable, a *firm* must deduct any asset in respect of deferred acquisition costs and add back in any liability in respect of deferred income (but exclude from the deduction or addition any asset or liability which will give rise to future cash flows), together with any associated deferred tax.

Amend IPRU(INV) 13.10.2AR as follows:

13.10.2A R For the purpose of calculating a *Category B firm's own funds*, the following adjustments apply to audited retained profits or, (for non-corporate entities), current accounts figures.

- (1) a *Category B firm* must deduct any unrealised gains or, where applicable, add back in any unrealised losses on cash flow hedges of financial instruments measured at cost or amortised cost;
- (2) a *Category B firm* must derecognise any *defined benefit asset*;
- (3) a *Category B firm* may substitute for a *defined benefit liability* its *deficit reduction amount*. The election must be applied consistently in respect of any one financial year.
- (4) a *Category B firm* must deduct any unrealised gains on investment property and include these within revaluation reserves;
- (5) where applicable, a *Category B firm* must deduct any asset in respect of deferred acquisition costs and add back in any liability in respect of deferred income (but exclude from the deduction or addition any asset or liability which will give rise to future cash flows), together with any associated deferred tax.

Amend IPRU(INV) 13.11.2R (Financial Resources Test 1A - Adjusted net current assets) as follows:

13.11.2 R A *Category B firm* must adjust its *net current assets* as follows:

exclude assets which cannot be realised or recovered within twelve months;

exclude amounts receivable from *connected persons* to the extent that they are not *properly secured*, except amounts that are *deposits* referred to in item (11) of table 13.12.3(1) or item (11) in table 13.12.3(2);

value *investments* at current *market value*, using the *bid price* for a *net long position* in an investment and the *offer price* for a *net short position* in an investment;:

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

Amend IPRU(INV) 13.12.3R(3) (Calculation of financial resources to meet tests 1, 1A or 2) as follows

- 13.12.3 R
- (1) ...
 - (2) ...
 - (3) the assets and liabilities in the balance sheet are also subject to the following adjustments:
 - (a) a *Category B firm* must deduct any unrealised gains or, where applicable, add back in any unrealised losses on cash flow hedges of financial instruments measured at cost or amortised cost;
 - (b) in respect of a *defined benefit occupational pension scheme*, a *Category B firm* must derecognise any *defined benefit asset*;
 - (c) a *Category B firm* may substitute for a *defined benefit liability* the *firm's deficit reduction amount*. The election must be applied consistently in respect of any one financial year;:
 - (d) where applicable, a *Category B firm* must deduct any asset in respect of deferred acquisition costs and add back in any liability in respect of deferred income (but exclude from the deduction or addition any asset or liability which will give rise to future cash flows), together with any associated deferred tax.

Annex D

Amendments to the Supervision manual

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

Amend SUP 16 Annex 2G form BSD3 as follows:

LIABILITIES

CORE CAPITAL – TIER 1

...

A500 Reserves

...

A500.2 Disclosed prior years reserves (excluding item A580), disclosed current year's positive movement on reserves and negative movements on reserves

Report the disclosed, undistributed balance on profit and loss account attributable to previous years (ie revenue reserves), reserves arising from exchange rate translation differences and other reserves (eg capital redemption reserves and capital gifts). Do not report reserves arising from the revaluation of fixed assets or the unrealised gains on investment property; such reserves and unrealised gains should be shown under item A580.

...

SUPPLEMENTARY TIER 2

A580 Fixed asset revaluation reserves

Report reserves relating to the revaluation of fixed assets and unrealised gains on investment property.

...

Amend SUP 16 Annex 4G form MFS1 as follows:

...

SECTION B: BALANCE SHEET: Liabilities

...

B3 CAPITAL

B3.1 Reserves should include general and any 'special' reserves but not revaluation reserves or any unrealised gains on investment property (which should be included at B3.3).

Amend SUP 16 Annex 4G form QFS1 as follows:

SECTION D: CAPITAL AVAILABLE: Own Funds

...

TIER I CAPITAL

D1.1 Reserves at start of year

Reserves exclude revaluation reserves which are to be shown at D2.1 and any unrealised gains on investment property.

...

**INTERIM PRUDENTIAL SOURCEBOOK FOR INSURERS
(AMENDMENT NO 9) INSTRUMENT 2006**

Powers exercised

- A. The Financial Services Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):
- (1) section 138 (General rule-making power);
 - (2) section 150(2) (Actions for damages);
 - (3) section 156 (General supplementary powers); and
 - (4) section 340 (Appointment).
- B. The rule-making powers listed above are specified for the purpose of section 153(2) (Rule-making instruments) of the Act.

Commencement

- C. This instrument comes into force on 6 June 2006.

Amendments to the Handbook

- D. The Interim Prudential sourcebook for Insurers (IPRU(INS)) is amended in accordance with the Annex to this instrument.

Citation

- E. This instrument may be cited as the Interim Prudential Sourcebook for Insurers (Amendment No 9) Instrument 2006.

By order of the Board
25 May 2006

Annex

Amendments to the Interim Prudential sourcebook for Insurers

In this Annex, underlining indicates new text and striking through indicates deleted text. Where a new section of text is inserted, this is indicated and the new text is not underlined

Chapter 9

FINANCIAL REPORTING

...

Certificates by Directors

9.34 (1) Except for reporting under rule 9.3A, ~~t~~There must be annexed to the documents referred to in rules 9.12, 9.13 and 9.14 a certificate in accordance with the requirements of Part I of **Appendix 9.6** which must be signed by the persons required by rule 9.33 to sign the documents to which the certificate relates.

(2) In respect of reporting under rule 9.3A, there must be annexed to the documents referred to in that rule a certificate in accordance with the requirements of Part IA of **Appendix 9.6** which must be signed by a *director of the insurer.*

...

APPENDIX 9.6 (rules 9.34 and 9.35)

CERTIFICATES BY DIRECTORS AND REPORT OF THE AUDITORS

Part I

Certificate by directors

1. (1) Subject to 3, the certificate required by rule 9.34(1) must state –

...

2. Subject to 3, if the *insurer* carries on *long-term insurance business*, the certificate required by rule 9.34(1) must also state that –

...

- (d) ...
 - (i) ~~advice in preparing the return~~ from every *actuary* appointed by the *insurer* to perform the *actuarial function* in accordance with *SUP* 4.3.13R; and
 - (ii) if applicable, advice from every *actuary* appointed by the *insurer* to perform the *with-profits actuary function* in accordance with *SUP* 4.3.16AR.

3. ...

Insert after Part I the following Part IA.

Part IA

Certificate by a director on the half-yearly balance sheet and report for realistic valuation

- 3A. Subject to 3C, the certificate required by rule 9.34(2) must state that the *return* has been properly prepared in accordance with the requirements in *IPRU(INS)* and *PRU*.
- 3B. Subject to 3C, the certificate required by rule 9.34(2) must also state that –
 - (a) the amount provided for *long-term insurance liabilities* for the purpose of determining the *insurer's capital resources* as shown in **Form 2** constitutes proper provision at the end of the six month period referred to in rule 9.3A(1) for those liabilities (including all liabilities arising from *deposit back arrangements*); and
 - (b) the *director* has, in preparing the *return*, taken and paid due regard to–
 - (i) advice from every *actuary* appointed by the *insurer* to perform the *actuarial function* in accordance with *SUP* 4.3.13R; and
 - (ii) advice from every *actuary* appointed by the *insurer* to perform the *with-profits actuary function* in accordance with *SUP* 4.3.16AR.
- 3C. (1) Where, in the opinion of the *director* signing the certificate, the circumstances are such that any of the statements required by 3A and 3B cannot truthfully be made, the relevant statements must be omitted.
- (2) Where, by virtue of (1), any statements have been omitted from the certificate, this fact, and the reasons for omission, must be stated in a note to the certificate.

**ANNUAL QUESTIONNAIRE FOR AUTHORISED PROFESSIONAL FIRMS
INSTRUMENT 2006**

Powers exercised

- A. The Financial Services Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):
- (1) section 138 (General rule-making power);
 - (2) section 156 (General supplementary powers); and
 - (3) section 157(1) (Guidance).
- B. The rule-making powers listed above are specified for the purpose of section 153(2) (Rule-making instruments) of the Act.

Commencement

- C. This instrument comes into force on 6 July 2006.

Amendments to the Handbook

- D. The Glossary of definitions is amended in accordance with Annex A to this instrument.
- E. The Supervision manual (SUP) is amended in accordance with Annex B to this instrument.
- F. The Professional Firms sourcebook (PROF) is amended in accordance with Annex C to this instrument.

Citation

- G. This instrument may be cited as the Annual Questionnaire for Authorised Professional Firms Instrument 2006.

By order of the Board
25 May 2006

Annex A

Amendments to the Glossary of definitions

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

...

*designated
professional body*

a professional body designated by the Treasury under section 326 of the *Act* (Designation of professional bodies) for the purposes of Part XX of the *Act* (Provision of Financial Services by Members of the Professions); ~~as at 21 June 2001~~ the following professional bodies have been designated in the Financial Services and Markets Act 2000 (Designated Professional Bodies) Order 2001 (SI 2001/1226), the Financial Services and Markets Act 2000 (Designated Professional Bodies) (Amendment) Order 2004 (SI 2004/3352) and the Financial Services and Markets Act 2000 (Designated Professional Bodies) (Amendment) Order 2006 (SI 2006/58):

- (a) The Law Society of ~~(England and~~ Wales);
- (b) The Law Society of Scotland;
- (c) The Law Society of Northern Ireland;
- (d) The Institute of Chartered Accountants in England and Wales;
- (e) The Institute of Chartered Accountants of Scotland;
- (f) The Institute of Chartered Accountants in Ireland;
- (g) The Association of Chartered Certified Accountants;
- (h) The Institute of Actuaries; ~~;~~
- (i) The Council for Licensed Conveyancers; and
- (j) The Royal Institution of Chartered Surveyors.

...

Annex B

Amendments to the Supervision manual

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

SUP 16 Annex 9R: Annual questionnaire for authorised professional firms

1. Annual questionnaire for authorised professional firms

(for FSA use only)



Annual qQuestionnaire for Authorised pProfessional fFirms

FSA Handbook Reference: *SUP* 16 Annex 9R
20-September-2004

Name of firm

FSA firm reference number

Accounting Reference Date

The Financial Services Authority
~~Notification, Reporting and Data Maintenance Department~~
~~44th Floor~~
Revenue and Information Management Department
25 The North Colonnade
Canary Wharf
London E14 5HS
United Kingdom
Telephone +44 (0) 20 7676 7066 1000
Website <http://www.fsa.gov.uk>

Registered as a Limited Company in England and Wales No 1920623. Registered Office as above

Guidance notes

This form should be completed only by *authorised professional firms* as defined in the *FSA's Handbook of rules and guidance*.

Completing this Form

This form must be submitted to the *FSA* within four months of the *accounting reference date* to which it relates.

The ~~Form~~ form must be completed in black ink and (if in manuscript) in BLOCK LETTERS.

All dates must be provided in numeric form (e.g. 29/02/2000 for 29 February 2000).

Tick the appropriate box where a yes/no answer is required.

~~Further details must be given in section 4 (supplementary information) if there is insufficient space for a detailed answer.~~

~~Additional information can be attached to the Form. It must be securely attached to the rest of the form and you must indicate at question 4.02 the number of additional sheets attached.~~

Expressions in the form in italics have the meaning given in the *Glossary* to the *FSA's Handbook of rules and guidance* (or, if no meaning is given there, are to be interpreted in accordance with the related expressions defined in the *Glossary*).

Section 1 – Professional regulation

This section must be completed to show which of the *designated professional bodies* the *firm* is regulated by.

Section 2 – Supervision and monitoring data

The questions must be completed for the period ending on the *firm's* latest *accounting reference date*.

Section 3 – Financial resources and reporting

The questions must be completed for the period ending on the *firm's* latest *accounting reference date*.

Section 4 – Supplementary information

This section provides space for additional information which could not be included elsewhere in the form.

If there is still insufficient space, please use a separate sheet or sheets, marked with the *firm's* name and *FSA* firm reference number. Additional information must be securely attached to the rest of the form and you must indicate in question 4.02 the number of additional sheets attached.

Declaration

~~The declaration must be signed as follows:~~

- ~~(i) If the *firm* is a sole practitioner, by that person;~~
- ~~(ii) If the *firm* is a *partnership* (or *limited liability partnership*), by two *partners* (or designated members);~~
- ~~(iii) If the *firm* is a *company*, by two *directors*. If the *company* has only one *director*, by the *director* and the *Company Secretary*.~~

See SUP SUP 16.3 for method of submission.

~~Annual questionnaire for authorised professional firms~~

1.01 Legal status

Indicate whether the *firm* is:

a an individual who is entitled to ~~practice~~ practise a profession regulated by a *designated professional body* and in doing so is subject to its rules; or YES NO


b a *person* (not being an individual) which is managed and controlled by one or more individuals each of whom is entitled to ~~practice~~ practise a profession regulated by a *designated professional body* and in doing so is subject to the rules of the *designated professional body*. YES NO

1.02 Designated Professional Body

To which of the following *designated professional bodies* is the ~~firm~~ firm subject?

PLEASE TICK ALL

- APPROPRIATE BOXES
- The Association of Chartered Certified Accountants
 - The Institute of Actuaries
 - The Institute of Chartered Accountants in England & Wales
 - The Institute of Chartered Accountants in Ireland
 - The Institute of Chartered Accountants of Scotland
 - The Law Society of (England & Wales)
 - The Law Society of Scotland
 - The Law Society of Northern Ireland
 - The Council for Licensed Conveyancers
 - The Royal Institution of Chartered Surveyors

 I have supplied further information related to this page in Section in 4.01 YES NO

2.01 Business – general information

**Latest period
£000**

**Previous period
£000**

a What was the total income (excluding VAT) from all the business activities (including *regulated activities*) of the *firm* during the latest and previous periods?

Please state length of period if not 12 months

b Please indicate the *firm's* **four main business activities**.

- 1. Accounts preparation/bookkeeping
- 2. Audit
- 3. Business start-ups
- 4. Consultancy
- 5. Corporate Finance
- 6. Information Technology
- 7. Insolvency
- 8. Investment business
- 9. Payroll preparation
- 10. Taxation
- 11. Pensions advice to individuals
- 12. Advice to pension scheme trustees
- 13. Technical advice to product providers
- 14. Banking & Finance
- 15. Competition
- 16. Corporate/Commercial
- 17. Crime

- 18. Defamation
- 19. Employment
- 20. Human Rights
- 21. Immigration
- 22. Intellectual Property
- 23. Landlord & Tenant
- 24. Matrimonial/Family
- 25. Personal Injury
- 26. Planning
- 27. Probate/Executory
- 28. Professional Negligence
- 29. Property/Conveyancing
- 30. Road Traffic
- 31. Trusts
- 32. Other

Specify: _____

c Does the *firm* have any branches or other places of business? YES NO

d b Does the *firm* have any appointed representatives? YES NO

If YES, how many?
(Give figure as at the date of this questionnaire)

 I have supplied further information related to this page in Section 4 YES NO

2.02 Income from mainstream regulated activities

a What was the total income from the *firm's mainstream regulated activities* during the latest and previous periods?
(Income excludes commission rebated to *clients* (as defined for *PROF*) or used to enhance policies)

b During the period, what please indicate the proportion of this income was generated from: the following regulated activities?
(An estimate to the nearest 10% is sufficient)

	Percentage
i) Fund <u>Investment management activities</u> (see 3.08 9)	
ii) Corporate finance <u>activities</u> (see 2.04)	
iii) Packaged products <u>Retail investment activities</u>	
iv) <u>Mortgage mediation activities</u>	
v) <u>Insurance mediation activities</u>	
iv) vi <u>Other</u>	
TOTAL	100 %

2.02 c How much income from *regulated activities* arose from ~~retained commission received from third parties?~~

£000

(An estimate to the nearest 10% is sufficient.)

d c Did the *firm* during the period: ~~carry on any regulated activities~~ in relation to

- (i) Trusts _____ YES NO
- (ii) Powers of attorney _____ YES NO
- (iii) Pension transfers/pension opt-outs _____ YES NO
- (iv) FSAVCs _____ YES NO
- (v) Endowments _____ YES NO
- (vi) Handling (i) Handle client money?
(i.e. money held in the course of *designated investment business*, mortgage mediation activity or insurance mediation activity)
YES NO
- (vii) Handling (ii) Handle custody assets?
(i.e. assets held in the course of *designated investment business*) e.g. custodial investments)
YES NO
- e** Did the *firm* during the period introduce *clients* to other *authorised persons*? _____ YES NO

2.03 Execution-only transactions

How many transactions during the period in the course of mainstream regulated activities were *execution-only* transactions?

- None
- 1 – 10
- > 10

(PLEASE TICK APPROPRIATE BOX)

 I have supplied further information related to this page in Section 4 YES NO

Annual questionnaire for authorised professional firms

2.04 Did the *firm* carry out any **corporate finance business** in the period? YES NO

If YES

Describe the nature of services provided during the period (summarise if necessary), and indicate whether the *firm* or any individual, *company* or trust within or associated with the *firm*, has taken an equity share as a result of a deal or been remunerated on a contingency basis.

Nature of services provided _____ Equity share taken or contingency basis for fee?

YES NO

YES NO

YES NO

YES NO

YES NO

 I have supplied further information related to this page in Section 4 YES NO

Annual questionnaire for authorised professional firms

Annual questionnaire for authorised professional firms Page 5

2.04 5 Life policies

Were any *life policies*, including *pension policies* arranged by the *firm* **surrendered or cancelled** in the period?

YES NO

If YES

(i) How many?

(ii) Are any of them associated with a complaint against the *firm* about ~~peer~~ the advice on investments provided?

YES NO

If YES, how many?

2.05 6 Indemnity commission

Was the *firm* ~~been~~ asked to repay or did it repay **indemnity commission** during the period?

YES NO

If YES

(i) On how many cases?

(ii) Do these requests for repayment represent more than 5 per cent of the *firm's commission* income received on indemnity terms during the period?

YES NO

2.06 7 Material changes

Since the *accounting reference date*, have there been, or will there be, changes in the way the *firm* carries on its *regulated activities* or other business, which may have a material effect on the type and volume of such work?

YES NO

If YES, please explain the main changes and their expected effects.

(e.g. New branch or department ~~dealing with regulated activities~~, new computer systems, employment of staff with relevant expertise, merger of businesses, ~~hiving off of business area dealing with regulated activities~~)

2.07 8 Record keeping

a Has the *firm* maintained **accounting and other records** in accordance with the *FSA's Handbook of rules and guidance*?

YES NO

If NO, please explain

b Has the *firm* maintained records to enable the *FSA* to verify the calculations prepared to support the financial declarations made in this questionnaire?

YES NO

If NO, please explain

 I have supplied further information related to this page in Section 4 YES NO

2.08 9 Professional indemnity insurance

a Are the terms of the *firm's* professional indemnity insurance policy compliant with the requirements set out in the Handbook? YES NO
(The professional indemnity insurance requirements for *authorised professional firms* are set out in PRU 9.2 and IPRU(INV) 13.)

If NO, please explain.

b Does the policy exclude any type of business or activity that has been carried on by the *firm* in the past, or that is currently carried on by the *firm* or that will be carried on by the *firm* during the time for which the policy is in force? YES NO

If YES, please provide further information on the excluded line of business or activity and explain how the *firm* has mitigated (or will mitigate) the risk of not having the business or activity covered in the policy.

c In relation to the *firm's* current policy, please provide the following information:


(i) Expiry date of the *firm's* current professional indemnity policy.
(For *firms* who are members of the Law Society of Scotland: please give details of the *firm's* *firm's* professional indemnity insurance under the Law Society of Scotland's Master Policy.)

b-(ii) Limit of indemnity: per claim

in aggregate

c (iii) Excess per claim

d (iv) Annual premium

 I have supplied further information related to this page in Section in 4.01 YES NO

Annual questionnaire for authorised professional firms

3.01 Material change in total income

a Was there any material change in the *firm's* total income (from all activities) during the period as compared with the previous period?

YES NO

If YES, please give details

For the purposes of this question 'material' is regarded as 25% of total income at the end of the accounting period, but will depend also on the size and nature of the *firm's* business.

Details should include the actual change in the figures to show the impact and the reasons for the change, which might include opening a new branch/office, gain/loss of sources of business, downsizing/merger.

b Has the *firm* made a profit after tax for the period?

YES NO

If NO, please explain how the loss has occurred.

3.02 Net assets and liabilities

a If the *firm* has produced accounts with a balance sheet as at the ~~end of the period ending on the firm's~~ *firm's* latest accounting reference date, please state the *firm's* total:

Latest Accounting Reference Date

Previous Accounting Reference Date

(i) net assets, or

(ii) net liabilities

b If the *firm* has net liabilities, please explain how the *firm* has met its liabilities and will continue to meet them as they fall due in future.

 I have supplied further information related to this page in Section 4 YES NO

3.03 Bank position

a Please state the *firm's* net bank position at the *firm's* latest *accounting reference date*

- (i) net credit balance (£000), or
- (ii) net overdrawn balance (£000)

b Overdraft facility (£000)

c Overdraft review date

d Details of security for the overdraft

3.04 Other loans borrowings

Please state whether the *firm* has any other ~~loans~~ borrowings.

YES NO

If YES, please give details

3.05 Bank overdraft

If the above bank balance is overdrawn by more than the overdraft limit, please provide details of the current position and explain how the *firm* has met and will continue to meet its liabilities as they fall due.

3.06 Contingent liabilities

Are there outstanding any legal proceedings or County Court Judgements or Decrees (Scotland) against the *firm* or its principals or any other contingent liabilities that may affect the *firm's* ability to meet its liabilities as they fall due in the future?

YES NO

If YES, please give details

 I have supplied further information related to this page in Section 4 YES NO

Annual questionnaire for authorised professional firms

3.07 Solvency

Have the *partners/directors* of the *firm* carried out appropriate procedures to enable them to satisfy themselves that the *firm* is able to meet its liabilities as they fall due until the end of the current accounting period (or twelve months from the last *accounting reference date*, if later)?

YES NO

(Supporting papers should be retained. The *FSA* may at any time require a *firm* to produce evidence to demonstrate that it can meet this requirement.)

3.08 Pensions/FSAVCs

Has the *firm* had to review any *pension transfer/pension opt out or FSAVC* cases? (This information is additional to that information provided in the return to the Pensions Review Monitoring Department)

YES NO

If YES, please provide the following information in respect of the amounts that have been included in the *firm's* accounts to its latest *accounting reference date*, or would be included if the accounts had been prepared by the date of signature of this Questionnaire

Accounting Reference Date _____ **£000**

a The provision in respect of redress

b The provision for the cost of conducting the review to completion

c Details and amounts of any contingent liabilities not recorded on the balance sheet in respect of *pension transfers and pension opt outs or FSAVCs*

3.09 3.08 Fund Investment management

Did the *firm* provide any investment management services act as an *investment manager* during the period?

YES NO

If YES, please provide the following information:

a If this includes **discretionary** management, what type of services has the *firm* provided during the period?

(e.g. *Managing investments for private customers/intermediate customers/non-UK customers, trustee activities, ISA manager management*)

b Funds under **discretionary** management:

Date _____ **£000**

(i) At the start of the accounting period

(ii) At the end of the accounting period

(iii) At latest practicable date within 1 month of date of signature of the Declaration on page 12

 I have supplied further information related to this page in Section YES NO

Annual questionnaire for authorised professional firms

3.09 c Funds under **non-discretionary** management:

Date

£000

At latest practicable date within
~~1 month of date of signature of the
Declaration on page 10~~

d Total funds under management :
(exclude 'custody only' funds)

Date

£

At latest practicable date within
~~1 month of date of signature of the
Declaration on page 12~~



I have supplied further information related to this ~~page~~ in Section in 4.01 YES NO

Annual questionnaire for authorised professional firms

4.01 Please use this space to provide any additional information relating to the previous sections.

If there is insufficient space, please continue on a separate sheet of paper, and clearly identify the section and question to which the additional information relates. Please include the name of the *firm* and the FSA firm reference number.

Question

Information

4.02 How many additional sheets are being submitted?

~~Annual questionnaire for authorised professional firms~~

Declaration

THIS DECLARATION MUST BE COMPLETED BY ALL FIRMS

I/ we confirm that the ~~firm~~ firm is, and continues to be, an ~~'authorised professional firm'~~ *authorised professional firm*. ~~as defined in the Financial Services Authority's Handbook of Rules and Guidance.~~

I/ we declare that the ~~firm~~ firm is able to meet its liabilities as they fall due until the end of the current accounting period (or twelve months from the last accounting reference date, if later).

Knowingly or recklessly giving the ~~FSA~~ FSA information which is false or misleading in a material particular may be a criminal offence (sections 398 and 400 of the Financial Services and Markets Act 2000). It should not be assumed that information is known to the ~~FSA~~ FSA merely because it is in the public domain or has previously been disclosed to the ~~FSA~~ FSA or another regulatory body.

I confirm that the information in this form is accurate and complete to the best of my knowledge and belief.

Name of *firm*

FSA firm reference number

Name of first signatory_

Position of first signatory

Signature of first signatory

Date

Name of second signatory_

Position of second signatory

Signature of second signatory

Date

_ The declaration must be signed as follows:

- (i) If the *firm* is a sole practitioner, by that person;
- (ii) If the *firm* is a *partnership* (or *limited liability partnership*), by two *partners* (or designated members);
- (iii) If the *firm* is a *company*, by two *directors*. If the company has only one *director*, by the *director* and the Company Secretary.

~~Annual questionnaire for authorised professional firms~~

Transitional Provisions and Schedules

SUP TP 1 Transitional provisions

SUP TP 1.1 Transitional provisions applying to the Supervision manual only

Definitions for these transitional provisions, additional to those in the *Glossary*, are provided at paragraph 16 of the table.

SUP TP 1.2

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
...					
<u>12I</u>	<u>SUP 16.7.54R</u>	<u>R</u>	<u>Until 6 September 2006, an authorised professional firm will not contravene SUP 16.7.54R if it submits to the FSA the annual questionnaire that was contained in SUP 16 Annex 9 immediately prior to 6 July 2006.</u>	<u>6 July 2006 – 6 September 2006</u>	<u>6 July 2006</u>
...					

Annex C

Amendments to the Professional Firms sourcebook

In this Annex underlining indicates new text.

PROF 2 Annex 1G

Status of exempt professional firm

On 28 March 2001 the following professional bodies were designated by the Treasury under section 326(1) of the *Act*:

The Law Society of England & Wales

The Law Society of Scotland

The Law Society of Northern Ireland

The Institute of Chartered Accountants in England & Wales

The Institute of Chartered Accountants of Scotland

The Institute of Chartered Accountants in Ireland

The Association of Chartered Certified Accountants

The Institute of Actuaries_

On 14 January 2005, the Council for Licensed Conveyancers was designated by the Treasury under section 326(1) of the *Act*.

On 10 February 2006, the Royal Institution of Chartered Surveyors was designated by the Treasury under section 326(1) of the *Act*.

COMPENSATION SOURCEBOOK (AMENDMENT NO 7) INSTRUMENT 2006

Powers exercised

- A. The Financial Services Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):
- (1) section 138 (General rule-making power);
 - (2) section 156 (General supplementary powers);
 - (3) section 157(1) (Guidance);
 - (4) section 213 (The compensation scheme);
 - (5) section 214 (General);
 - (6) section 216 (Continuity of long-term insurance policies); and
 - (7) section 217 (Insurers in financial difficulties).
- B. The rule-making powers listed above are specified for the purpose of section 153(2) (Rule-making instruments) of the Act.

Commencement

- C. This instrument comes into force on 6 June 2006.

Amendments to the Handbook

- D. The Compensation sourcebook (COMP) is amended in accordance with the Annex to this instrument.

Citation

- E. This instrument may be cited as the Compensation Sourcebook (Amendment No 7) Instrument 2006.

By order of the Board
25 May 2006

Annex

Amendments to the Compensation sourcebook

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

Transitional Provisions						
		Material to which the transitional provision applies		Transitional Provision	Transitional provision: dates in force	Handbook Provisions coming into force
...						
	<u>15</u>	<u>COMP 5.4.4 R (4)(a) and 5.4.4 R (4)(b)</u>	<u>R</u>	<u>The changes to COMP 5.4.4 R (4) made in the Compensation Sourcebook (Amendment No 7) Instrument 2006 do not apply in relation to defaults declared before 6 June 2006.</u>	<u>Indefinitely</u>	<u>6 June 2006</u>

...

3.3.1 R Securing continuity of long term insurance cover

The *FSCS* must make arrangements to secure continuity of insurance for an *eligible claimant* under a *protected contract of insurance* which is a *long term insurance contract* with a *relevant person*, if:

...

- (2) it is reasonably practicable to do so;
- (3) the cost of doing so would, in the opinion of the *FSCS* at the time it proposes to make the arrangements, be likely to be no more than the cost of paying compensation under COMP 3.2 in the opinion of the *FSCS* at the time it proposes to make the arrangements, it would be beneficial to the generality of *eligible claimants* covered by the proposed arrangements, and, in situations where the cost of securing continuity of insurance might exceed the cost of paying compensation under COMP 3.2, any additional cost is likely to be justified by the benefits; and

...

...

3.3.2 F R In making arrangements to secure continuity of insurance the FSCS must use its reasonable endeavours to seek the most cost-effective arrangements available.

3.3.3 R (1) ...

(a) ...

(b) ...

~~if at the time it proposes to take the measures, it considers that the cost of doing so is likely to be no more than the cost of paying compensation under COMP 3.2~~ if, in the opinion of the FSCS at the time it proposes to make the measures, it would be beneficial to the generality of eligible claimants covered by the proposed measures, and, in situations where the cost of taking those measures might exceed the cost of paying compensation under COMP 3.2, any additional cost is likely to be justified by the benefits.

...

...

5.4.4 R For the purposes of COMP 5.4.3R and COMP 5.4.5R(1)(b), the situation of a risk or commitment is determined as follows:

...

(4) in cases not covered by (1) to (3):

(a) where the policyholder who first took out the contract of insurance is an individual, the risk or commitment is situated where he has his habitual residence at the date when the *contract of insurance* commenced;

(b) where the policyholder who first took out the contract of insurance is not an individual, the risk or commitment is situated where the establishment to which the risk or commitment relates is situated at the date when the *contract of insurance* commenced.

...

7.2.3 R

...

(3) If the FSCS makes recoveries through rights assigned under COMP 7.2.1R, it may deduct from any recoveries paid over to the claimant under COMP 7.2.4R part or all of its reasonable costs of recovery and of distribution (if any).

...

Notice to customers and the FSCS

14.4.6 R When an incoming *EEA firm's top-up cover* comes to an end under *COMP 14.4.1R*, *COMP 14.4.4R* or *COMP 14.4.5R*, it must:

(1) inform all the clients of its *UK branch* no later than six weeks after the date that its participation ends that they are no longer protected by the *compensation scheme*, and of the level of compensation which is then available to them; and

(2) within two months, notify the FSCS whether it has done so.

14.4.7 R If an *incoming EEA firm* fails to comply with *COMP 14.4.6R(1)*, the *FSCS* must inform the *firm's Home State regulator* of that fact.

...

**PERIODIC FEES (UNAUTHORISED MUTUAL SOCIETIES REGISTRATION)
(2006/2007) INSTRUMENT 2006**

Powers exercised

- A. The Financial Services Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):
- (1) section 138 (General rule-making power);
 - (2) section 156 (General supplementary powers);
 - (3) section 157(1) (Guidance); and
 - (4) paragraph 17(1) of Schedule 1 (Fees).
- B. The rule-making powers listed above are specified for the purpose of section 153(2) (Rule-making instruments) of the Act.

Commencement

- C. This instrument comes into force on 1 June 2006.

Amendments to the Handbook

- D. The Unauthorised mutuals registration fees rules are amended in accordance with the Annex to this instrument.

Citation

- E. This instrument may be cited as the Periodic Fees (Unauthorised Mutual Societies Registration) (2006/2007) Instrument 2006.

By order of the Board
25 May 2006

Annex

Amendments to the Unauthorised mutuals registration fees rules manual

In this Annex, an entire new section of text is being inserted. The place where the change will be made is indicated and the text is not underlined.

Delete existing Ann 1R and insert new Ann 1R as follows:

ANNEX 1R

PERIODIC FEES PAYABLE FOR THE PERIOD 1 APRIL 2006 TO 31 MARCH 2007

Part 1

Periodic fee payable by Registered Societies (on 30 June 2006)

This fee is not payable by a *credit union*.

Transaction	Total assets (£'000s)	Amount payable (£)
Periodic Fee	0 to 50	45
	> 50 to 100	85
	> 100 to 250	135
	> 250 to 1,000	185
	> 1,000	355

Part 2

Methods of payment of periodic fees

A periodic fee must be paid using either direct debit, credit transfer (BACS/CHAPS), cheque, switch or by credit card (Visa/Mastercard only). Any payment by permitted credit card must include an additional 2% of the sum paid.

**INTER-PROFESSIONAL INVESTMENTS (EXCHANGE TRADED FUNDS)
INSTRUMENT 2006**

Powers exercised

- A. The Financial Services Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):
- (1) section 138 (General rule-making power);
 - (2) section 156 (General supplementary powers).
- B. The rule-making powers listed above are specified for the purpose of section 153(2) (Rule-making instruments) of the Act.

Commencement

- C. This instrument comes into force on 6 August 2006.

Amendments to the Handbook

- D. The Glossary of definitions is amended in accordance with the Annex to this instrument.

Citation

- E. This instrument may be cited as the Inter-Professional Investments (Exchange Traded Funds) Instrument 2006.

By order of the Board
27 July 2006

Annex

Amendments to the Glossary of definitions

In this Annex, underlining indicates new text and striking through indicates deleted text. Where new definitions are being inserted, the text is not underlined.

Insert the following new definition in the appropriate alphabetical position:

- exchange traded fund* a fund:
- (a) which is an *open-ended investment company*; and
 - (b) the *units* of which are traded on a *regulated market* or *designated investment exchange*.

Amend the following definition as shown:

- inter-professional investment* any of the following *investments* specified in Part III of the *Regulated Activities Order* (Specified investments) or, in the case of *units* in an *exchange traded fund*, defined in the *Glossary*:
- (a) *share* (article 76);
 - (b) *debenture* (article 77);
 - (c) *government and public security* (article 78);
 - (d) *warrant* (article 79);
 - (e) *certificate representing certain securities* (article 80);
 - (f) *option* (article 83); for the purposes of the *permission* regime, this is sub-divided into:
 - (i) *option* (excluding a *commodity option* and an *option on a commodity future*);
 - (ii) *commodity option* and *option on a commodity future*;
 - (g) *future* (article 84); for the purposes of the *permission* regime, this is sub-divided into:
 - (i) *future* (excluding a *commodity future* and a *rolling spot forex contract*);
 - (ii) *commodity future*;
 - (iii) *rolling spot forex contract*;

- (h) *contract for differences* (article 85); for the purposes of the *permission* regime, this is sub-divided into:
 - (i) *contract for differences* (excluding a *spread bet* and a *rolling spot forex contract*);
 - (ii) *spread bet*;
 - (iii) *rolling spot forex contract*;
- (i) *rights to or interests in investments* in (a) to (h) (article 89);₂
- (j) *units in an exchange traded fund.*

HANDBOOK ADMINISTRATION (NO 3) INSTRUMENT 2006**Powers exercised**

- A. The Financial Services Authority makes this instrument in the exercise of the powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”) referred to in Schedule 4 to the General Provisions (GEN) (Powers exercised) of the Handbook.
- B. The rule-making powers referred to above are specified for the purpose of section 153(2) (Rule-making instruments) of the Act.

Commencement

- C. This instrument comes into force on 6 July 2006.

Amendments to the Handbook

- D. The modules of the FSA Handbook of rules and guidance listed in column (1) below are amended in accordance with the Annexes to this instrument listed in column (2).

(1)	(2)
Glossary of definitions	Annex A
General Provisions (GEN)	Annex B
Fees manual (FEES)	Annex C
Conduct of Business sourcebook (COB)	Annex D
Insurance: Conduct of Business sourcebook (ICOB)	Annex E
Client Assets sourcebook (CASS)	Annex F
Supervision manual (SUP)	Annex G
Perimeter Guidance manual (PERG)	Annex H

Citation

- E. This instrument may be cited as the Handbook Administration (No 3) Instrument 2006.

By order of the Board
22 June 2006

Annex A

Amendments to the Glossary of definitions

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

Amend the following definitions as shown.

<i>advising on investments</i>	<p>the <i>regulated activity</i>, specified in article 53 of the <i>Regulated Activities Order</i> (Advising on investments), which is in summary: advising a <i>person</i> if the advice is:</p> <ul style="list-style-type: none">(a) given to the <i>person</i> in his capacity as an investor or potential investor, or in his capacity as agent for an investor or a potential investor; and(b) advice on the merits of his doing any of the following (whether as principal or agent):<ul style="list-style-type: none">(i) <i>buying, selling</i>, subscribing for or underwriting a particular <i>investment</i> which is a <i>security</i> or <i>relevant investment</i> (that is, any <i>designated investment, funeral plan contract, pure protection contract, general insurance contract</i> or right to or interests in a <i>funeral plan contract</i>); or(ii) exercising any right conferred by such an <i>investment</i>, other than a <i>pure protection contract</i> or a <i>general insurance contract</i>, to <i>buy, sell</i>, subscribe for or underwrite such an <i>investment</i>.
...	
<i>appropriate personal pension</i>	<p>a <i>personal pension policy</i> or a <i>personal pension contract</i> under which contributions are made to a <i>personal pension scheme</i> which is an appropriate scheme under section 1(8) <u>7(4)</u> of the Social Security Act 1986 <u>Pension Schemes Act 1993</u> or article 3(8) <u>section 3(4)</u> of the Social Security (Northern Ireland) Order 1986 <u>Pension Schemes (Northern Ireland) Act 1993</u>.</p>
...	
<i>individual pension account</i>	<p>an account for the holding of <i>IPA eligible investments</i> operated by a firm in accordance with the Personal Pension Schemes (Restriction on Discretion to Approve) (Permitted Investments) Regulations 2001 (SI 2001/117), which satisfies the conditions described in <u>regulation 2(2) of the Stamp Duty and Stamp Duty Reserve Tax (Definition of Unit Trust Scheme and Open-ended Investment Company) Regulations 2001 (SI 2001/964)</u>.</p>

...

insurance undertaking an undertaking, or (in CASS 5 and COMP) a *member*, whether or not an *insurer*, which carries on *insurance business*.

...

IPA eligible investments a type of investment specified in regulation ~~4.(6)~~ 2(2) (condition 5) of The Personal Pension Schemes (Restriction on Discretion to Approve) (Permitted Investments) Regulations 2001 (SI 2001/117) the Stamp Duty and Stamp Duty Reserve Tax (Definition of Unit Trust Scheme and Open-ended Investment Company) Regulations 2001 (SI 2001/964).

...

option the *investment*, specified in article ~~77~~ 83 of the *Regulated Activities Order* (Options), which is an option to acquire or dispose of:

- (a) a *designated investment* (other than an option); or
- (b) currency of the *United Kingdom* or of any other country or territory; or
- (c) palladium, platinum, gold or silver; or
- (d) an option to acquire or dispose of an option specified in (a), (b) or (c).

...

pure protection contract (1) a *long-term insurance contract* in respect of which the following conditions are met:

- (a) the benefits under the contract are payable only on death or in respect of incapacity due to injury, sickness or infirmity;
- (b) the contract provides that benefits are payable on death (other than death due to an accident) only where the death occurs within ten years of the date on which the life of the person in question was first insured under the contract, or where the death occurs before that person attains a specified age not exceeding seventy years;
- (c) the contract has no surrender value, or the consideration consists of a single premium and the surrender value does not exceed that premium; and

(d) the contract makes no provision for its conversion or extension in a manner which would result in it ceasing to comply with any of (a), (b) or (c); ~~and~~ or

(e) ~~the contract is not a reinsurance contract.~~ [deleted]

(2) a reinsurance contract covering all or part of a risk to which a person is exposed under a long-term insurance contract.

...

terms of business

a statement in a *durable medium* of the terms and conditions on which a *firm* will ~~conduct *designated investment* business~~ carry on a *regulated activity* with or for a *client* or *retail customer*.

Annex B

Amendments to the General Provisions (GEN)

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

Amend GEN 2.1 as shown. Deleted paragraphs are not shown struck through.

2.1 ~~Application and purpose~~ Introduction

Application

2.1.1 G ~~[deleted]~~

2.1.2 R This chapter applies to every *person* to whom any ~~rule~~ provision in the
- *Handbook* applies. In relation to a provision other than a rule, the rules in this chapter apply as if they were part of that provision.

2.1.3 P ~~[deleted]~~

2.1.4 E ~~[deleted]~~

2.1.5 D ~~[deleted]~~

2.1.6 G ~~[deleted]~~

2.1.7 R ~~[deleted]~~

2.1.8 R ~~[deleted]~~

2.1.9 G ~~[deleted]~~

~~Purpose~~ The Reader's Guide

2.1.10 G ~~The purpose of GEN 2 is to facilitate interpretation of the Handbook, in conjunction with the Reader's Guide. The Reader's Guide supplements this chapter. It provides an introduction to the structure and contents of the Handbook and its related materials, explaining how the different modules fit together and how to interpret and use the Handbook.~~

...

Continuity of authorised partnerships and unincorporated associations

2.2.18 R (1) If a *firm*, which is a ~~partnership~~ partnership or unincorporated association, is dissolved, ~~any firm~~ but its authorisation continues to have effect under section 32 of the Act (Partnerships and unincorporated associations) in relation to any partnership or unincorporated association which succeeds to the business of the

dissolved firm, the successor partnership or unincorporated association is to be regarded as the same firm for the purposes of the Handbook unless the context otherwise requires.

- (2) ~~For the purposes of (1), a firm is to be regarded as succeeding to the business of another firm only if:~~
- (a) ~~the members of the resulting firm are substantially the same as those of the former firm; and~~
 - (b) ~~succession is to the whole or substantially the whole of the business of the former firm. [deleted]~~
- (3) ~~In (1), “partnership” does not include a partnership which is constituted under the law of any place outside the United Kingdom and is a body corporate. [deleted]~~

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

Annex C

Amendments to the Fees manual (FEES)

In this Annex, striking through indicates deleted text.

FEES 4 Annex 5R

...

Notes

- (1) The *FSA register* includes details of *exempt professional firms* carrying out *insurance mediation activity*.
- (2) In addition to the periodic fees shown above, the sum of £31,400 will be due from the *designated professional bodies*, divided between the bodies in proportion to the number of *exempt professional firms* each has on the *FSA register* on 14 January 2006. This is a contribution towards the costs of developing this part of the *FSA register*.
- (3) ~~Each of the *designated professional bodies* will be invoiced for the appropriate amount in January 2006. The invoices must be paid on or before 28 February 2006.~~

Annex D

Amendments to the Conduct of Business sourcebook (COB)

In this Annex, underlining indicates new text.

COB Sch 2 Notification requirements

COB Sch 2.1G

Handbook reference	Matter to be notified	Contents of notification	Trigger event	Time allowed
...				
[deleted]	[deleted]	[deleted]	[deleted]	[deleted]
<u>COB 6.12.94R(1)</u>	<u>Fact that the <i>firm</i> has ceased to effect new <i>contracts of insurance</i> in a <i>with-profits fund</i></u>	<u>Fact that the <i>firm</i> has ceased to effect new <i>contracts of insurance</i> in a <i>with-profits fund</i></u>	<u><i>Firm</i> first ceasing to effect new <i>contracts of insurance</i> in a <i>with-profits fund</i></u>	<u>28 days</u>
<u>COB 6.12.94R(2)</u>	<u>Details of how the <i>firm</i> will ensure a full and fair distribution of the closed <i>with-profits fund</i> and its <i>inherited estate</i> (if any)</u>	<u>The information described in <i>SUP App 2.15</i></u>	<u><i>Firm</i> first ceasing to effect new <i>contracts of insurance</i> in a <i>with-profits fund</i></u>	<u>A maximum of 3 months</u>
COB 11.6.6R	...			

Annex E

Amendments to the Insurance: Conduct of Business sourcebook (ICOB)

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

5.3.1 R If a *non-investment insurance contract* is not a *distance contract*, an *insurance intermediary* must, in good time before the conclusion of the contract:

(1) ...

(2) draw the attention of the *retail customer* orally to ... the section of the *policy summary* on significant ~~and~~ or unusual exclusions or limitations.

...

5.3.6 R (1) ...

(2) The following exemptions from (1) apply:

(a) Telephone sales

...an *insurance intermediary* may proceed on the basis of at least the following information:

...

(iv) significant ~~and~~ or unusual exclusions or limitations;

...

(b) Certain other means of distance communication

...the *insurance intermediary* must provide the following information by other means before the conclusion of the contract:

...

(iv) significant ~~and~~ or unusual exclusions or limitations;

...

...

5.3.27 G When explaining the implications of a change in accordance with *ICOB* 5.3.24R(2) or *ICOB* 5.3.25R(2)(a) to a *retail customer*, an *insurance intermediary* should explain any changes to the benefits and significant ~~and~~ or unusual exclusions arising from the change.

Annex F

Amendments to the Client Assets sourcebook (CASS)

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

4.3.98 G The purpose of CASS 4.3.99R to CASS 4.3.102R is to set out those situations in which a *firm* will have fulfilled its contractual and fiduciary obligations in relation to any *client money* held for or on behalf of its *client*, or in relation to the *firm's* ability to require repayment of that *money* from a third party.

...

5.5.79 G The purpose of CASS 5.5.80R to CASS 5.5.83R is to set out those situations in which a *firm* will have fulfilled its contractual and fiduciary obligations in relation to any *client money* held for or on behalf of its *client*, or in relation to the *firm's* ability to require repayment of that *money* from a third party.

...

5.6.9 R *Client money* received by the *firm* ... after a *primary pooling event* ... must be placed in a *client bank account* that has been opened after that event and must be handled in accordance with the *client money rules*, and returned to the relevant *client* without delay, except to the extent that:

(1) ...

(2) it is *money* relating to a *client*, for whom the *client money entitlement requirement*, calculated in accordance with CASS 5.5.66R or CASS 5.5.68R, shows that *money* is due from the *client* to the *firm* ...

Annex G

Amendments to the Supervision manual (SUP)

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

10.10 Customer functions

...

- 10.10.7 R (1) The *investment adviser function* is the function of:
- (a) *advising on investments* other than a *non-investment insurance contract*; and
 - (b) performing functions within the *customer trading function* in connection with *advising on investments* other than *non-investment insurance contracts*.
- (2) This function does not include:
- (a) the *investment adviser (trainee) function*; ~~and~~
 - (b) the *pension transfer specialist function*; ~~and~~
 - (c) *advising on investments in the course of carrying on the activity of providing basic advice on a stakeholder product.*

...

...

Form of notification when acquiring or increasing control

11.3.7 D A notification (“notice of *control*”) given to the *FSA* by a *person* who is acquiring *control* or increasing his *control* over a *UK domestic firm*, in a way described in *SUP* 11.4.2R(1) to (4), or acquiring *control* in a way described in *SUP* 11.4.2AR(1), must:

- (1) where the *controller* or a proposed *controller* is not an *authorised person*, contain the information required in:
 - (a) ~~Controllers Form A (*SUP* 11 Annex 4); and~~
 - (b) ~~one or more of Controllers Form B (*SUP* 11 Annex 5) in accordance with *SUP* 11.3.8D; or~~

the relevant controllers form;

...

- (2) where the *controller* or proposed *controller* is any other *authorised person*, contain the information required in ~~these sections of Controllers Form A (SUP 11 Annex 4) which deal with details of the proposed change in control and the persons involved in the notification~~ the relevant controllers form; and

...

11.3.8 D The information in ~~Controllers Form B~~ is required in relation to the following *persons*:

- (1) ~~if the controller is an individual, that individual;~~
- (2) ~~if the controller is a body corporate:~~
- (a) ~~the individual who is its chief executive; and~~
- (b) ~~one other individual who is a director of the body corporate;~~
- (3) ~~if the controller is a partnership or is a controller because he is a partner in a partnership:~~
- (a) ~~the individual who is a managing partner or equivalent in the partnership; and~~
- (b) ~~one other individual who is a partner in the partnership.~~
[deleted]

11.3.9 D If a ~~Controllers Form B~~ relevant controllers form, or an Application to perform *controlled functions* under the *approved persons* regime (Form A in SUP 10 Annex 4D) in respect of a *governing function*, has already been submitted to the *FSA* in relation to a relevant individual, then the information in that form need not be submitted to the *FSA* as long as details of any changes in the information previously submitted, or confirmation that there are none, is submitted.

...

11.3.11 G The *FSA*, for administrative reasons, expects notifications within SUP 11.3.7D to be given on ~~Controllers Form A or Controllers Form B~~ the relevant controllers form, as appropriate. If notifications are not made on these forms the applicant must inform the *FSA* of the reasons for not using them.

11.3.12 G If a *controller* or proposed *controller* considers that the requirements in SUP 11.3.7D to SUP 11.3.9D are not appropriate to his circumstances,

(for example,:

- (1) if the *control* is temporary; ~~or~~
- (2) if ~~Form B is required (under ■ SUP 11.3.8 D) in relation to:~~
 - (a) ~~an individual who is an approved person; or~~
 - (b) ~~a partnership of which one or more of the partners are bodies corporate;~~

he should consult the *FSA*. The *FSA* has power, under section 182(3) of the *Act* (Notification), to amend those requirements if it considers it appropriate to do so.

...

Joint and shared notifications

- 11.5.8 G A *firm* and its *controller* or proposed *controller* may discharge an obligation to notify the *FSA* by submitting a single joint notification containing the information required from the *firm* and the *controller* or proposed *controller*. In this case, the ~~Controllers Form A~~ relevant controllers form may be used to submit a notification on behalf of both the *firm* and the *controller* or proposed *controller*.

...

SUP 11 Annexes 4D and 5D are deleted in their entirety. The deleted text is not shown struck through.

Annex 4 D [deleted]

Annex 5 D [deleted]

...

- 16.7.15 R A *bank* must submit the reports referred to in SUP 16.7.13 R(1) either:
- (1) ...
 - (2) in electronic format using the specifications for the Bank of England Reporting System and sent either:
 - (a) ...
 - (b) by e-mail to ~~mfsd_beers@bofe.co.uk~~ mfsd_beers@bankofengland.co.uk; or
 - (c) ...

1. Annual questionnaire for authorised professional firms

...

Supervision and monitoring data

Section 2

...

Latest period
£

Previous period
£

2.02 Income from mainstream regulated activities

a ...

b During the period, please indicate the proportion of this income generated from:

(An estimate to the nearest 10% is sufficient)

Percentage

i) Investment management activities (see 3.08)

ii) Corporate finance activities

iii) *Retail investment activities*

iv) *Mortgage mediation activities*

v) *Insurance mediation activities*

vi) Other

TOTAL

100 %

c ...

...

2.08 Professional indemnity insurance

a Are the terms of the *firm's* professional indemnity insurance policy compliant with the requirements set out in the *Handbook*?
(The professional indemnity insurance requirements for *authorised professional firms* are set out in *PRU* 9.2 and *IPRU(INV)* 2 and 13.)

YES NO

If NO, please explain.

b ...

c In relation to the *firm's* current policy, please provide the following information:

(i) Expiry date.

(For *firms* who are members of the Law

Society of Scotland, the Council for Licensed Conveyancers or the Royal Institution of Chartered Surveyors: please give details of the *firm's* professional indemnity insurance under the Law Society of Scotland's *designated professional body's* Master Policy.)

...

Financial resources and reporting

Section 3

...

3.08 Investment management

Did the *firm* act as an *investment manager* during the period?

YES NO

If YES, please provide the following information:

a If this includes **discretionary** management, what type of services has the *firm* provided during the period?

(e.g. *Managing investments for private customers/intermediate customers/non-UK customers, trustee trustee activities, ISA management*)

b ...

c ...

d Total funds under management :
(exclude '~~custody~~ custody only' funds)

Date £

At latest practicable date

...

Declaration

THIS DECLARATION MUST BE COMPLETED BY ALL FIRMS

I/ we confirm that the *firm* is, and continues to be, an *authorised professional firm*.

I/ we declare that the *firm* is able to meet its liabilities as they fall due until the end of the current accounting period (or twelve months from the last ~~accounting reference date~~ accounting reference date, if later).

...

SUP Sch 2 Notification requirements

SUP Sch 2.2G

Handbook reference	Matter to be notified	Contents of notification	Trigger event	Time allowed
<p>SUP App 2.10.1 R-(1) [deleted]</p>	<p><i>Insurers: scheme of operations</i> – an insurer which is not an <i>incoming EEA firm</i> or an <i>incoming Treaty firm</i> – obligations on insurers which have previously submitted a <i>scheme of operations</i> [deleted]</p>	<p>The fact of the transactions specified [deleted]</p>	<p>An <i>insurer</i> which has submitted a <i>scheme of operations</i>, during the period covered by the <i>scheme of operations</i>, entering into or carrying out any material transaction (see SUP App 2.11.1 R) with, or in respect of an <i>associate</i>, unless that transaction is in accordance with a <i>scheme of operations</i> which has been submitted to the <i>FSA</i> [deleted]</p>	<p>28 days before entering into or carrying out the specified transaction [deleted]</p>

Annex H

Amendments to the Perimeter Guidance manual (PERG)

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

2.7.7A G There are four arranging activities that are *regulated activities* under the *Regulated Activities Order*. These are:

...

- (3) *arranging (bringing about) regulated mortgage contracts*, which includes arranging for another *person* to vary the terms of a *regulated mortgage contract* entered into ~~before~~ after 31 October 2004 (article 25A(1)); and

...

...

PERG 2 Annex 2G, 2 Table, ‘Table 1: Regulated Activities’:

Regulated activity	Specified investment in relation to which the regulated activity (in the corresponding section of column one) may be carried on
...	
(j) <i>advising on investments</i> (article 53) [see note 1B to Table 1] [also see Section of Table 1 headed ‘Regulated mortgage activity’]	
For the purposes of the <i>permission</i> regime, this <i>regulated activity</i> : <u>(i) does not apply to advice given in the course of carrying on the regulated activity of providing basic advice on a stakeholder product; and</u> (ii) is subdivided into: (†) (A) <i>advising on investments (except pension transfers and pension opt-outs)</i> ; and (††) (B) <i>advising on pension transfers and pension opt-outs</i> [see note 4 to Table 1]	
...	
(pp) (pa) <i>providing basic advice on a stakeholder product</i> (article 5B)	...

Insurance mediation activity [see note 5A to Table 1]	
(pa) <u>(pb)</u> <i>dealing in investments as agent</i> (article 21)	...
(pb) <u>(pc)</u> <i>arranging (bringing about) deals in investments</i> (article 25(1))	non-investment insurance contract pure protection contract [see note 5C to Table 1] general insurance contract [see note 5D to Table 1]
(pe) <u>(pd)</u> <i>making arrangements with a view to transactions in investments</i> (article 25(2))	<i>rights to or interests in investments</i> (article 89) in so far as they relate to a <i>life policy</i>
(pd) <u>(pe)</u> <i>assisting in the administration and performance of a contract of insurance</i> (article 39A)	
(pe) <u>(pf)</u> <i>advising on investments</i> (article 53)	
For the purpose of the <i>permission</i> regime, this <i>regulated activity</i> is sub-divided into: (i) <i>advising on investments (except pension transfers or pension opt-outs)</i> ; (ii) <i>advising on pension transfers or pension opt-outs</i> [See note 5 <u>ED</u> to Table 1].	
...	

PERG 2 Annex 2G, 3Table, ‘Notes to Table 1’

...

Note 1B:

... The full list of *insurance mediation activities* is set out in ~~(pa)~~ (pb) to ~~(pe)~~ (pf). ...

...

Note 5A:

Where they are carried on in relation to a *life policy*, the activities listed as *insurance mediation activities* in ~~(pa)~~ (pb) to ~~(pe)~~ (pf) ...

...

Note 5C:

‘Non-investment insurance contract’ is the term used in firms’ permissions to mean *pure protection contract* or *general insurance contract*. *Pure protection contract* is the term used in the *Handbook* to mean a *long-term insurance contract* which is not a *life policy*. *General insurance contract* is the term used in the *Handbook* to mean *contract of insurance within column 1 of Table 2*.

Note 5D:

~~*General insurance contract* is the term used in the *Handbook* to mean *contract of insurance within column 1 of Table 2*. [deleted]~~

Note 5E:

For the purposes of the *permission* regime, the activity in ~~(pe)~~(pf)(ii) of *advising on pension transfers and pension opt-outs* is carried on in respect of the following *specified investments*:

- *life policy* (explained in note 5A); and
- *rights to or interests in investments* in so far as they relate to a *life policy*.

...

PERG 2 Annex 2G, 5 Table ‘Table 3: Securities, contractually based investments and relevant investments [see notes 1 and 2 to Table 3]’

Security (article 3(1))

Contractually based
investment (article 3(1))

Relevant investments (article
3(1))

...

...

...

non-investment insurance contract [see note 5C to

Table 1]

pure protection contract [see
note 5C to Table 1]

general insurance contract
[see note 5D to Table 1]

CAPITAL RESOURCES FOR SMALL FIRMS INSTRUMENT 2006

Powers exercised

- A. The Financial Services Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):
- (1) section 138 (General rule-making power);
 - (2) section 156 (General supplementary powers);
 - (3) section 157(1) (Guidance); and
 - (4) section 340 (Appointment of auditors and actuaries).
- B. The rule-making powers listed above are specified for the purpose of section 153(2) (Rule-making instruments) of the Act.

Commencement

- C. Annexes A to C to this instrument come into force on 6 October 2006.
- D. Annex D to this instrument comes into force on 1 January 2007.

Amendments to the Handbook

- E. The Integrated Prudential sourcebook (PRU) is amended in accordance with Annex A to this instrument.
- F. The Interim Prudential sourcebook for Investment Businesses (IPRU(INV)) is amended in accordance with Annex B to this instrument.
- G. The Supervision manual (SUP) is amended in accordance with Annexes C and D to this instrument.

Citation

- H. This instrument may be cited as the Capital Resources for Small Firms Instrument 2006.

By order of the Board
27 July 2006

Annex A

Amendments to the Integrated Prudential sourcebook (PRU)

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

...

9.3.52 R Table: Items which are eligible to contribute to the capital resources of a firm

Item	Additional explanation
1. ...	
...	
3. Reserves (Notes 1 and 2)	...
4. Interim net profits (Notes 1 and 2)	...
...	
6. General/ collective provisions (<u>Note 1</u>)	These are provisions that a <i>firm</i> carrying on <i>mortgage lending</i> or <i>mortgage administration</i> holds against potential losses that have not yet been identified but which experience indicates are present in the <i>firm's</i> portfolio of assets. Such provisions must be freely available to meet these unidentified losses wherever they arise. <u>Subject to Note 1, G</u> general/collective provisions must be verified by external auditors and disclosed in the <i>firm's</i> annual report and accounts.
...	
Notes	
1	In general, small <i>insurance intermediaries</i> which only carry on <i>insurance mediation activities</i> in relation to <i>non-investment insurance contracts</i> and small <i>mortgage intermediaries</i>, may be <u>Reserves must be audited and interim net profits, general and collective provisions must be verified by the <i>firm's</i> external auditor unless the <i>firm</i> is exempt from the requirement to appoint an auditor under provisions of Part VII of the Companies Act 1985 relating to the audit of accounts (section 249A (Exemptions from audit)). If so, the <i>firm</i> may include unaudited reserves and unverified interim net profits in the calculation of its capital resources.</u>
2	<i>Mortgage lenders</i> and <i>mortgage administrators</i> to which the Companies Act 1985 applies are required to appoint an auditor under that Act (section 249B (Cases where exemptions not available)). These <i>firms</i> will only be able to include audited reserves and verified interim net profits in the calculation of its capital resources.

...

Annex B

Amendments to the Interim Prudential sourcebook for Investment Businesses (IPRU(INV))

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

Chapter 3: Financial resources for Securities and Futures Firms which are not Investment Firms

...

Calculation of relevant annual expenditure

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

(a) ...

Absence of ~~audited~~ annual financial statements

3-73(3) R If a *firm* does not have ~~audited~~ *annual financial statements*, it must:

(a) where it has just commenced trading ~~or has not been authorised long enough to have submitted audited annual financial statements to the FSA (or to the FSA's predecessor)~~, base its *relevant annual expenditure* on budgeted or other accounts which it submitted to the *FSA* ~~(or to the FSA's predecessor)~~ as part of its application; or

(b) ...

...

Recent authorisation

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

...

Appendix 1 – Glossary of Terms for IPRU(INV) 3

...

annual accounting reference date

means the date as at which the ~~audited~~ *annual financial statements* are prepared as initially notified by the *firm* to the *FSA* or as subsequently notified under rule 3-31 for all other purposes and which may not be more than 55 weeks since the previous *annual accounting reference date* or, if applicable, the date on which the *firm* commenced trading;

...

audited annual financial statements means statements drawn up in accordance with Schedule 4 to the Companies Act 1985 or, where applicable, *international accounting standards* as at the *firm's annual accounting reference date* ~~together with~~ and, where required, an auditor's report thereon;

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

...

reporting statement means any one or more of the following types of report as required by the *Supervision manual*:

(a) ~~audited~~-audited *annual financial statements*;

(b) ...

...

...

Appendix 43 - Guidance Notes on the financial resources and accounting treatment of soft commission agreements

1. ...

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

3. ...

...

Chapter 5: Interim Prudential Requirements for Former IMRO Firms

...

5.2.3(4) (a) R ...

(c) The *liquid capital requirement* for an *ISD firm* whose *expenditure based requirement* consists of 6/52 of its *annual audited expenditure*, determined in accordance with Table 5.2.3(5)(a), is the greater of:

(i) one quarter of its *annual ~~audited~~ expenditure* calculated in accordance with rule 5.2.4(1); and

(ii) ...

...

Annual ~~Audited~~ Expenditure

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

...

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

...

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

...

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

PART I

METHOD OF CALCULATION

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

Financial resources	Category	Part II Para
Tier 1		
(1) Paid-up share capital (excluding preference shares)	A	2
(2) Share premium account		

(3) ~~Audited~~ Reserves

2A

(4) Non-cumulative preference shares

...

PART II

DETAILED REQUIREMENTS

1 Ratios ...

(Items 10, 11 and 15)

...

2A ~~Audited~~ Reserves ...

Note 1

A firm should keep a record ...

Note 2

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

...

7 Qualifying arrangements (Item 13) (a) ...

(b) A *firm* which is not an *ISD firm* may only include *qualifying undertakings* in its calculation of *liquid capital* if:

(i) it maintains *liquid capital* equivalent to 6/52 of its *annual ~~audited~~ expenditure* in a form other than *qualifying undertakings*; and

(ii) ...

...

8 Net trading book profits (Item 14)	<p>...</p> <p>Note</p> <p><i>Non-trading book</i> interim profits may only be included in Tier 1 of the calculation if they have been independently verified by the <i>firm's</i> external auditors, <u>unless the <i>firm</i> is exempt from the provisions of Part VII of the Companies Act 1985 relating to the audit of accounts (section 249A (Exemptions from audit)).</u></p> <p>...</p> <p>A <i>firm</i> wishing to include interim profits in Tier 1 capital in a <i>financial return</i> should submit to the <i>FSA</i> with the <i>financial return</i> a verification report signed by its external auditor which states whether the interim results are fairly stated, <u>unless the <i>firm</i> is exempt from the provisions of Part VII of the Companies Act 1985 relating to the audit of accounts (section 249A (Exemptions from audit)).</u></p> <p>Profits on the sale of capital items or arising from other activities which are not directly related to the <i>investment business</i> of the <i>firm</i> may also be included within the calculation of <i>liquid capital</i>, <u>but (unless the <i>firm</i> is exempt as above) only</u> if they can be separately verified by the <i>firm's</i> auditors. In such a case, such profits can form part of the <i>firm's</i> Tier 1 capital as audited profits.</p>
-----------------------------------------	----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------

...

<p>Table 5.2.3(5)(a) EXPENDITURE BASED REQUIREMENT</p> <p>PART I</p> <p>CALCULATION OF REQUIREMENT</p> <p><i>A firm's expenditure based requirement</i> is a fraction of its annual audited <i>annual expenditure</i> determined in accordance with Part II of this Table.</p> <p>PART II</p> <p>FRACTIONS</p> <p>...</p>	
--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------	--

...

- 5.7.1(5) R If the *firm* notifies the *FSA* under *rule 5.7.1(4)* that it will not apply the rules in this section, it must:
- (a) ...
 - (d) make a note in its ~~audited~~ financial statements that it is not subject to regulatory consolidated capital requirements.

...

Appendix 1 (Interpretation)

Glossary of Terms for Chapter 5 (Former IMRO Firms)

...

annual audited expenditure has the meaning given in rule 5.2.4(1) (Determination).

...

qualifying capital item means that part of a *firm's* capital which has the following characteristics:

- (a) ...
- (c) its amount is determined by the management of the *firm* and verified by independent auditors (unless the *firm* is exempt from the provisions of Part VII of the Companies Act 1985 relating to the audit of accounts (section 249A (Exemptions from audit))), and is made known to, and is monitored by, *FSA*.

...

Chapter 13: Financial Resources Requirements for Personal Investment Firms

...

Calculation

13.10.2 R A *Category B firm's own funds* must be calculated in accordance with table 13.10(2).

Table 13.10(2)

This table forms part of *rule* 13.10.2

OWN FUNDS	
Companies	Sole Traders: Partnerships
Paid-up <i>share</i> capital (excluding preference <i>shares</i> redeemable by shareholders within 2 years)	...
<i>Share</i> premium account	
Audited <u>Retained</u> profits (see 13.10.2AR) and verified interim net profits (<u>Note 1</u>)	
...	
<u>Note 1</u>	
<u>Retained profits must be audited and interim net profits must be verified</u>	

by the *firm's* external auditor, unless the *firm* is exempt from the provisions of Part VII of the Companies Act 1985 relating to the audit of accounts (section 249A (Exemptions from audit)).

13.10.2A R For the purpose of calculating a *Category B firm's own funds*, the following adjustments apply to ~~audited~~ retained profits or, (for non-corporate entities), current accounts figures:

(1) ...

...

...

Annex C

Amendments to the Supervision manual (SUP)

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

...

3.1.1A G For the avoidance of doubt, this chapter does not apply to the following firms if they do not hold client money or client assets and do not appoint an auditor under or as a result of a statutory provision other than in the Act:

- (1) authorised professional firms;
- (2) energy market participants, including oil market participants, to whom IPRU(INV) 3 does not apply;
- (3) exempt insurance intermediaries;
- (4) insurance intermediaries not subject to SUP 3.1.2R(10);
- (5) investment management firms;
- (6) mortgage administrators;
- (7) mortgage intermediaries;
- (8) mortgage lenders;
- (9) personal investment firms, including small personal investment firms;
- (10) securities and futures firms; and
- (11) service companies.

3.1.2 R Applicable sections (see SUP 3.1.1R)

(1) Category of firm	(2) Sections applicable to the firm	(3) Sections applicable to its auditor
(1) <u>Authorised professional firm</u> which is required by IPRU(INV) 2.1.2R to comply with chapters 3, 5, 10 or 13 of IPRU(INV) <u>and which has an auditor appointed under or as a result of a statutory provision other than in the Act</u> (Note 1)	SUP 3.1 – SUP 3.7	SUP 3.1, SUP 3.2, SUP 3.8 – SUP 3.10
...		
(7) <u>Investment management firm, personal investment firm</u> (other than a <u>small personal investment firm</u>), UCITS management company, or <u>securities and futures firm</u> (Note 3) <u>which, in each case, has an auditor</u>	SUP 3.1 – SUP 3.7	SUP 3.1, SUP 3.2, SUP 3.8 – SUP 3.10

	<u>appointed under or as a result of a statutory provision other than in the Act</u>		
(7A)	<u>Investment management firm, personal investment firm (other than a small personal investment firm), or securities and futures firm not within (7) to which either or both of CASS 2 (Client assets) and CASS 4 (Client money and mandates: designated investment business) applies</u>	<u>SUP 3.1 – SUP 3.7</u>	<u>SUP 3.1, SUP 3.2, SUP 3.8, SUP 3.10</u>
(7B)	<u>UCITS management company</u>	<u>SUP 3.1 – SUP 3.7</u>	<u>SUP 3.1, SUP 3.2, SUP 3.8 – SUP 3.10</u>
...			
(9)	<u>Mortgage lender which has an auditor appointed under or as a result of a statutory provision other than in the Act</u>	<u>SUP 3.1 – SUP 3.7</u>	<u>SUP 3.1, SUP 3.2, SUP 3.8</u>
...			

...

Limited application for certain types of firm and their auditors

3.2.4 G ~~SUP 3.1.1.R and SUP 3.1.2R~~ limit the application of this chapter in relation to:

- (1) ~~authorised professional firms to which COB 9.1 (Custody) and COB 9.3 (Client money) do not apply or which are not required by IPRU(INV);~~
- (2) ~~oil market participants, and energy market participants, to whom IPRU(INV) 3 does not apply;~~
- (3) ~~small personal investment firms;~~
- (4) ~~service companies;~~
- (5) ~~exempt insurance intermediaries;~~
- (6) ~~insurance intermediaries not subject to SUP 3.1.2R(!0)~~
- (7) ~~mortgage intermediaries; and~~
- (8) ~~mortgage administrators.~~

Such ~~firms~~ are not required, under this chapter, to appoint an auditor because ~~SUP 3.3 (Appointment of auditors) does not apply~~. If such ~~firms~~ appoint an

auditor under or as a result of a statutory provision other than in the Act, for example, under the Companies Act 1985, SUP 3.7 (Notification of matters raised by auditor) and SUP 3.8 (Rights and duties of all auditors) nevertheless apply to help the FSA discharge its functions under the Act. See SUP 3.1.2R, Note 4, for further clarification concerning *insurance intermediaries* and those which qualify as *exempt insurance intermediaries*. [deleted]

Insurance intermediaries and their auditors

- 3.2.5 G It is the responsibility of an *insurance intermediary's* senior management to determine, on a continuing basis, whether the *insurance intermediary* is an *exempt insurance intermediary* for the purposes of this requirement and to appoint an auditor if management determines the *firm* is no longer exempt. SUP 3.7 (amplified by SUP 15) sets out what a *firm* should consider when deciding whether it should notify the FSA of matters raised by its auditor.

...

- 16.7.21 R Financial reports required from *service companies* (see SUP 16.7.20R)

Report	Frequency	Due Date
Annual audited financial statements (Note 1)	Annually	6 months after the <i>firm's accounting reference date</i>
<u>Note 1 = A <i>firm</i> need only submit this report to the FSA if the report was audited as a result of a statutory provision other than the Act.</u>		

...

- 16.7.25 R Financial reports required from a *securities and futures firm* which is category A or B firm or a broad scope firm (see SUP 16.7.24R)

Report	Frequency	Due Date
...		
Audited annual financial statements (Note 5A)	Annually	3 months after the <i>firm's accounting reference date</i>
...		
Audited accounts of any <i>subsidiary</i> unless the <i>rules</i> in this chapter require that <i>subsidiary</i> to submit accounts to the FSA (Note 5A)	Annually	3 months after the <i>firm's accounting reference date</i>
...		
<u>Note 5A = A <i>firm</i> need only submit this report to the FSA if the report was audited as a result of a statutory provision other than the Act.</u>		

...

16.7.27 R Financial reports from a *securities and futures firm* which is category C or D firm or an arranger or venture capital firm (see SUP 16.7.26R)

Report	Frequency	Due Date
...		
Audited annual financial statements (<u>Note 5A</u>)	Annually	3 months after the <i>firm's accounting reference date</i>
...		
Audited accounts of any <i>subsidiary</i> unless the <i>rules</i> in this chapter require that <i>subsidiary</i> to submit accounts to the <i>FSA</i> (<u>Note 5A</u>)	Annually	3 months after the <i>firm's accounting reference date</i>
...		
<u>Note 5A = A firm need only submit this report to the FSA if the report was audited as a result of a statutory provision other than the Act.</u>		

...

16.7.29 R Financial reports from a *securities and futures firm* which is an adviser, local or a traded options market maker (see SUP 16.7.28R)

Report	Frequency	Due Date
...		
Audited annual financial statements (<i>partnerships and bodies corporate</i> only) (<u>Note 1</u>)	Annually	3 months after the <i>firm's accounting reference date</i>
Audited accounts of any <i>subsidiary</i> unless the <i>rules</i> in this chapter require that <i>subsidiary</i> to submit accounts to the <i>FSA</i> (<u>Note 1</u>)	Annually	3 months after the <i>firm's accounting reference date</i>
<u>Note 1 = A firm need only submit this report to the FSA if the report was audited as a result of a statutory provision other than the Act.</u>		

...

16.7.77 R Reports from a *firm* not subject to other reporting requirements in SUP 16.7.1G - SUP 16.7.75R

Report	Return (Note 1)	Frequency	Due Date
...			
If the <i>firm</i> is a <i>mortgage</i>			

<i>lender or mortgage administrator, annual report and audited accounts (Note 10).</i>			
...			
Audited consolidated statutory accounts (Notes 9 and 10)			
...			
<u>Note 10 = A firm need only submit this report to the FSA if the report was audited as a result of a statutory provision other than the Act.</u>			

...

SUP 16 Annex SUP 16 Ann 5R: Investment management firms' reporting forms and requirements applying to their completion

...

Annual Financial Return

...

Financial Resources

...

TIER 1

Paid up share capital (excluding preference shares) (*Item 1*) (36)

Share premium account (*Item 2*) (37)

~~Audited~~ Reserves (*Item 3*) (38)

...

~~Audited~~ Expenditure

Annual ~~Audited~~ Expenditure

(pro-rated where relevant to annual amount) (*IPRU(INV) 5.2.4(1)(b)R*)

(audited unless the firm is exempt from the requirement to audit accounts) (*IPRU(INV) 5.2.4(3)R*)

Expenditure Based Requirement

(6/52* or 13/52* of Annual ~~Audited~~ Expenditure)

...

Note: The Expenditure Based Requirement calculated above becomes effective from the date on which this Annual Financial Return is approved by the auditor. At all times throughout the period from this date until the next Annual Financial Return is approved, the Firm's Financial Resources must satisfy its Financial Resources Requirement incorporating the above Requirement. If the Firm is not required to have an auditor, then the Expenditure Based Requirement becomes effective when approved by the management of the Firm.

...

Declaration

...

It is accompanied by the Annual Accounts and, if required by the rules, the report of the auditor to the FSA ~~as required by the rules~~.

...

Quarterly Financial Return

...

Financial Resources

...

TIER 1

Paid up share capital (excluding preference shares) (*Item 1*) (36)

Share premium account (*Item 2*) (37)

~~Audited~~ Reserves (*Item 3*) (38)

...

Monthly Financial Return

...

Financial Resources

...

TIER 1

Paid up share capital (excluding preference shares) (*Item 1*) (36)

Share premium account (*Item 2*) (37)

~~Audited~~ Reserves (*Item 3*) (38)

...

Consolidated Financial Resources Return for Investment Management Firms

Part 1: Group Financial Resources:

...

~~Audited~~ Consolidated reserves

...

SUP 16 Annex 10R: Securities and Futures Firms' Reporting Forms and Requirements Applying to their Completion

...

Section 6: Securities and Futures Firms: Form and content of report

...

3 Table ~~Audited~~ Annual Financial Statements

1.1.2 A firm's ~~audited~~ annual financial statements must be drawn up in accordance with Schedule 4 of the Companies Act 1985 as at the firm's accounting reference date.

...

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

...

Section 3

Guidance Notes: standard reporting statement for Securities and Futures Firms which are not ISD firms

...

SUP 16 Ann 10R Accounting policies

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

...

SUP 16 Annex 18 AR: Retail Mediation Activities Return ('RMAR')

...

Section D2: Financial Resources - Non-ISD Personal Investment Firms

Own Funds (Test 1)

1. ...

3. ~~Audited~~ Retained profits

4. ~~Verified interim~~ Interim profits

...

...

...
RR0255
RR0256
...

SUP 16 Annex 18 BG: Notes for Completion of the Retail Mediation Activities Return ('RMAR')

...

Section D2: non-ISD personal investment firms

...

Expenditure Based Requirement (test 2)

This is a capital requirement for *personal investment firms* that are not *low resource firms*, based on a *firm's* overall audited expenditure. The Expenditure Based Requirement is calculated as a fraction of the *firm's* annual fixed costs which, for this purpose, are based upon the *firm's* annual ~~audited~~ expenditure and, in general terms, exclude cost items that would not be incurred were there no income. Thus staff bonuses and *partners'* profit shares (unless guaranteed) and any shared commissions are not treated as fixed costs for the purposes of the calculation.

...

SUP 16 Annex 19 BG: Notes for Completion of the Mortgage Lending & Administration Return ('MLAR')

...

C1-2 CAPITAL RESOURCES

...

(3) ~~Audited~~ Reserves

~~Audited~~ Reserves are ~~audited~~ accumulated profits retained by the *firm* (after deduction of tax, dividends and proprietors' or *partners'* drawings) and other reserves created by appropriations of *share* premiums and similar realised appropriations. Reserves also include gifts of capital, for example, from a parent company. For *partnerships*, ~~audited~~ reserves include *partners'* current accounts according to the most recent financial statement. Reserves must be audited unless the *firm* is eligible to include unaudited reserves in its capital resources calculation under PRU 9.3.52R.

The ~~audited~~ reserves figure is subject to the following adjustments, where appropriate:

(a) ...

...

(4) Interim net profits and partners' interim current accounts

A *firm* is not required to take into account interim net profits. However, if it does, the profits have to be verified by the *firm's* external auditors, net of tax, anticipated dividends or proprietors' drawings and other appropriations unless the *firm* is eligible to include unverified interim net profits in its capital resources calculation under PRU 9.3.52R.

...

(6) General /collective provisions

Firms should report general/collective provisions that are held against potential losses that have not yet been identified, but which experience indicates are present in the *firm's* portfolio of assets. Such provisions must be freely available to meet these unidentified losses wherever they arise. General/collective provisions must be verified by external auditors and disclosed in the *firm's* annual report and accounts unless the *firm* is eligible to include unaudited general and collective provisions in its capital resources calculation under PRU 9.3.52R.

...

Treatment of eligible capital items (listed above) in section C1:

C1.1 Reserves: include items

- ~~audited~~ reserves
- revaluation reserves

C1.2 Interim profits: include items

- ~~externally verified~~ interim net profits
- ~~externally verified~~ *partners'* interim current accounts

...

C5 Capital requirements

...

C5.2 Total income

Firms should report the amount of total income in their most recent ~~audited~~ (or other) financial statements, and an estimate of income for the current reporting year.

...

Annex D

Amendment to the Supervision manual (SUP)

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

16.7.29 R Reports from a securities and futures firm which is an adviser, local or traded options market maker (see SUP 16.7.28R)

Report	Return	Frequency	Due date
...			
Adequate information relating to the following activities: (1) <i>insurance mediation activity</i> ; (2) <i>mortgage mediation activity</i> ; (3) <i>retail investment activity</i> .	<i>RMAR</i> (excluding sections A, B, C, D <u>and</u> E) (Note † <u>2</u>)	Half yearly	For half yearly report: 30 <i>business days</i> after period end
Adequate information relating to <i>mortgage lending</i> and <i>mortgage administration</i> .	<i>MLAR</i> (excluding A1, A2 and B1) (Note † <u>2</u>)	Quarterly	20 <i>business days</i> after quarter end

Note † 2 = When giving the report required, a *firm* must use the return indicated. The *RMAR* and *MLAR* are located at SUP 16 Ann 18AR and Ann 19AR respectively and have the status of *rules*.

**NEW COLLECTIVE INVESTMENT SCHEMES SOURCEBOOK
(ACCOUNTING REFERENCE PERIODS AND OTHER AMENDMENTS)
INSTRUMENT 2006**

Powers exercised

- A. The Financial Services Authority makes this instrument in the exercise of the powers and related provisions in or under:
- (1) the following sections of the Financial Services and Markets Act 2000 (“the Act”):
 - (a) section 138 (General rule-making power);
 - (b) section 140 (Restriction on managers of authorised unit trust schemes);
 - (c) section 156 (General supplementary powers);
 - (d) section 157(1) (Guidance);
 - (e) section 238(5) (Restrictions on promotion);
 - (f) section 242 (Applications for authorisation of unit trust schemes);
 - (g) section 247 (Trust scheme rules); and
 - (h) section 248 (Scheme particulars rules); and
 - (2) regulation 6 (FSA rules) of the Open-Ended Investment Companies Regulations 2001 (SI 2001/1228).
- B. The rule-making powers and related provisions listed above are specified for the purpose of section 153(2) (Rule-making instruments) of the Act.

Commencement

- C. This instrument comes into force on 6 August 2006.

Amendments to the Handbook

- D. The Glossary of definitions is amended in accordance with Annex A to this instrument.
- E. The New Collective Investment Schemes sourcebook (COLL) is amended in accordance with Annex B to this instrument.

Citation

- F. This instrument may be cited as the New Collective Investment Schemes Sourcebook (Accounting Reference Periods and Other Amendments) Instrument 2006.

By order of the Board
27 July 2006

Annex A

Amendments to the Glossary of definitions

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

Amend the following definitions as shown:

...

*accounting
reference date* ...

(2) (in *COLL* and *CIS*): the date stipulated in the *prospectus* on which the *annual accounting period* of an *authorised fund* ends.

...

*annual
accounting
period* ...

(2) (in *COLL*): the ~~12-month~~ period determined in accordance with *COLL* 6.8.2R(3) to (7) (*Accounting periods*) stipulated in the *prospectus* which ends on the ~~accounting reference date~~.

...

*UCITS
Directive*

the Council Directive of 20 December 1985 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) (No 85/611/EEC), as amended by Directives 88/220/EEC, 95/26/EC, 2000/64/EC, 2001/107/EC, 2001/108/EC ;

Annex B

Amendments to the New Collective Investment Schemes sourcebook

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

...

Preparation of long and short reports

4.5.3 R ...

- (4) ~~The first annual accounting period of a scheme must begin:~~
- (a) ~~on the first day of any period of initial offer; or~~
 - (b) ~~in any other case, on the date of the relevant authorisation order.~~ [deleted]

...

Spread: government and public securities

5.6.8 R ...

- (2) The requirements in COLL 5.2.12R (Spread: government and public securities) apply to investment in *government and public securities* by a *non-UCITS retail scheme*, except for COLL 5.2.12R(4) which will apply to such a scheme only to the extent that it concerns the most recently published prospectus of the scheme.

...

Prohibition on promotional payments

- 6.7.12 R (1) No payment may be made from *scheme property* to any person ...
- (2) Paragraph (1) shall not apply to the costs of preparing and printing the simplified prospectus or key features of the authorised fund, provided the prospectus states in accordance with COLL 4.2.5R(13) and (14) (Table: contents of the prospectus) that these costs are properly payable to the authorised fund manager from scheme property.

Prohibition on promotional payments: guidance

6.7.13 G Examples of payments which are not permitted by COLL 6.7.12R include:

...

- (2) payments or costs in relation to the preparation or dissemination of *financial promotions* (other than ~~the preparation of key features or the simplified prospectus~~ costs allowed under COLL 6.7.12R(2)); and

...

...

Accounting periods

6.8.2 R ...

- (2) A half-yearly accounting period begins with the first day of an annual accounting period and ends on:

(a) the day which is six months later before the last day of that annual accounting period; or

(b) ~~ends on~~ some other reasonable date as set out in the *prospectus* of the *scheme*.

- (3) The first annual accounting period of a scheme must begin:

(a) on the first day of any period of initial offer; or

(b) in any other case, on the date of the relevant authorisation order;

and in either case must end on the next accounting reference date, except where (4) applies.

- (4) When the accounting reference date of a scheme falls less than six months after the beginning of the first annual accounting period, that period may be extended until the subsequent accounting reference date.

- (5) Each annual accounting period of a scheme subsequent to the first period is to run for a period of 12 months, beginning on the next day after the accounting reference date, except where (6) applies.

- (6) Following a revision to the prospectus of the scheme that includes a change to the accounting reference date, the annual accounting period may be shortened, or extended by up to six months, so as to end on the new accounting reference date.

- (7) The authorised fund manager must consult the depositary and the

scheme's auditor before shortening or extending an accounting period in accordance with (4) or (6).

6.8.2A G When the annual accounting period of a scheme is extended under COLL 6.8.2R(4) or (6), resulting in a longer than usual period before the publication of reports to unitholders, the authorised fund manager should make summary information about the investment activities of the scheme available to unitholders during that period, in accordance with Principles 6 (Customers' interests) and 7 (Communications with clients).

...

Report and accounts

8.3.5 R ...

- (2) ~~The first annual accounting period must begin:~~
- (a) ~~on the first day of any period of initial offer; or~~
 - (b) ~~in any other case, on the date of the relevant authorisation order. [deleted]~~

...

Income

8.5.15 R ...

(1A) COLL 6.8.2R (2) to (7) (Accounting periods) also apply to the half-yearly accounting period and annual accounting period of a qualified investor scheme.

...

COLL Sourcebook – Transitional Provisions

(1)	(2)	(3)	(4)	(5)	(6)
	Material to which the transitional provision applies		Transitional provision	Transitional provision: dates in force	Handbook provision: coming into force
...					
1A	Each and every rule in <u>COLL</u>	R	<u>The rules in COLL do not apply to any relevant party in relation to an authorised fund where the winding up</u>	<u>From 12 February 2007</u>	<u>12 February 2007</u>

			<u>of the fund has commenced before 12 February 2007, provided that each relevant party shall continue to comply with the provisions of CIS as if they still applied to them.</u>		
--	--	--	-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------	--	--

KEYFACTS LOGO INSTRUMENT 2006

Powers exercised

- A. The Financial Services Authority makes this instrument in the exercise of the powers and related provisions in the following sections of the Financial Services and Markets Act 2000 (“the Act”):
- (1) section 138 (General rule-making powers);
 - (2) section 156 (General supplementary powers); and
 - (3) section 157(1) (Guidance); and
- B. The rule-making powers listed above are specified for the purpose of section 153(2) (Rule-making instruments) of the Act.

Commencement

- C. This instrument comes into force on 6 November 2006.

Amendments to the Handbook

- D. The modules of the FSA’s Handbook of rules and guidance listed in column (1) below are amended in accordance with the Annexes to this instrument listed in column (2).

General amendment to Handbook forms	Annex A
General Provisions (GEN)	Annex B
Conduct of Business sourcebook (COB)	Annex C
Insurance: Conduct of Business sourcebook (ICOB)	Annex D
Mortgages: Conduct of Business sourcebook (MCOB)	Annex E

Citation



- E. This instrument may be cited as the Keyfacts Logo Instrument 2006.

By order of the Board
28 September 2006

Annex A

General amendment to Handbook forms

All instances in the Handbook of the keyfacts logo in column (1) of the table below are replaced with the keyfacts logo and regulatory mark in column (2) of the table.

(1)	(2)
 The logo consists of the word "keyfacts" in a white, lowercase, sans-serif font, centered within a black speech bubble shape that points downwards and to the right.	 The logo is identical to the one in column (1), but includes a small registered trademark symbol (®) to the upper right of the word "keyfacts".

Annex B

Amendments to the General Provisions sourcebook

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

...

GEN 5 The FSA logo and the keyfacts logo

...

Purpose

5.1.2 G The FSA logo is a registered UK service mark, with number 2150560. The keyfacts logo is a registered Community trade mark, with the number 386688. ~~and is~~ Both are the property of the FSA. ~~It is~~ They are also subject to copyright and may be used or reproduced with permission of the FSA only. If the FSA or keyfacts logos are ~~is~~ reproduced or otherwise used by any person without such permission the FSA may seek to enforce its rights over its property through the Courts.

5.1.3 G *GEN 5 Annex 1 is a general licence, which sets out the circumstances in which the FSA permits firms and their appointed representatives to reproduce the FSA and keyfacts logos. A firm or an appointed representative need not apply for an individual licence if it uses or reproduces the ~~FSA logos~~ in accordance with the general licence.*

5.1.4 G The FSA has no policy to allow use of the ~~FSA logos~~ by a firm or appointed representative other than as set out in GEN 5 Annex 1. If, however, a firm or appointed representative wishes to use or reproduce either of the FSA logos other than in accordance with the general licence, it may apply to the FSA for an individual licence, giving full reasons why it considers the FSA should grant the licence.

...

The keyfacts logo

5.1.5 R A firm must not use the keyfacts logo other than as and when it is required or permitted to be used by the rules, and in accordance with the general licence in GEN 5 Annex 1G.

...

Annex 1 G Licence for use of the FSA and keyfacts logos by authorised firms and

appointed representatives

Application

- 1.1 The *FSA* grants this licence to *firms* and *appointed representatives*.

The FSA and keyfacts logos

- 2.1 The FSA logo is made up of two elements which together make up the registered UK service mark, with number 2150560:

...

- 2.2 ~~Together, these elements make up the registered UK service mark, with number 2150560.~~ The keyfacts logo is made up of two elements which together make up the registered Community trade mark, with number 3866688:

(1) the symbol (the rectangular speech bubble); and

(2) the word 'keyfacts'.

- 2.3 There are two versions of the FSA logo, version A and a smaller version B in which the scroll has been simplified. There are two versions of the keyfacts logo, a low resolution version and a high resolution version.

- 2.4 Copyright subsists in the FSA and keyfacts logos.

- 2.5 Copies of the FSA and keyfacts logos that are capable of being reproduced for printing can be found on the *FSA's* website at ~~http://www.fsa.gov.uk/pubs/other/copies_of_the_fsa_logo/index.html~~ http://www.fsa.gov.uk/Pages/Library/Other_publications/Logos_and_Photos/index.shtml.

Permission to use the FSA logo

...

Permission to use the keyfacts logo

- 3A.1 A firm and its appointed representatives are permitted to use the keyfacts logo as and when it is required or permitted to be used by the rules.

3A.2 The following are examples of places where the *rules* require or permit the keyfacts logo to be used:

(1) In *COB*:

- (a) in an initial disclosure document or combined initial disclosure document (*COB* 4.3.9R); and
- (b) in a fees and commission statement (*COB* 4.3.11R).

(2) In *ICOB*:

- (a) in an initial disclosure document or combined initial disclosure document (*ICOB* 4.2.4G to *ICOB* 4.2.7R);
- (b) in a *policy summary* (*ICOB* 5.5.5R); and
- (c) in a *key features* as an alternative to a *policy summary* (*ICOB* 5.5.4R).

(3) In *MCOB*:

- (a) in an initial disclosure document or combined initial disclosure document (*MCOB* 4.4.1R, *MCOB* 4.4.7R, *MCOB* 8.3.1R and *MCOB* 8.4.1R); and
- (b) in an *illustration* (*MCOB* 5.6.2R and *MCOB* 9.4.2R).

Conditions on appearance of the FSA logo

...

Conditions on appearance of the keyfacts logo

4A.1 The permission in paragraph 3A.1 is subject to the following conditions:

- (1) the regulatory mark (®) is attached to the keyfacts logo;
- (2) the keyfacts logo and regulatory mark appear:
 - (a) in black type;

- (b) reversed out white on a coloured background; or
- (c) in colour provided that this does not diminish their prominence;
- (3) the two elements of the keyfacts logo appear together in the same way, and in the same proportion, as in the Community trade mark;
- (4) the keyfacts logo is not redrawn in any way, or matched by a typesetter;
- (5) the low resolution version of the keyfacts logo is used only in documents intended to be read on a computer, television or other screen; and
- (6) if the keyfacts logo is reproduced electronically, no hyperlink is incorporated.

Further conditions on the use of the FSA and keyfacts logos

5.1 The permissions in paragraphs 3.1 and 3A.1 are ~~is~~ also subject to the conditions that any material, whether produced on paper or electronically, on which the FSA or keyfacts logos are ~~is~~ displayed does not:

- (1) in any way imply that the *FSA* is endorsing the *firm* or its *appointed representatives* or products, services or communications (see also *GEN* 1.2.2R(1)); or
- (2) misrepresent the *firm's* or its *appointed representative's* relationship with the *FSA* or present false information about the *FSA*; or
- (3) contain content that could be construed as distasteful, offensive or controversial; or
- (4) infringe any intellectual property or other rights of any *person* or otherwise not comply with any relevant law or regulation.

Commencement and duration

7.1 This licence comes into effect on 1 May 2003 except that in relation to the keyfacts logo it comes into effect on 6 November 2006.

7.2 The *FSA* may alter or revoke this licence at any time, by giving at least two months' notice on the *FSA's* website.

Interpretation

8.1 This licence is to be interpreted in accordance with chapter 2 of the General provisions (Interpreting the Handbook) of the *FSA's* Handbook of Rules and Guidance. In particular, expressions in italics are defined in the Handbook Glossary.

Governing law and jurisdiction

9.1 This licence is governed by and interpreted in line with English law. The courts of any jurisdiction in the United Kingdom have the exclusive jurisdiction to settle any dispute in connection with this licence.

...

GEN TP 1 Transitional provisions

...

(3) Transitional Provisions applying to GEN only

(1)	(2)	(3)	(4)	(5)	(6)
	Material to which the transitional provision applies		Transitional provision	Transitional provision: dates in force	Handbook provision: coming into force
...
<u>9</u>	<u>GEN 5 Ann 1G</u>	<u>G</u>	<u>A firm may continue to use a keyfacts logo which is not accompanied by a regulatory mark (®).</u>	<u>From 6 November 2006 to 6 November 2007</u>	<u>6 November 2006</u>

Annex C

Amendments to the Conduct of Business sourcebook

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

...

4.3.10 G ~~Firms can obtain from the FSA website <http://www.fsa.gov.uk> a specimen of the initial disclosure document.~~ Further requirements regarding the use of the logo and the location of specimens are set out in GEN 5.1 and GEN 5 Annex 1G. ...

...

COB 4 Annex 4R: Initial disclosure document required by COB 4.3.9R(1) ("IDD")

...

Note 2 – ... Further requirements regarding the use of the keyfacts logo are set out in GEN 5.1 and GEN 5 Annex 1G. ~~A specimen of the keyfacts logo can be obtained from the FSA website http://www.fsa.gov.uk/pubs/other/keyfacts_logo.~~

...

COB 4 Annex 5R: Combined initial disclosure document required by COB 4.3.9R(2) ("CIDD")

...

Note 2 – ... Further requirements regarding the use of the keyfacts logo are set out in GEN 5.1 and GEN 5 Annex 1G. ~~A specimen of the keyfacts logo can be obtained from the FSA website http://www.fsa.gov.uk/pubs/other/keyfacts_logo.~~

...

COB TP 4 Miscellaneous transitional provisions applying to all firms

TP 4.4

(1)	(2)	(3)	(4)	(5)	(6)
	Material to which the transitional provision applies		Transitional provision	Transitional provision: dates in force	Handbook provision: coming into force
...
<u>18</u>	<u>COB 4 Annex 4R, COB 4 Annex 5R and COB 4</u>	<u>R</u>	<u>Key facts logo</u> <u>A firm may continue to use a keyfacts logo</u>	<u>From 6 November 2006 to 6</u>	<u>6 November 2006</u>

	<u>Annex 6R</u>		<u>which is not accompanied by a regulatory mark (®).</u>	<u>November 2007</u>	
--	-----------------	--	-----------------------------------------------------------	----------------------	--

Annex D

Amendments to the Insurance: Conduct of Business sourcebook

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

...

'Key facts' logo

2.2.2 R ~~A firm must not use the key facts logo unless it is required by a rule.~~[deleted]

...

Clear, fair and not misleading: comparisons ~~and restrictions on the use of the~~ key facts logo

3.8.1 R ...

(3) ~~A non-investment financial promotion must not contain the key facts logo unless it is required by a rule.~~[deleted]

...

5.5.11 R ... The logo may be a different size from that in *ICOB* 4 Annex 1 ~~but its proportions must not be distorted.~~

5.5.12 G The *FSA* has developed a common 'key facts' keyfacts logo to be used on significant pieces of information directed to *customers*. Further requirements regarding the use of the logo and the location of specimens are set out in *GEN* 5.1 and *GEN* 5 Annex 1G. ~~When reproducing the logo, insurers and insurance intermediaries may use colour, providing this does not diminish the prominence of the logo. A specimen of the 'key facts' logo can be obtained from the *FSA* website:~~
http://www.fsa.gov.uk/pubs/other/keyfacts_logo.

...

ICOB 4 Annex 1G: Initial disclosure document ("IDD")

...

Note 2 – ... *ICOB* 4.2.6R sets out requirements on the use of the ~~key facts~~ keyfacts logo. Further requirements are set out in *GEN* 5.1 and *GEN* 5 Annex 1G. ~~A specimen of the key facts~~keyfacts logo can be obtained from the *FSA* website
http://www.fsa.gov.uk/pubs/other/keyfacts_logo.

...

ICOB 4 Annex 2R: Combined initial disclosure document ("CIDD")

...

Note 2 – ... Further requirements regarding the use of the keyfacts logo are set out in *GEN 5.1* and *GEN 5 Annex 1G*. ~~A specimen of the keyfacts logo can be obtained from the FSA website http://www.fsa.gov.uk/pubs/other/keyfacts_logo.~~

...

ICOB TP 1 Transitional provisions

TP 1.1

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
...
<u>11</u>	<u>ICOB 4 Annex 1G and ICOB 4 Annex 2R</u>	<u>G</u>	<u>Key facts logo</u> <u>A firm may continue to use a keyfacts logo which is not accompanied by a regulatory mark (®).</u>	<u>From 6 November 2006 to 6 November 2007</u>	<u>6 November 2006</u>

Annex E

Amendments to the Mortgages: Conduct of Business sourcebook

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

...

'Key facts' logo

2.2.4 R ~~In MCOB, a firm must only use the 'key facts' logo where it is required by a rule.~~[deleted]

...

5.6.2 R An illustration provided to a customer must:

(1) ...

(2) follow the layout of the template in MCOB 5 Annex 1 with:

...

(a) prominent use of the ~~'key facts'~~ keyfacts logo followed by the text 'about this mortgage' ~~(if a firm resizes the logo it must ensure that the proportions remain consistent with the original design, so as not to distort it in any way);~~

...

...

5.6.4 G (1) ~~Firms can obtain from the FSA website <http://www.fsa.gov.uk> a specimen of the 'key facts' logo. When reproducing the logo firms may use colour providing this does not diminish the prominence of the logo. Further requirements regarding the use of the keyfacts logo and the location of specimens are set out in GEN 5.1 and GEN 5 Annex 1G.~~

...

9.4.2 R An illustration provided to a customer must:

(1) ...

(2) follow the format of the template in MCOB 9 Annex 1 with:

(a) prominent use of the ~~'key facts'~~ keyfacts logo followed by the text 'about this lifetime mortgage' ~~(if a firm resizes the logo it must ensure that the proportions remain consistent with the original design, so as not to distort it in any way);~~

...

9.4.3 G (1) ~~Firms can obtain from the FSA website <http://www.fsa.gov.uk> a specimen of the 'key facts' logo. When reproducing the logo firms may use colour providing this does not diminish the prominence of the logo. Further requirements regarding the use of the keyfacts logo and the location of specimens are set out in GEN 5.1 and GEN 5 Annex 1G.~~

...

MCOB 4 Annex 1R: Initial disclosure document ("IDD")

...

Note 2 – ... Further requirements regarding the use of the keyfacts logo are set out in GEN 5.1 and GEN 5 Annex 1G.

...

MCOB 4 Annex 2R: Combined initial disclosure document ("CIDD")

...

Note 2 – ... Further requirements regarding the use of the keyfacts logo are set out in GEN 5.1 and GEN 5 Annex 1G. A specimen of the keyfacts logo can be obtained from the FSA website http://www.fsa.gov.uk/pubs/other/keyfacts_logo.

...

MCOB 8 Annex 1R: Initial disclosure document ("IDD")

...

Note 2 – ... Further requirements regarding the use of the keyfacts logo are set out in GEN 5.1 and GEN 5 Annex 1G.

...

MCOB TP 1 Transitional provisions

MCOB TP 1.1 Transitional provisions

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
...
<u>10</u>	<u>MCOB 4 Annex 1R, MCOB 4 Annex 2R,</u>	<u>R</u>	<u>Key facts logo</u> <u>A firm may continue to</u>	<u>From 6 November 2006 to 6</u>	<u>6 November 2006</u>

	<u>MCOB 5 Annex 1R, MCOB 8 Annex 1R and MCOB 9 Annex 1R</u>		<u>use a keyfacts logo which is not accompanied by a regulatory mark (®).</u>	<u>November 2007</u>	
--	-------------------------------------------------------------	--	-------------------------------------------------------------------------------	----------------------	--

FEES PROVISIONS (REMISSION OF FEES LIMITATION) INSTRUMENT 2006

Powers exercised

- A. The Financial Services Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):
- (1) section 138 (General rule-making power);
 - (2) section 156 (General supplementary powers);
 - (3) section 157(1) (Guidance);
 - (4) section 234 (Industry funding); and
 - (5) paragraph 17(1) of Schedule 1 (Fees).
- B. The rule-making powers listed above are specified for the purpose of section 153(2) (Rule-making instruments) of the Act.

Commencement

- C. This instrument comes into force on 6 October 2006.

Amendments to the Handbook

- D. The Fees manual (FEES) is amended in accordance with the Annex to this instrument.

Citation

- E. This instrument may be cited as the Fees Provisions (Remission of Fees Limitation) Instrument 2006.

By order of the Board
28 September 2006

Annex

Amendments to the Fees manual

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

Remission of Fees

- 2.3.1 R If it appears to the *FSA*, or *FOS Ltd* (in relation to any *FOS* case fee only), that in the exceptional circumstances of a particular case, the payment of any fee or *FOS* levy would be inequitable, the *FSA* or *FOS Ltd*, as relevant, may (unless *FEES* 2.3.2BR applies) reduce or remit all or part of the fee or levy in question which would otherwise be payable.
- 2.3.2 R If it appears to the *FSA*, or *FOS Ltd* (in relation to any *FOS* case fee only), that in the exceptional circumstances of a particular case to which *FEES* 2.3.1R does not apply, the retention by the *FSA*, or *FOS Ltd*, as relevant, of a fee or *FOS* levy which has been paid would be inequitable, the *FSA*, or *FOS Ltd*, may (unless *FEES* 2.3.2BR applies) refund all or part of that fee or levy.
- 2.3.2A G A poor estimate or forecast by a fee payer, when providing information relevant to an applicable tariff base, is unlikely, of itself, to amount to an exceptional circumstance for the purposes of *FEES* 2.3.1R or 2.3.2R. By contrast, a mistake of fact or law by a fee payer may give rise to such a claim.
- 2.3.2B R The *FSA* may not consider a claim under *FEES* 2.3.1R and/or 2.3.2R to reduce, remit or refund any overpaid amounts paid by a fee payer in respect of a particular period, due to a mistake of fact or law by the fee payer, if the claim is made by the fee payer more than 2 years after the beginning of the period to which the overpayment relates.
- 2.3.3 G ~~*FEES* 2.3.1R, and *FEES* 2.3.2R~~ and *FEES* 2.3.2BR do not apply to the payment of shares of the *FSCS* levy.

FINANCIAL REINSURANCE INSTRUMENT 2006

Powers exercised

- A. The Financial Services Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):
- (1) section 138 (General rule-making power);
 - (2) section 150(2) (Actions for damages);
 - (3) section 156 (General supplementary powers);
 - (4) section 157(1) (Guidance); and
 - (5) section 340 (Appointment).
- B. The rule-making powers listed above are specified for the purpose of section 153(2) (Rule-making instruments) of the Act.

Commencement

- C. This instrument comes into force on 6 October 2006 and:
- (1) Annex B applies to insurers in relation to their respective financial years ending on and after 31 December 2006; and
 - (2) Annex C applies to the Society of Lloyd's and managing agents in relation to financial years ending on and after 31 December 2006.

Amendments to the Handbook

- D. The Integrated Prudential sourcebook (PRU) is amended in accordance with Annex A to this instrument.
- E. The Interim Prudential sourcebook for insurers (IPRU(INS)) is amended in accordance with Annex B to this instrument.
- F. The Lloyd's sourcebook (LLD) is amended in accordance with Annex C to this instrument.

Citation

- G. This instrument may be cited as the Financial Reinsurance Instrument 2006.

By order of the Board
28 September 2006

Annex A

Amendments to the Integrated Prudential sourcebook (PRU)

In PRU 7.1 (Insurance risk systems and controls) insert the following new paragraph after PRU 7.1.34G:

- 7.1.34A G A *firm* should analyse regularly the full effect of all its *reinsurance* agreements and other risk transfer agreements (both current and proposed), including any related agreements or side-letters, on both its current and potential future financial position, and ensure that:
- (1) all significant risks related to these agreements, and the residual risks borne by the *firm*, have been identified; and
 - (2) appropriate risk mitigation techniques have been applied to manage and control the risks.

Annex B

Amendments to the Interim Prudential sourcebook for insurers (IPRU(INS))

In this Annex underlining indicates new text. Where an entire section of text is inserted, the place where the change is made is indicated and the text is not underlined.

Chapter 9

FINANCIAL REPORTING

CONTENTS

Part I – Accounts and statements

...

9.32 Additional information on general insurance business ceded

9.32A Additional information on financial reinsurance and financing arrangements: general insurers

9.32B Additional information on financial reinsurance and financing arrangements: guidance

...

Insert after rule 9.32 new rule 9.32A and accompanying guidance 9.32B as follows:

Additional information on financial reinsurance and financing arrangements: general insurers

- 9.32A
- (1) An *insurer* which carries on *general insurance business* must annex to the documents referred to in rules 9.12, 9.13 and 9.14, and relating to the *financial year in question*, a statement of the information required by this rule.
 - (2) This rule applies to any *contract of insurance* under which *general insurance business* has been *ceded* by the *insurer*, where -
 - (a) the value placed on future payments in respect of the contract in the *return* for the *financial year in question* is not commensurate with the economic value provided by that contract, after taking account of the level of risk transferred; or
 - (b) there are terms or foreseeable contingencies (other than the insured event) that have the potential to affect materially the value placed on the contract in the *insurer's* balance sheet at, or any time after, the end of the *financial year in question*.
 - (3) In determining whether a *contract of insurance* meets one or both of the

- conditions in (2), the *insurer* must -
- (a) treat as part of a contract any agreements, correspondence (including side-letters) or understandings that amend or modify, or purport to amend or modify, the contract or its operation; and
 - (b) consider whether the contract meets the condition in (2)(a) when considered together with one or more other *contracts of insurance* entered into between:
 - (i) the *insurer* and the *reinsurer* under the first contract; or
 - (ii) the *insurer* and any other *person*, where it could reasonably be predicted, at the time the most recent contract was entered into, that the contracts when considered together would meet the condition in (2)(a).
- (4) Subject to (9), for each *contract of insurance* to which this rule applies the statement must contain the following information -
- (a) the *financial year* of the *return* in which the contract was first reported in the *return*;
 - (b) the financial effect of the contract on the *insurer's capital resources* as shown in line 13 of **Form 1** of the *return* for the *financial year in question*;
 - (c) the amount of any undischarged obligation of the *insurer* under the contract and a brief description of the conditions for the discharge of such obligation; and
 - (d) how any undischarged obligations, including any contingent obligations, have been taken into account in determining the *insurer's capital resources*.
- (5) The statement must include a general description of how the *insurer* makes the financial assessment that enables it to determine whether a contract satisfies the condition in (2)(a), even if there are no contracts in respect of which information is required by (4).
- (6) This rule also applies to any **financing arrangement**, which for the purpose of this rule means any contract, other than a *contract of insurance*, that has been entered into by the *insurer*, in respect of *contracts of insurance* written by the *insurer*, which has the effect of increasing the *capital resources* of the *insurer* in line 13 of **Form 1**, and which includes terms for –
- (a) the transfer of assets to the *insurer*, the creation of a *debt* to the *insurer* or the transfer from the *insurer* to another party of liabilities to *policyholders* (or any combination of these); and
 - (b) either an obligation for the *insurer* to return (with or without interest)

some or all of such assets, a provision for the diminution of such *debt* or a provision for the recapture of such liabilities, in each case, in specified circumstances.

- (7) In determining whether a contract falls within the definition of 'financing arrangement' in (6), the *insurer* must -
- (a) treat as part of a contract any agreements, correspondence (including side-letters) or understandings that amend or modify, or purport to amend or modify, the contract or its operation; and
 - (b) consider whether the contract meets the conditions in (6) when considered together with one or more other contracts entered into between:
 - (i) the *insurer* and the *counterparty* under the first contract; or
 - (ii) the *insurer* and any other *person*, where it could reasonably be predicted, at the time the most recent contract was entered into, that the contracts when considered together would meet the conditions in (6).
- (8) Subject to (9), for each 'financing arrangement' entered into by the *insurer* the statement must contain the following information -
- (a) the *financial year* of the *return* in which the 'financing arrangement' was first reported in the *return*;
 - (b) the financial effect of the 'financing arrangement' on the *insurer's capital resources* as shown in line 13 of **Form 1** of the *return* for the *financial year in question*;
 - (c) the amount of any undischarged obligation of the *insurer* under the 'financing arrangement' and a brief description of the conditions for the discharge of such obligation; and
 - (d) how any undischarged obligations, including any contingent obligations, have been taken into account in determining the *insurer's capital resources*.
- (9) No information need be supplied pursuant to (4) or (8) in respect of a *contract of insurance* or 'financing arrangement' if, when it is considered in aggregate with all such contracts with the same *reinsurer* or *counterparty* or any other *person* with whom the *insurer* has entered into a contract in the circumstances described in (3)(b)(ii) or, as the case may be, (7)(b)(ii) -
- (a) A is less than 1% of B in the *return* for the *financial year in question*; and
 - (b) the *insurer* expects A to remain less than 1% of B for the foreseeable future;

where:

- (i) A is the financial effect on the *insurer's capital resources* as a result of the existence of the contract(s); and
 - (ii) B is the *insurer's total technical provisions*.
- (10) Where the statement required by (1) includes information about a *contract of insurance* in respect of which information has been included in the statement required by rule 9.32 relating to the *financial year in question*, the *insurer* must include in the statement under (1) a cross-reference to that other information.

Additional information on financial reinsurance and financing arrangements: guidance

- 9.32B
- (1) In line with normal practice, an *insurer* may take account of an appropriate risk margin to reflect the nature and level of risk transferred, including any uncertainty in the amount and timing of future payments, when assessing the economic value of the transaction at the end of the *financial year in question* in order to see whether the condition in rule 9.32A(2)(a) is met. In addition, an *insurer* would be expected to take account of any credit or legal risk associated with the transaction when assessing its economic value.
 - (2) For most *proportional reinsurance treaties* and most standard *non-proportional reinsurance treaties*, such as contracts providing excess-of-loss cover, which include a significant transfer of risk to the *reinsurer* and do not contain any of the features described in (5) below, it is likely that the *insurer* will be able to determine that the contracts do not meet the condition in rule 9.32A(2)(a) without making a detailed calculation. The approach taken to the assessment made for the purpose of rule 9.32A(2)(a) should, however, still be described in the statement provided as required by rule 9.32A(5).
 - (3) When considering whether there are foreseeable contingencies, other than the insured event, that may affect the contract's given value, the *insurer* should consider the normal commercial uncertainties about the size of the *claim* that may ultimately be payable (for example, the outcome of any possible court action) to be part of the insured event. These normal commercial uncertainties would not then trigger any disclosure requirement under rule 9.32A.
 - (4) It is likely that one or both of the conditions in rule 9.32A(2) will be satisfied if the *contract of insurance* contains features that have the effect of materially limiting the size of the difference between -
 - (a) the extent of the indemnity cover provided by the contract and by any related or potentially related contracts, and
 - (b) the *premiums* payable under those contracts,

relative to the size of the *premiums* payable under those contracts.

- (5) Some characteristic features which the *insurer* should consider carefully in relation to a *contract of insurance* before deciding whether one or both of the conditions in rule 9.32A(2) are satisfied with respect to a particular contract include (but are not limited to) the following -
- (a) sliding scale fees, retrospectively rated *premiums* and profit-sharing formulae which adjust cash flows between the *insurer* and the *reinsurer* based on loss experience (for example, increasing payments from the *insurer* as losses increase and decreasing payments as losses decrease, subject to maximum and minimum limits);
 - (b) provision for an *experience account* or arrangements having similar effect, including arrangements which recognise an assumed rate of investment return;
 - (c) provision for, or a contingent obligation on, the *insurer* to make payments to the *reinsurer* or to any other *person*, where the payments -
 - (i) depend upon the loss experience of *general insurance business* that has been or may be carried on by the *insurer*; and
 - (ii) are not simply reinstatement *premiums*;
 - (d) provision for termination or commutation of the contract at the sole discretion of the *reinsurer*, when there is a positive balance of money due from the *reinsurer*;
 - (e) a provision for, or a contingent obligation on, the *insurer* to make payments to the *reinsurer* or to any other *person*, where the payments are in respect of business carried on in a period outside of the term of the contract;
 - (f) the contract includes a term requiring the *insurer* to enter into a further contract if the loss experience of the business subject to the contract attains a specified level;
 - (g) the term of the contract exceeds, or may exceed, 12 months, and the *premium* or amount of indemnity payable under the contract in subsequent years may be affected by the loss experience of earlier years;
 - (h) dual triggers which require the occurrence of both -
 - (i) an insurable event; and
 - (ii) a change in a separate variable specified in the contract;

in order to trigger payment of a benefit/*claim*;

- (i) amounts payable under the contract could affect, or depend on, other contracts or agreements entered into by the *insurer*, or a *person connected* with the *insurer*, except where -
 - (i) that effect or dependence is clear from the description of that other contract or agreement given by the *insurer*; or
 - (ii) that effect or dependence arises solely as part of the normal market mechanism for the pricing of a risk; and
 - (j) terms that defer payment of *claims* -
 - (i) for a period of more than 12 months after the amount payable under the contract has been agreed; or
 - (ii) until some specified date that is more than 12 months after the end of the term of the contract.
- (6) For the purpose of rule 9.32A(4), (8) and (9), the 'financial effect' of the transaction (that is, the contract or 'financing arrangement') on the *insurer's capital resources* should normally be regarded as the sum of (a) the value placed on the transaction in the *return* for the *financial year in question* plus (b) the net sum of all receipts less payments made in respect of the transaction since the transaction was first reported in the *return*.

...

Chapter 11

DEFINITIONS

PART 1

DEFINITIONS

Insert the following new definition in the appropriate alphabetical place:

<i>experience account</i>	<p>an account (whether real or notional) established under a <i>contract of insurance</i> where:</p> <ul style="list-style-type: none">(a) <i>premiums</i> payable or paid, or amounts related to <i>premiums</i> payable or paid, under the contract are credited to the account;(b) <i>claims</i> payable or paid or incurred, or amounts related to <i>claims</i> payable or paid or incurred, under the contract are deducted from the account; and
---------------------------	--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------

	<p>(c) either:</p> <ul style="list-style-type: none">(i) some part of the amount held in the account is paid out on expiry or termination of the contract in accordance with rights specified in the contract; or(ii) the amount held in the account affects the amount payable under the contract.
--	----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------

...

Annex C

Amendments to the Lloyd's sourcebook (LLD)

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

...

- 15.2.4 R With the exception of the statements required to be annexed to the *Lloyd's Return* by LLD 15.3.6R, the ~~The~~ *Lloyd's Return* must be examined and reported on by the auditors appointed to audit the affairs of the *Society*.

...

Insert after LLD 15.3.5R new rules LLD 15.3.6R and LLD 15.3.7R as follows:

- 15.3.6 R The *Society* must annex to the *Lloyd's Return* a copy of each statement completed by a *managing agent* under LLD 15.13.9R.
- 15.3.7 R For the purposes of the *Lloyd's Return* and LLD 15.3.6R, the *Society* must, for each statement annexed, identify the *syndicate* to which the *contract of insurance* or 'financing arrangement' relates.

...

Insert after LLD 15.13.6R new guidance paragraph LLD 15.13.6AG as follows:

- 15.13.6 G The statements required to be annexed to the return by LLD 15.13.9R should
A not be included in the audit under LLD 15.13.6R.

...

Insert after LLD 15.13.8R new rule LLD 15.13.9R as follows:

- 15.13.9 R A *managing agent* must annex to each return which it prepares under LLD 15.13.1R a statement of the information required by *IPRU(INS) rule 9.32A*, as if in that *rule* references to:

- (1) '*insurer*' were to the *members* carrying on *insurance business* through the relevant *syndicate*;
- (2) the '*return*' were to the return required to be prepared by it in respect of the business carried on through the relevant *syndicate* under *LLD 15.13.1R*;
- (3) the '*insurer's* balance sheet' were to the *syndicate* balance sheet;
- (4) the '*insurer's capital resources*' were to the *capital resources* managed by or at the direction of the *managing agent* in respect of the *insurance business* carried on through the relevant *syndicate*; and
- (5) the '*insurer's* total *technical provisions*' were to the *technical provisions* in respect of the *insurance business* carried on through the relevant *syndicate*.

PERSONAL PENSION SCHEMES INSTRUMENT 2006

Powers exercised

- A. The Financial Services Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (the “Act”):
- (1) section 138 (General rule-making power);
 - (2) section 139 (4) (miscellaneous ancillary matters);
 - (3) section 145 (financial promotions rules);
 - (4) section 156 (General supplementary powers);
 - (5) section 157 (Guidance);
 - (6) section 213 (The compensation scheme);
 - (7) section 214 (General);
 - (8) section 226 (Compulsory jurisdiction);
 - (9) section 227 (Voluntary jurisdiction); and
 - (10) the other rule and guidance making powers listed in Schedule 4 (Powers exercised) to the General Provisions module of the FSA’s Handbook.
- B. The rule-making powers listed above are specified for the purpose of section 153(2) (Rule-making instruments) of the Act.

Commencement

- C. (1) Annex A and Annex C of this instrument come into force on 2 October 2006.
- (2) Annex E of this instrument comes into force on 1 November 2006.
- (3) The balance of this instrument comes into force on 6 April 2007.

Amendments to the Handbook

- D. The modules of the FSA's Handbook of rules and guidance listed in column (1) below are amended in accordance with the Annexes to this instrument listed in column (2).

(1)	(2)
Glossary of definitions	Annex A
Glossary of definitions	Annex B
Fees Manual (FEES)	Annex C
Interim Prudential sourcebook for Investment Businesses (IPRU(INV))	Annex D
Conduct of Business sourcebook (COB)	Annex E
Conduct of Business sourcebook (COB)	Annex F
Insurance: Conduct of Business sourcebook (ICOB)	Annex G
Mortgages: Conduct of Business sourcebook (MCOB)	Annex H

Authorisation manual (AUTH)	Annex I
Supervision manual (SUP)	Annex J
Dispute Resolution manual (DISP)	Annex K
Compensation sourcebook (COMP)	Annex L

Citation

- E. This instrument may be cited as the Personal Pension Schemes Instrument 2006.

By order of the Board
28 September 2006

Annex A

Amendments to the Glossary of definitions from 2 October 2006

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

Amend or insert the following definitions as indicated:

- establishing, operating or winding up a personal pension scheme the regulated activity, specified in article 52(b) of the Regulated Activities Order (Establishing etc. a pension scheme), of establishing, operating or winding up a personal pension scheme.
- occupational pension scheme* (a) (as a scheme specified in article 3(1) of the Regulated Activities Order (Interpretation)) which is, in summary, a pension scheme established for the purpose of providing benefits to people with service in employments of a prescribed description. ~~any scheme or arrangement which is comprised in one or more instruments or agreements and which has, or is capable of having, effect in relation to one or more descriptions or categories of employment so as to provide benefits, in the form of pensions or otherwise, payable on termination of service, or on death or retirement, to or in respect of earners with a qualifying service in an employment of any such description or category.~~
- operator* (1) (except in ENF):
...
(f) (in relation to an *investment trust savings scheme*) any person appointed, by those responsible for managing the property of the *investment trust*, to manage the *investment trust savings scheme*:-
(g) (in relation to a personal pension scheme or stakeholder pension scheme) the person who carries on the regulated activity specified in article 52 of the Regulated Activities Order (Establishing etc. a pension scheme).
- personal pension scheme* (a) ~~a scheme of investment in accordance with section 630 of the Income and Corporation Taxes Act 1988.~~
(in relation to a specified investment) the investment specified in article 82(2) of the Regulated Activities Order (Rights under a pension scheme) which is rights under a personal pension scheme in (b);
(b) (in relation to a scheme) (in accordance with article 3(1) of the Regulated Activities Order) a pension scheme or arrangement which:
(i) is not an occupational pension scheme or stakeholder

pension scheme; and

(ii) is comprised in one or more instruments or agreements capable of providing benefits on retirement, death or on having reached a particular age.

stakeholder pension scheme

(a) (in relation to a *specified investment*) the *investment* specified in article 82(1) of the *Regulated Activities Order* (Rights under a stakeholder pension scheme) which is rights under a stakeholder pension scheme in (b);

(b) (in relation to a scheme) a scheme established in accordance with Part I of the Welfare Reform and Pensions Act 1999 and the Stakeholder Pension Schemes Regulations 2000 (S.I. 2000/1403).

Annex B

Amendments to the Glossary of definitions from 6 April 2007

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

Amend or insert the following definitions as indicated:

<i>agreeing to carry on a regulated activity</i>	<p>the <i>regulated activity</i>, specified in article 64 of the <i>Regulated Activities Order</i> (Agreeing to carry on specified kinds of activity), of agreeing to carry on an activity specified in Part II of that Order other than:</p> <p>...</p> <p>(g) <i>establishing, operating or winding up a stakeholder pension scheme</i>;</p> <p><u>(h) <i>establishing, operating or winding up a personal pension scheme</i>.</u></p>
<i>alternative trading system</i>	<p>a system that brings together multiple buying and selling interests in <i>designated investments</i> (other than <i>life policies</i>, <u><i>personal pension schemes</i></u>, <i>or stakeholder pension schemes</i> or rights to or interests in <u>any of those investments</u> <i>life policies or stakeholder pension schemes</i>), in the system and according to non-discretionary rules set by the system's operator in a way that results in a contract but does not include:</p> <p>(a) a system that is operated by an <i>RIE</i> or that is a <u><i>regulated market</i></u> or an <i>EEA commodities market</i>; or</p> <p>(b) a <i>bilateral system</i>.</p>
<i>appropriate personal pension</i>	<p>a <i>personal pension policy</i>, <u>a <i>personal pension deposit</i></u> or a <i>personal pension contract</i> under which contributions are made to a <i>personal pension scheme</i> which is an appropriate scheme under section 7(4) of the Pension Schemes Act 1993 or section 3(4) of the Pension Schemes (Northern Ireland) Act 1993.</p>
<i>client</i>	<p>(1) (except in <i>PROF</i> in relation to a <i>regulated mortgage contract</i>) any <i>person</i> with or for whom a <i>firm</i> conducts or intends to conduct <i>designated investment business</i> or any other <i>regulated activity</i>; and</p> <p>...</p> <p>(b) 'client' includes:</p>

(iv) ...

(v) for a firm that is establishing, operating or winding up a personal pension scheme, a member or beneficiary of that scheme;

(c) 'client' does not include:

(i) a trust beneficiary not in (b)(v);

...

designated investment a security or a contractually-based investment (other than a funeral plan contract and a right to or interest in a funeral plan contract), that is, any of the following investments, specified in Part III of the Regulated Activities Order (Specified Investments), and a long-term care insurance contract which is a pure protection contract:

...

(h) stakeholder pension scheme (article 82(1));

(ha) personal pension scheme (article 82(2));

...

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

...

(l) establishing, operating or winding up a stakeholder pension scheme (article 52(a));

(la) establishing, operating or winding up a personal pension scheme (article 52(b));

...

establishing operating or winding up a stakeholder pension scheme

the regulated activity, specified in article 52(a) of the Regulated Activities Order (Establishing etc. a stakeholder pension scheme), of establishing, operating or winding up a stakeholder pension scheme.

intermediate customer

(1) (except in COB 3) a client who is not a market counterparty and who is:

...

(g) a trustee of a trust (other than an occupational pension scheme, SSAS, personal pension scheme or stakeholder pension scheme)

which has (or has had at any time during the previous two years) assets of at least £10 million (or its equivalent in any other currency at the relevant time) calculated by aggregating the value of the cash and *designated investments* forming part of the trust's assets, but before deducting its liabilities;

(h) a trustee of an *occupational pension scheme*, or *SSAS*, or a trustee or operator of a *personal pension scheme* or *stakeholder pension scheme* where the ~~trust~~ *scheme* has (or has had at any time during the previous two years):

(i) at least 50 members; and

(ii) assets under management of at least £10 million (or its equivalent in any other currency at the relevant time);

...

investment management firm

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

(a) a *firm*:

...

(c) ...

...

(E) *establishing, operating or winding up a collective investment scheme* (other than an *AUT* or *ICVC*);

(Ea) *establishing, operating or winding up a personal pension scheme*; and

...

<i>open-market option</i>	<p>the option to apply:</p> <p>(a) the proceeds of a <u>personal pension policy scheme or pension contract</u>; or</p> <p>...</p>
<i>overseas person</i>	<p>(in accordance with article 3(1) of the <i>Regulated Activities Order</i> (Interpretation)) a <i>person</i> who:</p> <p>(a) carries on any of the following <i>regulated activities</i>:</p> <p>...</p> <p>(xiv) <i>establishing, operating or winding up a stakeholder pension scheme</i>;</p> <p>(xiva) <u><i>establishing, operating or winding up a personal pension scheme</i></u>;</p> <p>...</p>
<i>packaged product</i>	<p>...</p> <p>(d) <i>a stakeholder pension scheme</i>;</p> <p>(e) <u><i>a personal pension scheme</i></u>;</p> <p>whether or not (in the case of (a), (b) or (c)) held within a <i>PEP</i>, an <i>ISA</i> or a <i>CTF</i> and whether or not the packaged product is also a <i>stakeholder product</i>.</p>
<i>pension transfer</i>	<p>a transaction resulting from a decision made, with or without advice from a <i>firm</i>, by a <i>customer</i> who is an individual, to transfer deferred benefits from:</p> <p>(a) an <i>occupational pension scheme</i>; or</p> <p>(b) an <i>individual pension contract</i> providing fixed or guaranteed benefits that replaced similar benefits under a <i>defined benefits pension scheme</i>; or</p> <p>(c) (in <i>COB 6.7</i> (Cancellation and withdrawal) a <i>stakeholder pension scheme</i> or a <i>personal pension scheme</i>)</p> <p>to a <i>stakeholder pension scheme</i> or to a <i>personal pension scheme</i> (including a self-invested <u><i>self-invested personal pension scheme</i></u>), or to any deferred annuity <i>policy</i> (including a <i>pension buy-out contract</i>) where the eventual benefits depend in whole or in part on investment performance in the period up to the <i>intended retirement date</i>.</p>

<i>personal pension deposit</i>	<u>a contract under which rights to benefits are obtained by making contributions to a <i>personal pension scheme</i> operated by a <i>deposit-taking firm</i>.</u>
<i>personal pension product</i>	<u>a contract under which rights to benefits are obtained by making contributions to a <i>personal pension scheme</i> other than a <i>personal pension policy</i>, a <i>personal pension contract</i>, a <i>personal pension deposit</i> or a <i>SIPP</i>.</u>
<i>product provider</i>	<p>(1) (except in <i>ICOB</i> and <i>COB</i>) a <i>firm</i> which is:</p> <ul style="list-style-type: none"> (i) a <i>long-term insurer</i>; (ii) a <i>friendly society</i>; (iii) the <i>operator</i> of a <i>regulated collective investment scheme</i> or an <i>investment trust savings scheme</i>. <p>(2) (in <i>ICOB</i>) in relation to a <i>non-investment insurance contract</i>, an <i>insurer</i> not acting as an <i>insurance intermediary</i>.</p> <p>(3) (in <i>COB</i>) a <i>firm</i> which is:</p> <ul style="list-style-type: none"> (i) a <i>long-term insurer</i>; (ii) a <i>friendly society</i>; (iii) <u>the <i>operator</i> of a <i>regulated collective investment scheme</i> or an <i>investment trust savings scheme</i>;</u> (iv) <u>the <i>operator</i> of a <i>personal pension scheme</i>.</u>
<i>regulated activity</i>	<p>(in accordance with section 22 of the <i>Act</i> (The classes of activity and categories of investment)) any of the following activities specified in Part II of the <i>Regulated Activities Order</i> (Specified Activities):</p> <p>...</p> <ul style="list-style-type: none"> (o) <i>establishing, operating or winding up a stakeholder pension scheme</i> (article 52(a)); (oa) <i>providing basic advice on a stakeholder product</i> (article 52B); (ob) <u><i>establishing, operating or winding up a personal pension scheme</i> (article 52(b));</u> <p>...</p>
<i>regulated collective investment scheme</i>	(a) an <i>ICVC</i> ; or

	(b) an <i>AUT</i> ; or
	(c) a recognised scheme;
	whether or not the <i>units</i> are held within a <i>PEP</i> , <i>ISA</i> or <u><i>personal pension scheme contract</i></u> .
<i>retail investment</i>	...
	(c) a <i>stakeholder pension scheme</i> ; or
	<u>(ca) a <i>personal pension scheme</i>; or</u>
	...
<i>security</i>	(1) (except in <i>LR</i> and <i>ENF</i> 21 (in accordance with article 3(1) of the <i>Regulated Activities Order</i> (Interpretation)) any of the following <i>investments</i> specified in that Order:
	...
	(g) <i>stakeholder pension scheme</i> (article 82(1));
	<u>(ga) <i>personal pension scheme</i> (article 82(2));</u>
	...
<u><i>self-invested personal pension scheme</i></u>	<u>an arrangement which forms all or part of a <i>personal pension scheme</i>, which gives the member the power to direct how some or all of the member's contributions are invested.</u>
<i>simplified prospectus scheme</i>	means:
	(a) a <i>UCITS scheme</i> that is not a recognised scheme under section 264 of the <i>Act</i> (Schemes constituted in other EEA States); or
	(b) a <i>key features scheme</i> for which an election that is permitted by <i>COB</i> 6.2.22R(2)(Key features schemes) has been made;
	<u>whether or not the <i>units</i> are held within a <i>PEP</i>, <i>ISA</i> or <i>personal pension scheme</i>.</u>
<u><i>SIPP</i></u>	<u>a <i>self-invested personal pension scheme</i>.</u>
<i>small personal investment firm</i>	a <i>personal investment firm</i> :
	(a) which is not an <i>ISD investment firm</i> ;
	<u>(b) whose <i>permission</i> does not include <i>establishing</i>.</u>

operating or winding up a personal pension scheme;

(c) which is not a *network*; and

~~(b)~~

(d) which has fewer than 26 *representatives*.

~~(e)~~

specified investment

any of the following *investments* specified in Part III of the *Regulated Activities Order* (Specified Investments):

...

(i) *stakeholder pension scheme* (article 82(1));

(ia) *personal pension scheme* (article 82(2));

...

Annex C

Amendment to the Fees manual

In section 1 of this Annex striking through indicates deleted text and underlining denotes new text. In section 2 of this Annex, all of the text is new and is not underlined.

Annex C: section 1

FEES 3 Annex 1R Authorisation fees payable

...

Moderately complex cases R

...

A9 Operators, trustees and depositaries of collective investment schemes, operators of personal pension schemes and operators of stakeholder pension schemes

...

FEES 4 Annex 1R Activity groups, tariff bases and valuation dates applicable

Part 1

...

Activity group

Fee payer falls into the activity group if

...

A9 Operators, Trustees and Depositaries of collective investment schemes and Operators of personal pension schemes or stakeholder pension schemes

...

(1) its *permission*:

(a) includes one or more of the following:

- ...
- *acting as the depositary or sole director of an open-ended investment company;*
- *establishing, operating or winding up a personal pension scheme or a stakeholder pension scheme (but only if the firm does not fall within activity group A1 or A4);*

...

A10 Firms dealing as principal

its *permission* includes *dealing in investments as principal*;

BUT NOT if one or more of the following apply:

- ...
- the above activity is limited either to acting as an *operator of a collective investment scheme, establishing, operating or winding up a personal pension scheme or a stakeholder pension scheme*, or to carrying out *trustee activities*;

...

Part 2

...

A9

GROSS INCOME

For operators (including ACDs and managers of units trusts but excluding operators of a personal pension scheme or a stakeholder pension scheme):

...

For depositaries (including trustees of collective investment schemes and ICVC depositaries):

The amount of the annual charge levied on funds in regulated collective investment schemes for which they act as depositary (typically a % of the total funds for which they act as depositary).

For operators of a personal pension scheme or a stakeholder pension scheme:

The amount of the charges levied on the personal pension scheme or stakeholder pension scheme for which they act as operator:

- including up-front charges, fund related charges, transaction related charges and periodic charges; but
- excluding charges made to an investor in respect of third party suppliers; for example, charges for stock broking, borrowing, banking services and charges for arranging third party legal services, surveys or environmental screening in connection with property.

...

...

FEES 5 Annex 1R Annual fees payable in relation to 2006/7

...

Industry block

Tariff base

General levy payable by firm

...

6 - Operators, trustees and depositaries of collective investment schemes and operators of personal pension schemes or stakeholder pension schemes

...

6.5.9 R Table: The contribution groups and tariff bases for the investment business sub-scheme (see FEES 6.5.7R (2)). (The contribution groups, legal bases for

activity and tariff bases are the same as the correspondingly numbered activity groups and tariff bases set out in part 1 and part 2 of FEES 4 Ann 1R).

SUB-SCHEME	CONTRIBUTION GROUP (references to A7 etc are to the activity groups in part 1 of FEES 4 Ann 1R)	LEGAL BASIS FOR ACTIVITY (this is merely a summary of the basis in part 1 of FEES 4 Ann 1R; references to articles are to articles of the <i>Regulated Activities Order</i>)	TARIFF BASE (this is merely a summary of the base in part 2 of FEES 4 Ann 1R)
...	A9 – managers of an <i>AUT</i> , <i>ACDs</i> and depositaries <u>and operators of personal pension schemes or stakeholder pension schemes</u>	Any of the following: ... (c) acting as a depositary, or sole director of an open-ended investment company (article 51); <u>(d) establishing, operating or winding up a personal pension scheme or a stakeholder pension scheme.</u>	Gross income
...			

Annex C: section 2

Create a new schedule of Transitional Provisions at the end of the FEES manual, as follows.

FEES TP 1 Transitional Provisions

FEES TP 1.1

(1)	(2)	(3)	(4)	(5)	(6)
	Material to which the transitional provision applies		Transitional Provision	Transitional Provision: dates in force	Handbook provision: coming into force
1.	<i>FEES</i> 3.2.7R (p)	R	A <i>firm</i> does not have to pay a fee if: (1) it is seeking only to increase the scope of its <i>permission</i> to include: (a) <i>establishing, operating or winding up a personal pension scheme; or</i> (b) (if the <i>firm</i> is in activity group A12 or A13) the <i>designated investments</i> : (i) <i>personal pension scheme; or</i> (ii) <i>rights to or interests in a personal pension scheme,</i> and (2) it was, as at 1 October 2006, carrying on what would become on 6 April 2007: (a) the <i>regulated activity</i> in (1)(a), or	2 October 2006 to 5 April 2007	1 June 2006

(b) a *regulated activity* in relation to the *designated investments* in (1)(b).

2.	<i>FEES</i> 4 Annex 1R Part 3, Activity group A9 (operators, trustees and depositaries of collective investment schemes)	R	References to gross income received in connection with operating a <i>personal pension scheme</i> or a <i>stakeholder pension scheme</i> include gross income received in connection with operating a personal pension scheme or a stakeholder pension scheme before 6 April 2007, if and to the extent that, if the same activities had been carried out in relation to the same scheme on 6 April 2007 those activities would have amounted to <i>operating a personal pension scheme</i> or a <i>stakeholder pension scheme</i> .	From 6 April 2007 to 30 April 2008	6 April 2007
----	--------------------------------------------------------------------------------------------------------------------------	---	--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------	------------------------------------	--------------

Annex D

Amendments to the Interim Prudential sourcebook for Investment Businesses IPRU (INV)

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

...

- 2.1.2 R (1) An *authorised professional firm* of a kind falling within (2) must comply with such of *IPRU(INV)* 3, 5, 10 or 13 which in accordance with *IPRU(INV)* 2.1.4R, most appropriately correlates to the type and scale of the business which it conducts.
- (2) The type of *authorised professional firm* to which (1) applies is one:
- ...
- (f) whose main business, having regard to (3), is not the practice of its profession or professions; ~~or~~
- (g) whose *permission* includes a requirement that it acts in conformity with the financial resources *rules* applicable to another type of firm; ~~or;~~
- (h) whose *permission* includes *establishing, operating or winding up a personal pension scheme.*

...

- 2.1.4 R This table belongs to IPRU (INV) 2.1.1R
- | TYPE OF BUSINESS ACTIVITY | CHAPTER OF SOURCEBOOK |
|------------------------------------------------------------------------------------------|-------------------------------------------------|
| ... | <i>Investment management firm – IPRU(INV) 5</i> |
| ... | |
| (v) <i>establishing, operating or winding-up other collective investment schemes; or</i> | |
| <u>(va) <i>establishing, operating or winding up a personal pension scheme; or</i></u> | |

...

3-60(6) R

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

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

...

...

...

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

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

...

...

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

....

packaged product means ~~a life policy or a unit in a regulated collective investment scheme;~~

...

....

5.2.3(2) R The *financial resources requirement* for a firm which is not an *ISD firm* is an own funds requirement determined in accordance with paragraph (a) of rule 5.2.3(3) if its permitted business does not include establishing, operating or winding up a personal pension scheme and:

...

...

Table 5.2.3(5)(a) EXPENDITURE BASED REQUIREMENT

PART 1

CALCULATION OF REQUIREMENT

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

PART II

FRACTIONS

1 The fraction is 6/52 where:

...

(c) the firm is:

(i) an investment manager (including the operator of an unregulated collective investment scheme in relation to which the firm carries on the activity of an investment manager); or

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

unless paragraph 2 applies.

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

(a) an investment manager as in paragraph 1(c)(i) above;

(b) one whose permitted business includes establishing, operating or winding up a personal pension scheme; or is

(c) a custodian,

and the firm either:

(d) itself holds customers' monies or assets; or

~~(a)~~

(e) procures the appointment as custodian of its customers' monies or assets of

~~(b)~~ an associate of the firm which is not an approved bank.

...

10-60(2)

10-60(3) R A category D firm whose permission includes establishing, operating or winding-up a personal pension scheme must comply with the higher of the financial resources requirements applied by rules 10-60 to 10-176 and the requirements applied by rules 5.2.1(1) to 5.2.7(5) of IPRU(INV).

....

13.9.1A G Table 13B is a summary of the financial resources test for a category B firm.

Table 13B This table forms part of *rule* 13.9.1

SUMMARY OF FINANCIAL RESOURCES FOR *CATEGORY B FIRMS*

...				
<i>Network in ...</i>				
<i>Category B2 or</i>				
<i>B3</i>				
<u>All Category B firms that do not hold client money or assets, but are permitted to establish, operate or wind up a personal pension scheme.</u>	<u>£10,000</u>	<u>Adjusted net current assets of £1</u>	<u>Adjusted capital equal to the highest of 6/52 of relevant annual expenditure, £400 per adviser, and £10,000</u>	<u>13.10</u> <u>13.11</u> <u>13.12.1G</u> <u>13.12.2 to</u> <u>13.12.5A.</u>
<u>All Category B firms that hold client money or assets and are permitted to establish, operate or wind up a personal pension scheme.</u>	<u>£10,000</u>	<u>Adjusted net current assets of £1</u>	<u>Adjusted capital equal to the highest of 13/52 of relevant annual expenditure, £400 per adviser and £10,000</u>	<u>13.10</u> <u>13.11</u> <u>13.12.1G</u> <u>13.12.2 to</u> <u>13.12.5A.</u>

...

13.12.1F R ...

13.12.1G R A Category B firm whose permission includes establishing, operating or winding up a personal pension scheme must have financial resources calculated in accordance with (1) or (2):

- (1) For a firm which holds client money or assets, the highest of:
 - (a) 13/52 of its relevant annual expenditure, calculated in accordance with 13.12.2 to 13.12.2D;
 - (b) an amount equal to £400 multiplied by the number of its advisers; and

- (c) £10,000.
- (2) For a firm which does not hold client money or assets, the highest of:
 - (a) 6/52 of its relevant annual expenditure, calculated in accordance with 13.12.2 to 13.12.2D;
 - (b) an amount equal to £400 multiplied by the number of its advisers; and
 - (c) £10,000.

IPRU(INV) Appendix 13(1)

investment management ...
firm

- E. *establishing, operating or winding up a collective investment scheme (other than an AUT or ICVC); and*
- Ea. *establishing, operating or winding up a personal pension scheme; and*

...

...

low resource firm

a *Category B3 firm* which is not a *network*, has fewer than 26 *financial advisers or representatives* and is not *permitted to:*

- (a) carry on discretionary portfolio management;
- (b) *establish, operate or wind up a personal pension scheme; or to*
- (c) delegate such the activities in (a) or (b) to an investment firm;

...

Annex E

Transitional to the Conduct of Business sourcebook

In this Annex underlining indicates new text.

COB TP 6 Transitional rules for Depolarisation (applicable to all firms)

COB TP 6.1

Transitional rules for Depolarisation (applicable to all firms)

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
7	...				
8	<u>COB 4.3.11R(1)</u>	R	<u>Notwithstanding COB 4.3.11R (1), a firm may use the fees and commission statement that will appear in COB 4 Annex 6R when Annex F of the Personal Pension Schemes Instrument 2006/28 comes into force on 6 April 2007.</u>	<u>From 1 November 2006 to 5 April 2007.</u>	<u>1 December 2004.</u>

Annex F

Amendments to the Conduct of Business sourcebook

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

...

1.10.2 G This sourcebook adopts the concepts of “initial service agreement” and “successive operations” from the *DMD*.

- (1) A *firm’s* contract with a *customer* may take the form of an initial service agreement under which successive operations or a series of operations of the same nature are performed over time. Where this is the case, the *DMD* disclosure and cancellation requirements apply in relation to the initial service agreement only and not to the successive or separate operations. However, if new elements are added to the initial service agreement, the addition of those new elements is treated as a new contract to which the *DMD* disclosure and cancellation requirements apply. In accordance with recital 17 of the *Distance Marketing Directive*, examples are:

...

Other examples are, in the *FSA’s* view:

...

- (f) concluding a *life policy*, *personal pension scheme* ~~*contract*~~ or *stakeholder pension scheme* that includes a pre-selected option providing for future increases or decreases in regular *premiums* or payments, and subsequent index-linked changes to those premiums or increases or decreases to pension contributions following fluctuations in salary.

...

1.11.1G Table: Application of rules in COB in relation to deposits

...

Notes:

...

(3) This table does not deal with the application of COB in relation to *personal pension deposits*.

...

3.7.1 R (1) A *firm* must make an adequate record of each *non-real time financial promotion* which it has confirmed as complying with the *rules* in this chapter:

- (2) A record in (1) must be retained for the following periods:

...

- (b) six years in the case of a *financial promotion* relating to a *life policy*, *personal pension scheme* ~~*contract*~~ or *stakeholder pension scheme*;

...

...

4.1.12 R A *firm* may classify a *client* (other than another *firm*, *regulated collective investment scheme*, or an *overseas financial services institution*) who would otherwise be an *intermediate customer* as a *market counterparty* if:

(1) the *client* at the time he is classified is one of the following:

(a) ...

...

(e) a trustee of a trust (other than an *occupational pension scheme*, *SSAS*, *personal pension scheme* or *stakeholder pension scheme*) with assets of at least 10 million (or its equivalent in any other currency), calculated by aggregating the value of the cash and *designated investments* forming part of the trust's assets, but before deducting its liabilities;

(f) a trustee of an *occupational pension scheme*, ~~or SSAS~~, or a trustee or operator of a *personal pension scheme* or *stakeholder pension scheme* where the ~~trust~~ scheme has (or has had at any time during the previous two years):

(i) at least 50 members; and

(ii) assets under management of not less than £10 million (or its equivalent in any other currency at the relevant time); and

...

4.2.14 R (1) A *firm* must make a record of each *terms of business* it provides to a *customer*, and any amendment to them, as soon as the *terms of business* come into force.

(2) A *firm* must retain each record referred to in (1):

...

(b) for six years, where the *terms of business* relate to a *life policy*, *personal pension scheme* ~~*contract*~~ or *stakeholder pension scheme*; and

4.3.3 R ...

- (8) A firm must take reasonable steps to ensure that its representatives on first making contact with a private customer with a view to advising on investments in SIPPs, personal pension deposits, or personal pension products, inform the customer of the amount and nature (i.e. fees and/or commission (or equivalent) and/or a combination of fees and commission (or equivalent)) of any payments that the customer will have to pay, directly or indirectly, for the advice on investments.

4.3.7 R (1) A firm which has started to provide a private customer with services in relation to packaged products following the provision of a fees and commission statement or the original payment information must not (at least until the completion of those services):

- (b) subject to (4), arrange to retain any commission which exceeds the maximum amount or rate disclosed ~~in the statement~~;

without first providing a further appropriate ~~statement~~ statement or further payment information and obtaining the customer's prior consent to the proposed alteration in a durable medium.

- (3) If a firm decides to provide a private customer with advice on investments on a type of packaged product (which falls within a product group specified in Notes 14 or 18A to COB 4 Annex 6R) in relation to which the fees and commission statement previously given to the customer does not contain the information required in those Notes 14 to COB 4 Annex 6R, it must issue a new and appropriate ~~statement~~ statement or payment information to that customer.

- (4) (a) Notwithstanding (1)(b) a firm is not required to provide a further fees and commission statement or further payment information for the purposes of (1) if:
- (i) the maximum amounts or rates already disclosed in the statement ~~already provided~~ to the customer only apply to products policies of the example term or age of customer policyholder given ~~in the fees and commission statement~~, or to products policies with shorter terms; and

(ii) the *firm* arranges a product policy for a term longer than the example term ~~in the *statement*~~ (or longer than the term deemed for the example age given) and the increase in the *commission* which the *firm* arranges to retain over the maximum already disclosed in the *statement* is not more than an amount that is directly proportional to the increase in the duration of the term of the product policy (or to the term deemed from the age of customer policyholder).

(b) If requested by a *customer*, a *firm* must explain the basis of the higher maximum *commission* or *fees* charged in accordance with (4)(a)(ii).

...

...

4.3.13 G (1) *COB* 4.3.11 R requires a *firm* to maintain statements showing the amount it may charge its *customers* by way of *fees*, or which it may receive from others by way of *commission*, in either case in respect of the services it provides in relation to the sale of certain packaged products. Consistent with *COB* 5.1 and *COB* 5.5 the basis on which a *firm* may provide such services may differ from *customer to customer* (for example as to whether the *firm* will select from the whole market, or a limited number of *product providers*).

...

4.3.27 R A *firm* must take reasonable steps to ensure that its *representatives* on first making contact with an employee with a view to advising on his employer's *group personal pension scheme* or *stakeholder pension scheme*, inform the employee:

...

(3) the amount and nature (i.e. *fees* and/or *commission* (or *equivalent*) and/or a combination of *fees* and *commission* (or *equivalent*)) of any payments that the employee will have to pay, directly or indirectly, for the *advice on investments*.

COB 4 Annex 1 Exemptions from terms of business requirement

COB 4 Annex 1.1R Circumstances in which the terms of business requirement in *COB* 4.2.5 R does not apply and conditions for using the exemption (R)

This table belongs to *COB* 4.2.5R

Exempted type of firm or transaction or event:

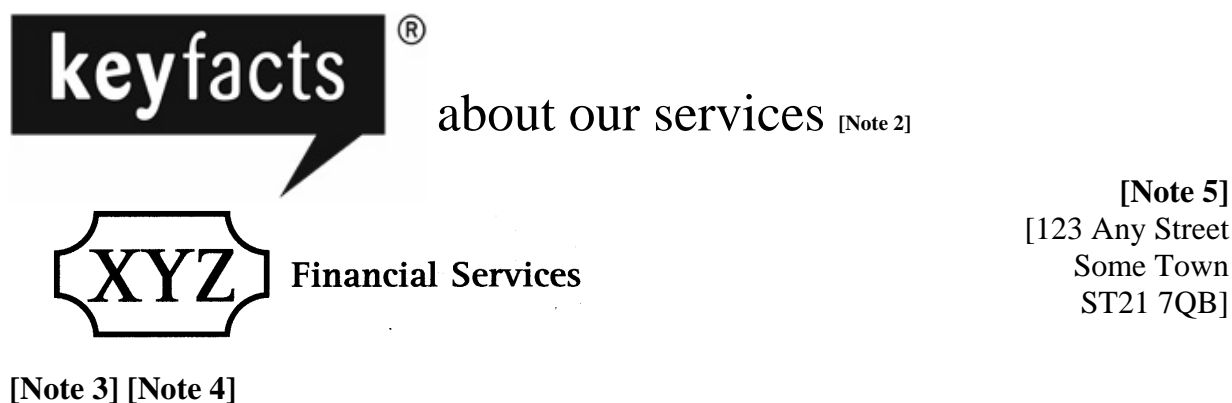
Conditions for using the exemption

8	....	.....
8A	<u>Operating a personal pension scheme or stakeholder pension scheme.</u>	<u>The customer is a scheme member.</u>
9	...	...

COB 4 Annex 4 R: Initial disclosure document required by COB 4.3.9 R
(1) ("IDD")

1. Firms should omit the notes and square brackets which appear in the following specimen.

...



The specimen shows a logo for 'keyfacts' in a black speech bubble with a registered trademark symbol. To its right is the text 'about our services' with a note reference '[Note 2]'. Below the logo is a stylized 'XYZ' in a decorative frame, followed by 'Financial Services'. To the right of this is another note reference '[Note 5]' and an address: '[123 Any Street, Some Town, ST21 7QB]'. At the bottom left of the specimen are two more note references: '[Note 3] [Note 4]'. A thick horizontal line is drawn below the specimen.

...

2. Whose products do we offer? [Note 6] [Note 7]

- [We offer products from the whole market.] [Note 6A] [We offer our own product(s); you can ask us for a list but our recommendation will be made following an analysis of the whole market.] [Note 6B]

- We [can] [Note 8] only offer products from a limited number of companies. [These include our own product(s) but our recommendation will be made following an analysis of our entire range of products.] [Note 8A]
Ask us for a list of the companies and products we offer. [Note 11]

...

The following notes do not form part of the IDD.

...

Note 6A ...

Note 6B – a firm should only include these words if it offers whole of market advice and it owns or operates products that fall within the relevant market (e.g. a SIPP).

Note 8A – a firm should only include these words if it offers limited range advice and it owns or operates products that fall within the relevant range (e.g. a SIPP).

...

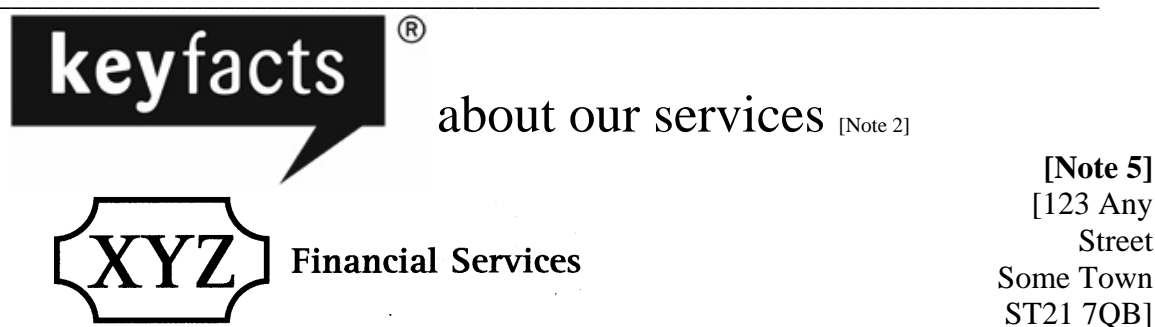
Note 21 – insert, in the *firm's* own words, a short description of any direct or indirect holding of more than 10 per cent in the capital or voting power of the *firm* which is held by a provider or operator of a packaged products or by the parent of the provider or operator.

Note 22 – insert, in the *firm's* own words, a short description of any direct or indirect holding of more than 10 per cent in the capital or voting power of a provider or operator of a packaged products which is held by the *firm*.

COB 4 Annex 5 R: Combined initial disclosure document required by COB 4.3.9 R (2) (“CIDD”)

1. Firms should omit the notes, asterisks and square brackets which appear in the following specimen.

...



The specimen shows a header for a firm named 'XYZ Financial Services'. The word 'keyfacts' is in a speech bubble with a registered trademark symbol. The text 'about our services' is followed by a note reference '[Note 2]'. The firm's name 'XYZ Financial Services' is in a decorative frame, with a note reference '[Note 3] [Note 4]' below it. To the right, the firm's address is listed with a note reference '[Note 5]': '[123 Any Street Some Town ST21 7QB]'.

[Note 3] [Note 4]

...

2 Whose products do we offer? [Note 6] [Note 7]

Investment

- [We offer products from the whole market.] [Note 6A] [We offer our own product(s); you can ask us for a list, but our recommendation will be made following an analysis of the whole market.] [Note 6B]
- We [can] [Note 8] only offer products from a limited number of companies. [These include our own product(s) but our recommendation will be made following an analysis of our entire range of products.] [Note 8A]

Ask us for a list of the companies and products we offer. [Note 12]

...

The following notes do not form part of the CIDD.

...

Note 6A ...

Note 6B – a firm should only include these words if it offers whole of market advice and it owns or operates products that fall within the relevant market (e.g. a SIPP).

...

Note 8A – a firm should only include these words if it offers limited range advice and it owns or operates products that fall within the relevant range (e.g. a SIPP).

...
...

Note 30 – insert, in the *firm's* own words, a short description of any direct or indirect holding of more than 10 per cent in the capital or voting power of the *firm* which is held by a provider or operator of a packaged products or by the parent of the provider or operator.

Note 31 – insert, in the *firm's* own words, a short description of any direct or indirect holding of more than 10 per cent in the capital or voting power of a provider or operator of a packaged products which is held by the *firm*.

...

COB 4 Annex 6R: (Fees and Commission Statement required by COB 4.3.11R (1) and (2)

...

Table 1 - Commission if you invest monthly [Notes 12- 17]

Products	Example term or age	Comparison of costs		Example based on £100 per month
		Our maximum	Market average	<i>This shows the maximum costs of our sales and advice for a monthly investment or premium of £100, ignoring any changes in fund value</i>
...				
Saving for retirement				
Personal and Stakeholder pensions	25 year term	[Note 18]	[Note 19]	[Note 20]
	10 year term	[Note 18]	[Note 19]	[Note 20]
<u>Personal Pension Schemes</u>				
<p><u>Not all types of personal pension scheme are included in the information above about commissions. Instead only the more common types are included, and schemes such as SIPPs are not. Before we start advising you, we will inform you of how much we could be paid if we do recommend one of these products to you.</u></p> <p><u>You can also ask us about commission we might receive on underlying investments we recommend you hold within a SIPP if not contained in the information above.</u></p>				
[Note 18A]				

Table 2 - Commission if you invest a lump sum [Notes 12-17]

Products	Example term or age	Comparison of costs		Example based on £10 000 lump sum
		Our maximum	Market average	<i>This shows the maximum costs of our sales and advice for a lump sum investment of £10 000, ignoring any changes in fund value</i>
...				
Saving for retirement				
Personal and Stakeholder pensions	Any	[Note 18]	[Note 19]	[Note 20]
<u>Personal Pension Schemes</u>				
<p><u>Not all types of personal pension scheme are included in the information above about commissions. Instead only the more common types are included, and schemes such as SIPPs are not. Before we start advising you, we will inform you of how much we could be paid if we do recommend one of these products to you.</u></p> <p><u>You can also ask us about commission we might receive on underlying investments we recommend you hold within a SIPP if not contained in the information above.</u></p>				
[Note 18A]				
At retirement				
Annuities	Any	[Note 18]	[Note 19]	[Note 20]

Income drawdown	Any	[Note 18]	[Note 19]	[Note 20]
-----------------	-----	-----------	-----------	-----------

...

The following notes do not form part of the template.

...

Note 12 If a *fees and commission statement* contains information relating to *commission*, then a *firm* must set out information concerning *commission (or equivalent)* in the tabular format prescribed. The headings for Tables 1 and Table 2; the headings and sub-headings for each column; the product headings in each row of the first column; and the example term and age set out in the second column of each table are all prescribed and must not be amended. If the boxes entitled 'Personal and Stakeholder pensions' are to be included, the positioning and wording of those boxes is prescribed and must not be amended.

...

Note 14 The text and information contained in the commission section of Section 4 must be included if a *firm* reasonably expects to provide those services to a *private customer* receiving the *fees and commission statement* in respect of any of the following product groups.

Regular contribution business

The following product groups relate to regular contribution investments (including annual and quarterly premium contracts) and includes any non-contractual top-ups or increments (to existing regular contribution investments) which generate *commission (or equivalent)*.

(a) Collective investments (See note 18)

Any regulated collective investment scheme or investment trust savings scheme.

...

(d) Personal and stakeholder pensions

Any personal pension scheme, FSAVC scheme or stakeholder pension scheme (other than a SIPP, personal pension product, personal pension deposit, group personal pension scheme or stakeholder pension scheme arranged on a group basis for the employees of a particular employer). (See note 18)

...

Lump sum business

The following product groups relate to single contribution business, including commission (or equivalent) generating, non-contractual, top-ups or increments to existing lump sum investments.

...

(c) Personal and stakeholder pensions

Any personal pension scheme, FSAVC scheme or stakeholder pension scheme (other than a SIPP, personal pension product, personal pension deposit, group personal pension scheme or stakeholder pension scheme arranged on a group basis for the employees of a particular employer). (See note 18)

...

Note 15 *A firm which conducts business with private customers in relation to any packaged products not falling within any of the product groups for which maximum commission is disclosed on the fees and commission statement, may provide a customer with information about commission (or equivalent) relating to that business by way of a separate annex. For the purpose of the rules, any such information does not form part of a firm's fees and commission statement.*

...

Note 18 ...

Note 18A Where a firm expects to advise on SIPPs, personal pension products or personal pension deposits, in addition to a product listed in Note 14, this box and prescribed wording must be included.

...

COB 4 Annex 7 R Identifying and describing the maximum rate of commission (or equivalent), the market average and the Example

1. A *firm* must state in each *fees and commission statement* it issues:
 - (a) its maximum rate of *commission* (or *equivalent*) for each product group in the statement in accordance with Note 18 of COB 4 Annex 6R;
 - (b) the market average rate for each product group in accordance with Note 19 of COB 4 Annex 6R;
 - (c) an illustration in the example column of an amount of *commission* (or *equivalent*) calculated by reference to its maximum rate for each product group in the statement and the example contribution levels stated in the tables (ie eg £100 per month or £10,000 lump sum) in accordance with Note 20 of COB 4 Annex 6R.

...

- 5.1.6B G (10) ...
- (11) Advice on pensions as a sector or category of the market includes advice on all *personal pension schemes* including *SIPPs*.
-
- ...
- 5.2.9 R (1) Unless (2) applies, a *firm* must make and retain a record of a *private customer's* personal and financial circumstances that it has obtained in satisfying *COB 5.2.5R*. The *firm* must retain the record for a minimum period after the information is obtained, as follows:
- ...
- (b) six years for a record relating to a *life policy*, *personal pension scheme* ~~*contract*~~ or *stakeholder pension scheme*; or
- ...
- ...
- 5.3.1 R This section applies to a *firm* when it:
- ...
- (3) manages the assets of an *occupational pension scheme (OPS)*, *personal pension scheme* or ~~a *stakeholder pension scheme*~~; or
- ...
- ...
- Requirement for suitability: manager of OPS, *personal pension scheme* and stakeholder pension scheme
- 5.3.12 R A *firm* that manages the assets of an *occupational pension scheme*, *personal pension scheme* or *stakeholder pension scheme* must take reasonable steps to ensure the suitability of specific transactions and of the investment portfolio under management with regard to the *investment* objectives specified in the portfolio mandate.
- ...
- 5.3.14 R (1) ...
- (2) If, following a *personal recommendation* by a *firm* that does not fall within (1), a *private customer*:
- (a) buys, sells, surrenders, converts, cancels, or suspends *premiums* for or contributions to, ~~a *pension contract*~~ *personal pension scheme* or a *stakeholder pension scheme*; or

...

the *firm* must provide the *customer* with a *suitability letter*, within the time period stipulated by *COB 5.3.18 R*, unless one of the exceptions in *COB 5.3.19 R* applies.

...

5.3.19A R A *firm* must make and retain a record of a *private customer's* suitability letter that it has provided in satisfying *COB 5.3.14 R*. The record must be retained for a minimum period after the letter is provided, as follows:

...

(2) for a record relating to a *life policy*, ~~*pension contract*~~ *personal pension scheme* or *stakeholder pension scheme*, six years;

...

...

6.1.5 R A *firm* must ensure that any *key features* or information document it produces in relation to a *packaged product*, *cash deposit ISA* or *cash deposit CTF* is in writing, whether in printed hard copy or in electronic format, and:

...

(2) is separate from any other material given to the *customer*, unless it is produced for a *key features scheme*, ~~*or stakeholder pension scheme*~~, *or personal pension scheme other than a personal pension policy*; in that case it may be included as part of another item of sales or marketing material, but only if the *key features* or information document appears with due prominence.

...

6.4.1 R *COB 6.4* applies to a *firm* in accordance with *COB 6.1.1R*, in respect of *occupational pension schemes*, ~~*self-invested personal pension schemes*~~, *income withdrawals* and *short-term annuities*, *cash deposit ISAs*, *cash deposit CTFs*, *Revenue allocated CTFs*, *traded life policies*, ~~*stakeholder pension schemes*~~, *packaged products*, other *deposits* and *long-term care insurance contracts*.

...

6.4.5 G ...

SIPPs, *personal pension deposits* and *personal pension products*

6.4.5A R When a *firm* sells, manages, *personally recommends* or arranges the sale of a *SIPP*, *personal pension deposit* or *personal pension product* (not the assets within them) to or for a *private customer*, the *firm* must, unless *COB*

6.4.27R to COB 6.4.31AR apply, provide the *private customer* with:

- (1) sufficient information about the relevant scheme for the *private customer* to be able to make an informed decision before that customer completes an application for that scheme; and
- (2) (in respect of a *distance contract* with a *retail customer*) the relevant contractual terms and conditions and the information set out in COB App 1,

in a *durable medium* in good time before the customer is bound by the transaction.

6.4.5B G The sufficient information provided should include the range and depth of information normally found in *key features*.

6.4.5C R COB 6.4.5AR does not apply to a scheme *operator* when its scheme is sold on the *personal recommendation* of, or arranged to be sold by, another *person*, provided that other *person*:

- (1) is a *firm* (or an *appointed representative*) operating from an establishment maintained by the *firm* (or *appointed representative*) in the *United Kingdom*; or
- (2) is operating from an establishment in an *EEA State* whose law imposes an obligation on the *person* to provide information about the scheme in accordance with articles 3 and 5(1) and (2) of the *Distance Marketing Directive*.

Assets to be held within a SIPP

6.4.5D R Where a *firm* makes a *personal recommendation* to a *private customer* about the purchase of an asset to be held within a *SIPP*, the *firm* must, unless COB 6.4.27R to COB 6.4.31AR applies, provide the *private customer* with:

- (1) sufficient information about that asset, and the risks and advantages of the proposed asset purchase, for the customer to be able to make an informed decision about the asset purchase before it takes place; and
- (2) (in respect of a *distance contract* with a *retail customer*) the relevant contractual terms and conditions and the information set out in COB App 1;

in a *durable medium* in good time before the customer is bound by the transaction.

6.4.5E G If this chapter requires a particular type of product disclosure for a particular type of asset, the product disclosure provided in accordance with those *rules* is sufficient information for this purpose.

~~Self-invested personal pension schemes~~ Sales of life policies (etc.) to operators of personal pension schemes

6.4.6 R (1) A *firm* which sells, *personally recommends* or arranges the sale of a new group or master *life policy*, the first in a series of individual *life*

policies or the first units in a particular key features scheme packaged product (other than a or simplified prospectus scheme to the operator of a personal pension scheme, must provide the operator of that scheme with key features) to or for a member, prospective member or trustees of a self-invested personal pension scheme, must provide key features to that member or trustees, (in accordance with COB 6.2.7R to COB 6.2.25R) or for the sale of a simplified prospectus scheme, provide a simplified prospectus to that member or trustees, (in accordance with COB 6.2.26R to COB 6.2.45R), as the case may be.

(2) ...

6.4.6A G The illustrative figures included in the key features or simplified prospectus can be on an example basis, using a range of representative actual or hypothetical scheme members (covering, for example, different ages, sexes and salaries), provided the illustrative figures and the range of representative scheme members are sufficient for the operator to be able to assess the effectiveness of the relevant investment for scheme members.

....

6.4.7 G [deleted] Investments within a self-invested personal pension scheme (a "SIPP") are effected by the trustees on behalf of scheme members. Key features or a simplified prospectus should be given to the trustees and to members of SIPPs when packaged products (whether life policies or schemes) are recommended by a firm to scheme members or effected by SIPP trustees. Notice of the right to cancel should also be copied to SIPP members in these circumstances, in accordance with COB 6.7.31 R.

6.4.8 R Except in relation to a SIPP, personal pension deposit or personal pension product, When a firm personally recommends, arranges or effects income withdrawals or the purchase of a short-term annuity annuities to or for a private customer, the customer must be provided with key features or with a simplified prospectus in good time before he signs any form of application or authority electing to make those withdrawals or purchases, whether that election or purchase is made with advice on investments or on an execution-only basis, unless COB 6.4.10R to COB 6.4.12R or COB 6.4.27R to COB 6.4.31R (telephone sales and other exemptions) applies.

6.4.8A R When a firm personally recommends, arranges or effects an income withdrawal from a SIPP, personal pension deposit or personal pension product to or for a private customer, it must provide that customer with:

- (1) sufficient information about the income withdrawal for the customer to be able to make an informed decision; and
- (2) (in respect of a distance contract with a retail customer), the relevant contractual terms and conditions and the information set out in COB App 1,

in a durable medium in good time before the customer is bound by the transaction.

6.4.8B G The sufficient information provided should include the range and depth of information normally found in key features.

...

- 6.4.11 R When a *private customer* makes a series of elections within a period of 12 months to make *income withdrawals*, or purchase *short-term annuities*, the *firm* that is *personally recommending*, arranging or effecting the elections may provide ~~one~~ a combined set, or separate sets, of key features, or simplified prospectuses or equivalent information for those elections (as appropriate), ~~or may provide separate sets of key features, for elections which relate to life policies and key features schemes or separate simplified prospectuses for simplified prospectus schemes.~~

...

Entering into a distance contract for accepting deposits (other than a cash deposit ISA or a personal pension deposit)

- 6.4.25 R A *retail customer* must be provided with all the contractual terms and conditions and the information in COB App 1 in a *durable medium* in good time before he is bound by a *distance contract* or offer under which the *firm* will *accept deposits* (other than a *cash deposit ISA*; (for which see COB 6.5.42R) or a personal pension deposit (for which see COB 6.4.5AR)), unless an exemption in COB 6.4.27R to COB 6.4.31R (telephone sales and other exemptions) applies.

- 6.4.31A R This exemption applies where a *private customer* is automatically enrolled by his employer in a *stakeholder pension scheme*; ~~or a personal pension scheme policy or a pension contract~~ provided through the workplace. In that case, in good time before the *private customer* is bound by the contract or offer, he must be provided with the appropriate *key features* or other information.

...

...

- 6.5.16A G

...

- 6.5.16B G Although there is no requirement to provide a projection for a SIPP, personal pension deposit or personal pension product, a firm may still produce one if it wishes. A firm that chooses to produce such a projection should do so in a way which is consistent with COB 6.6 (Projections).

...

...

- 6.5.22 G

....

- 6.5.22.A G There is no requirement for a tabular illustration of charges under a SIPP, personal pension deposit or personal pension product. Instead, a firm should ensure that the information provided contains a full and fair description of all of the charges that apply or may apply to the private customer in respect of the scheme, including asset transactions under a

SIPP.

...

...

6.6.1 R COB 6.6 applies to a *firm* in respect of *projections* for *life policies, key features schemes, simplified prospectus schemes, personal pension schemes* and *stakeholder pension schemes*.

...

6.6.4 R ...

6.6.4A G If a *firm* produces a *projection* for a *SIPP*, it should do so in a way which is consistent with the principles in *COB 6.6 (Projections)*.

...

6.7.1 R COB 6.7 applies to:

...

(5) the operator of a *personal pension scheme* or a *stakeholder pension scheme*;

...

6.7.5 G Cancellable investment agreements.

This table belongs to COB 6.7.4. G

...

Post- sale right to cancel?	Pre-sale right to withdraw?	Maximum period of reflection (but see COB 6.7.11R)
-----------------------------	-----------------------------	----------------------------------------------------

A. Contracts where the right arises regardless of means of sale.

...

<i>Life policy</i> (including <i>pension policy</i> , <i>pension annuity</i> or within <i>ISA</i> or <i>CTF</i>) or a <u><i>personal pension scheme</i></u>	Yes ^{1,5,6,12}	No ¹	30 days
-------------------------------------------------------------------------------------------------------------------------------------------------------------------------	-------------------------	-----------------	---------

<i>Personal pension contract</i>	Yes ^{1,5,6}	No ¹	30 days
----------------------------------	----------------------	-----------------	---------

....

Certain variations of existing <i>life policies, pension contracts personal pension schemes</i> and <i>SHP's</i>	Yes ^{1,5,6,8}	No ¹	30 days
------------------------------------------------------------------------------------------------------------------	------------------------	-----------------	---------

....

Notes:

...

12. ...

13. A private customer's right to cancel a contract for a SIPP may lapse in certain circumstances (see COB 6.7.13AR (Right to cancel a personal pension deposit, a personal pension product or a SIPP)).

- 6.7.7 R A retail customer has a right to cancel:
- (1) ...
 - (2) a contract to join for a stakeholder pension scheme, a personal pension deposit, a personal pension product or a SIPP for which a right to cancel applies under COB 6.7.12R or COB 6.7.13AR;
 - (3) ...
 - (4) a variation of a *life policy, personal pension scheme contract* or *stakeholder pension scheme* for which a right to cancel applies under COB 6.7.23R, COB 6.7.23AR and COB 6.7.26AR.
- 6.7.8 R The trustees of an *occupational pension scheme*, the operator of a personal pension scheme or the trustees and managers of a *stakeholder pension scheme* must be treated so far as necessary as a *retail customer* for the purposes of the *cancellation rules*, and acquire the same right to cancel as a *retail customer*.
- 6.7.9 G (1) COB 6.7.8R applies, for example, when the trustees or operators of a personal pension scheme purchase life policies or schemes as investments of their pension schemes. Individual members of a personal pension scheme or a stakeholder pension schemes have a

right to cancel initial membership of the scheme and, in some circumstances, a subsequent variation of their contributions.

....

...

- 6.7.10 G When a *retail customer* has a right to cancel under COB 6.7.7R, that right must (unless COB 6.7.11R applies) be exercised:
- (1) (in the case of a *life policy, personal pension ~~scheme policy,~~ personal pension contract* or *stakeholder pension scheme*) within 30 days; or

...

...

- 6.7.12 R (1) A *retail customer* who has entered into a contract for a *stakeholder pension scheme* has a right to cancel, unless:
- (a) the right to cancel is disappplied for a *distance contract* by case 15 of row 2 to COB 6.7.17R; or
- (b) the relevant transaction is funded (wholly or partly) by a pension transfer, but only if and to the extent that the right to cancel has been replaced by a right to withdraw (see COB 6.7.17R (Cancellable contracts and exceptions – non-life).
- (2) ...

...

Right to cancel a personal pension deposit, a personal pension product or a SIPP

- 6.7.13A R A retail customer who has entered into a contract to join a personal pension deposit, personal pension product or a SIPP has a right to cancel, unless:
- (1) the right to cancel is disappplied for a distance contract by case 15 of row 2 to COB 6.7.17R (Cancellable contracts and exceptions – non-life);
- (2) the relevant transaction is funded (wholly or partly) by a pension transfer, but only if and to the extent that the right to cancel has been replaced by a right to withdraw (see COB 6.7.19R (Cancellation substitute)); or
- (3) (in the case of a SIPP) the performance of the contract (to join the SIPP) has been fully completed by both parties at the customer's express request before the customer exercises his right to cancel.

- 6.7.13B G If a customer requests that a firm complete a transaction to join a SIPP before the expiry of the cancellation period, the firm should, in having regard

to the information needs of the *customer*, make the *customer* aware that he will lose his right to cancel and satisfy itself on reasonable grounds that the *customer* understands the cost and other implications.

...

6.7.15 R Cancellable contracts and exceptions-life

This table belongs to COB 6.7.7R(1)

Cancellable contracts and exceptions- life

Long-term insurance contracts which a *retail customer* has a right to cancel under COB 6.7.7 R(1)(subject to Row 2)

...

Row 2 There is no right to cancel where any one or more of the following cases applies:

3. ...

3A. A *pension policy* that is itself a *SIPP*;

4. ~~*pension policy* or *stakeholder pension scheme*~~ funded (wholly or in part) from payment derived from:

(a) a *pension transfer*, to the extent that the right to cancel is provided through the right to withdraw (see COB 6.7.14R(2)), using the cancellation substitute in COB 6.7.19R; or

(b) ...

...

6.7.17 R Cancellable contracts and exceptions – non-life

Contracts which a *retail customer* has a right to cancel under COB 6.7.7R (1) (subject to row 2):

Row 1 A. ...

B. ...

C. subscriptions (but see notes 1, 2 and 5 in COB 6.7.18R) which can be invested only in *units* (whether or not held within an *ISA*, *PEP*, ~~*pension contract*, *personal pension product*~~ or *SIPP*) in an *AUT*, *recognised scheme* or *ICVC* purchased from:

(a) ...

D. *distance contracts* (but see notes 6 and 8 in COB 6.7.18R) (whether or not held within a *CTF*) (other than for a *life policy*, *stakeholder pension scheme*, *personal pension deposit*, *personal pension product*, *SIPP*, *cash deposit ISA*, *cash deposit CTF* or a contract in A, B or C) the making or performance of which by the

firm constitutes or is part of:

...

Row 2 There is no right to cancel where any one or more of the following cases applies:

...

12. ~~*pension contract or stakeholder pension scheme*~~ funded (wholly or in part) from payments derived from a *pension transfer* to the extent that the right to cancel is provided through a right to withdraw (see *COB 6.7.14R (2)*) using the cancellation substitute in *COB 6.7.19R*;

6.7.19 R This table belongs to *COB 6.7.12R, COB 6.7.13AR(2), COB 6.7.14R(2)*, cases 4(a) and 7(a) of row 2 to *COB 6.7.15R*, case 12 of row 2 to *COB 6.7.17R, COB 6.7.23R(3)* and *COB 6.7.26AR(2)*.

Cancellation substitute

The *retail customer's* right to cancel under *COB 6.7.7R (1)*; ~~or *COB 6.7.7R (4)*~~ or *COB 6.7.13AR(2)* is provided through (see note 2) a right to withdraw only if:

....

.....

6.7.23 R (1) After an increase in regular or single *premiums* or payments (including a *pension transfer*) to a *life policy, personal pension scheme* ~~*contract*~~ or *stakeholder pension scheme*, a *retail customer* has a right to cancel (see *COB 6.7.7R (4)*) in the following circumstances unless (2) applies:

...

(2) Paragraph (1) does not apply if:

...

(c) the variation is in respect of a *life policy* held within a *CTF*; or

(d) the variation is in respect of a *SIPP* that is itself a *life policy*.

....

6.7.26A R (1) If a *customer* who is an individual varies an existing *personal pension scheme* ~~or *stakeholder pension scheme*~~ by exercising an option to make *income withdrawals*, he has a right to cancel that first variation.

....

....

6.7.31 R When the *customer* is a trustee or an operator of a personal pension scheme who is reasonably believed by the *firm* to be expected to act on the instructions of the individual beneficiary, scheme member or purchaser of the *policy* or contract, the *firm* must send the notice of the right to cancel in *COB* 6.7.30R to:

- (1) the trustee or operator, as appropriate; and
- (2) the beneficiary, scheme member or purchaser;

and must inform the beneficiary, scheme member or purchaser of the need to give instructions, within the specified cancellation period, to the trustee or operator where the right to cancel is to be exercised.

...

6.7.47 R Where notice of cancellation or withdrawal has been served on a *firm* (or its *appointed representative* or agent), the *firm* must make and retain records (which include a copy of any receipt of notice issued to the *customer* and the *customer's* original notice instructions):

- (1) ...
- (2) for a minimum period of:
 - (a) six years in the case of a record relevant to a *life policy*, ~~*pension contract*~~ *personal pension scheme* or *stakeholder pension scheme*; and

...

....

6.7.51 R By exercising a right to cancel under *COB* 6.7.7R(1), (2), ~~(4)~~, (5) or (6), the *customer* withdraws from the contract and:

...

.....

6.7.52 R Obligations on cancellation
Unless the agreement relates to a *CTF*, when a *retail customer* exercises a right to cancel under *COB* 6.7.7R(1), (2), ~~(3)~~ or (4):

...

....

6.7.57 R Table: Contracts which are subject to a shortfall

This table belongs to *COB* 6.7.54R

Investment agreements subject to shortfall

...

Part II: any contract specified in COB 6.7.13AR or row 1 of *COB 6.7.17R* (unless note 2 applies):

which is: where the *investment agreement* is effected as a:

...

(1) ...

(1A) a person

pension

product

...

...

(a) ...

...

7.5.4 R *COB 7.5.3R* does not apply in any of the following circumstances:

(1) the *customer order* is for:

(a) the purchase of a *life policy*; ~~or~~

(b) the purchase or sale of *units* in a *regulated collective investment scheme* from or to the *operator* of that *scheme*; or

(c) an asset to be held within a *personal pension scheme*, unless that asset is itself a *designated investment*;

...

7.15.4 R *COB 7.15.3R* does not apply to:

(1) a transaction in an asset in a *personal pension scheme*, unless that asset is itself a *designated investment*; or

(2) a *non-market-price transaction* if it is subject to the rules of a *recognised investment exchange*.

...

11.1.1 R This Chapter:

(1) applies to *depositories* and *trustee firms* when acting as such;

(2) does not apply to *trustee firms* when acting as the trustee of a *personal pension scheme* or *stakeholder pension scheme*.

...

COB TP 4 Miscellaneous transitional provisions applying to all firms

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional Provision	(5) Transitional Provision: dates in force	(6) Handbook provision: coming into force
17.	...				
18.	...				
19.	<u>Every amendment made to COB by the Personal Pensions Schemes Instrument 2006 (FSA 2006/28</u>	<u>R</u>	<u>If the application of a provision listed in (2) is dependent on the occurrence of a series of events, some of which occur before, and some of which occur on or after, 6 April 2007, the provision applies with respect to the events that occur on or after that date.</u>	<u>From 6 April 2007.</u>	<u>6 April 2007</u>

Annex G

Amendments to Insurance: Conduct of Business sourcebook (ICOB)

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

ICOB 4 Annex 2 R: Combined initial disclosure document (“CIDD”)

This Annex belongs to *ICOB 4.2.7R*.

...



about our services [Note 2]



Financial Services

[Note 5]

[123 Any Street

Some Town

ST21 7QB]

[Note 3] [Note 4]

...

2 Whose products do we offer? [Note 6] [Note 7]

Investment

- [We offer products from the whole market.] [Note 6A] [We offer our own product(s); you can ask us for a list, but our recommendation will be made following an analysis of the whole market.] [Note 6B]
- We [can] [Note 8] only offer products from a limited number of companies. [These include our own product(s) but our recommendation will be made following an analysis of our entire range of products.] [Note 8A]

...

...

The following notes do not form part of the CIDD.

...

Note 6 ...

Note 6B – a *firm* should only include these words if it offers whole of market advice and it owns or operates products that fall within the relevant market.

...

Note 8 ...

Note 8A – a *firm* should only include these words if it offers limited range advice and it owns or operates products that fall within the relevant range.

...

Note 30 – insert, in the *firm's* own words, a short description of any direct or indirect holding of more than 10 per cent in the capital or voting power of the *firm* which is held by a provider or operator of a packaged products or by the parent of the provider or operator.

Note 31 – insert, in the *firm's* own words, a short description of any direct or indirect holding of more than 10 per cent in the capital or voting power of a provider or operator of a packaged products which is held by the *firm*.

...

Annex H

Amendments to Mortgages: Conduct of Business sourcebook (MCOB)

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

MCOB 4 Annex 2 R: Combined initial disclosure document required by MCOB 4.4.1R (1) (“CIDD”)

1. Firms should omit the notes, asterisks and square brackets which appear in the following specimen.

...

keyfacts®
about our services [Note 2]

XYZ Financial Services [Note 3] [Note 4]

[Note 5]
[123 Any
Street
Some Town
ST21 7QB]

...

2 Whose products do we offer? [Note 6] [Note 7]

Investment

- [We offer products from the whole market.] [Note 6A] [We offer our own product(s); you can ask us for a list but our recommendation will be made following an analysis of the whole market.] [Note 6B]
- We [can] [Note 8] only offer products from a limited number of companies. [These include our own product(s) but our recommendation will be made following an analysis of our entire range of products.] [Note 8A]

Ask us for a list of the companies and products we offer. [Note 12]

...

The following notes do not form part of the CIDD.

...

Note 6A ...

Note 6B – a firm should only include these words if it offers whole of market advice and it owns or operates products that fall within the relevant market.

...

Note 8 ...

Note 8A – a *firm* should only include these words if it offers limited range advice and it owns or operates products that fall within the relevant range.

...

Note 18 - insert a short plain language description of when any *fees* are payable for services relating to *regulated mortgage contracts*, *regulated lifetime mortgage contracts* or home reversion schemes. This description could include, for example, a cash amount, a percentage of the loan or reversion amount or the amount per hour, as appropriate. However, where a cash amount is not disclosed, one or more examples of the cash amount must be included. If a *firm* offers more than one pricing option, it may illustrate each with a separate box. If a *firm* ~~firm~~ does not charge a *fee*, the text for the second box should be abbreviated to 'A fee'.

...

Note 30 – insert, in the *firm's* own words, a short description of any direct or indirect holding of more than 10 per cent in the capital or voting power of the *firm* which is held by a provider or operator of a packaged products or by the parent of the provider or operator.

Note 31 – insert, in the *firm's* own words, a short description of any direct or indirect holding of more than 10 per cent in the capital or voting power of a provider or operator of a packaged products which is held by the *firm*.

...

Annex I

Amendments to the Authorisation Manual (AUTH)

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

- 3.16 ~~Specific obligations: applicants seeking to establish, operate or wind up a stakeholder pension scheme~~
- 3.16.1 ~~G Applicants should be aware that, in addition to requiring *permission* from the FSA to *establish, operate or wind up a stakeholder pension scheme*, a firm will need to obtain exempt approval of the *stakeholder pension scheme* from ⁺HM Revenue and Customs⁺ and to register the scheme with the ⁺Pensions Regulator⁺.~~
- 3.16.2 ~~G Establishment and operation of a *stakeholder pension scheme* may involve heavy investment in new systems or changes to existing systems which, in view of the limit on charges, might not be recovered for some time. So, the FSA will normally require an applicant wishing to *establish, operate or wind up a stakeholder pension scheme* to provide financial projections for the whole period up to the point at which the new business is expected to break even. The applicant must also be able to demonstrate to the FSA that it is ready, willing and organised to comply with the requirements (including those in *COB 5*, *COB 6* and *TC 2*) applicable to operation of a *stakeholder pension scheme*~~

Annex J

Amendments to the Supervision manual (SUP)

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

SUP 13A Annex 1G Application of the handbook to Incoming EEA Firms G

...

(1) Module of handbook	(2) Potential application to an incoming EEA firm with respect to activities carried on from an establishment of the firm (or its appointed representative) in the United Kingdom	(3) Potential application to an incoming EEA firm with respect to activities carried on other than from an establishment of the firm (or its appointed representative) in the United Kingdom
------------------------	-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------	----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------

...

SUP

...

...

SUP 16 (Reporting requirements)

SUP 16 (Reporting requirements)

Parts of this chapter may apply if the *firm* has a *top-up permission* or if the *firm* is:

Parts of this chapter may apply if the *firm* has a *top-up permission* or if the *firm* is:

...

...

(e) a *firm* with *permission* to *establish, operate or wind up a personal pension scheme or a stakeholder pension scheme*; or

(f) a *firm* with *permission* to *establish, operate or wind up a personal pension scheme or a stakeholder pension scheme*; or

...

...

...

16.1.2

G

The only categories of *firm* to which no section of this chapter applies are:

(2)...

- (c) a firm with permission to establish, operate or wind up a personal pension scheme or a stakeholder pension scheme;

...

16.1.3 R Application of different sections of SUP 16

(1) Section(s)	(2) Categories of firm to which section applies	(3) Applicable rules and guidance
-------------------	----------------------------------------------------	-----------------------------------------

<i>SUP</i> 16.1, <i>SUP</i> 16.2 and <i>SUP</i> 16.3	All categories of <i>firm</i> except: ... (b) an <i>incoming EEA firm</i> or <i>incoming Treaty firm</i> , which is not:	Entire section
---------------------------------------------------------------	--------------------------------------------------------------------------------------------------------------------------------------	----------------

...

- (iii) a *firm* with
permission to
establish, operate or
wind up a personal
pension scheme or a
stakeholder pension
scheme;

...

<i>SUP</i> 16.8	... <i>Firm with permission to establish, operate or wind up a <u>personal pension scheme</u> or a <u>stakeholder pension scheme</u></i>	Entire section
-----------------	-------------------------------------------------------------------------------------------------------------------------------------------------------------	----------------

Annex K

Amendments to the Dispute Resolution Manual (DISP)

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

2.4.12 R The circumstances relevant for *DISP* 2.4.10R(2)(b) are:

...

- (4) that the complainant is the beneficial owner of *units* in a *collective investment scheme*, and the *firm* or the *VJ Participant* is the *operator* or *depository* of the *scheme*; ~~;~~
or
- (5) that the complainant is a beneficiary of, or has a beneficial interest in, a *personal pension scheme* or *stakeholder pension scheme*.

Annex L

Amendments to the Compensation Sourcebook (COMP)

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

Table COMP 4.2.2R Persons not eligible to claim unless COMP 4.3 applies (see COMP 4.2.1R)

This table belongs to COMP 4.2.1R

- 4.2.2 R (1) *Firms* (other than a *sole trader firm*; ~~a credit union~~; a trustee of a *stakeholder pension scheme* (which is not an *occupational pension scheme*) or *personal pension scheme*; a *firm carrying on the regulated activity of operating, or winding up, a stakeholder pension scheme* (which is not an *occupational pension scheme*) or *personal pension scheme*; or a *small business*; in each case, whose *claim* arises out of a *regulated activity* for which they do not have a *permission*)
...
- (9) *Bodies corporate* in the same *group* as the *relevant person in default* unless that *body corporate* ~~except *bodies corporate* which fall within COMP 4.2.2 R (4) (a) or (b)~~ is:
(i) a trustee that falls within COMP 4.2.2 R(1) or (4); or
(ii) carrying on the regulated activity of operating, or winding up, a stakeholder pension scheme (which is not an *occupational pension scheme*) or *personal pension scheme*.
...
- 5.5.1 R *Protected investment business* is:
(1) *designated investment business* carried on by the *relevant person* with, or for the benefit of, the claimant (so long as that claimant has a claim), or as agent on ~~his~~ the claimant's behalf;
...
- 12.6 Quantification: trustees, operators of pension schemes, persons winding up pension schemes, personal representatives, agents, and joint claims
Trustees, operators of pension schemes and persons winding up pension schemes
- 12.6.1 R If a claimant's *claim* includes a *claim* as:
(1) trustee; or
(2) the operator of, or the person carrying on the regulated activity of winding up, a stakeholder pension scheme (which is not an *occupational pension scheme*) or *personal pension scheme*,
the *FSCS* must treat him in respect of that *claim* as if his ~~claim as trustee were~~ a was the claim of a different *person*.

- 12.6.2 R If a claimant has a *claim* as:
A
- (1) ~~a the trustee of a kind falling within COMP 4.2.2 R(1) or COMP 4.2.2R(4)(a) or (b)~~ of a small self-administered scheme or an occupational pension scheme of an employer which is not a large company, large partnership or large mutual association or the trustee or operator of, or the person carrying on the regulated activity of winding up, a stakeholder pension scheme (which is not an occupational pension scheme) or personal pension scheme,
 - (2) for one or more members of a pension scheme (or, where relevant, the ~~widow or widower or surviving civil partner~~ beneficiary of any member) whose benefits are *money-purchase benefits*,
- the *FSCS* must treat the member or members (or, where relevant, the ~~widow or widower or surviving civil partner~~ beneficiary of any member) as having the *claim*, and not the claimant.
- 12.6.3 R If any group of *persons* has a *claim* as:
- (1) trustees; or
 - (2) operators of, or as persons carrying on the regulated activity of winding up, a stakeholder pension scheme (which is not an occupational pension scheme) or a personal pension scheme,
- (or any combination thereof), the *FSCS* must treat them as a single and continuing *person* distinct from the *persons* who may from time to time be the trustees, operators or persons winding up the relevant pension scheme.
- 12.6.4 R ...
Where the same *person* has a *claim* as:
- (1) trustee for different trusts or for different stakeholder pension schemes (which are not occupational pension schemes) or personal pension schemes; or
 - (2) the operator of, or the person carrying on the regulated activity of winding up, different stakeholder pension schemes (which are not occupational pension schemes) or personal pension schemes,
- COMP* applies as if the *claims* relating to each of these trusts or schemes were claims of different *persons*.
- 12.6.6 R ...
Where any of the provisions of *COMP* 12.6.1R to *COMP* 12.6.5 R apply, the *FSCS* must try to ensure that any compensation paid to:
- (1) the trustee; or
 - (2) the operator of, or the person carrying on the regulated activity of

winding up, a stakeholder pension scheme (which is not an occupational pension scheme) or personal pension scheme,

is, in each case:

- (13) ~~is~~ for the benefit of members or beneficiaries who would be *eligible claimants* if they had a *claim* themselves; and
- (24) ~~does not exceed~~ no more than the amount of the loss suffered by those members or beneficiaries.

...

12.6.11 R In applying *COMP* to *claims* arising out of business done with a *branch* or ~~establishment~~ *establishment* of the *relevant person* outside the *United Kingdom*, the *FSCS* must interpret references to:

- (1) *persons* entitled as personal representatives, trustees, bare trustees or agents, operators of pension schemes or persons carrying on the regulated activity of winding up pension schemes; or
- (2) ~~or references to~~ *persons* having a joint beneficial *claim* or carrying on business in partnership,

as references to *persons* entitled, under the law of the relevant country or territory, in a capacity appearing to the *FSCS* to correspond as nearly as may be to that capacity.

**MORTGAGES: CONDUCT OF BUSINESS SOURCEBOOK (AMENDMENT NO 3)
INSTRUMENT 2006**

Powers exercised

- A. The Financial Services Authority makes this instrument in the exercise of the powers listed in Schedule 4 to the Mortgages: Conduct of Business sourcebook.
- B. The rule-making powers referred to above are specified for the purpose of section 153(2) (Rule-making instruments) of the Financial Services and Markets Act 2000.

Commencement

- C. This instrument comes into force on 31 October 2006.

Amendments to the Handbook

- D. The Mortgages: Conduct of Business sourcebook (MCOB) is amended in accordance with the Annex to this instrument.

Citation

- E. This instrument may be cited as the Mortgages: Conduct of Business Sourcebook (Amendment No 3) Instrument 2006.

By order of the Board
28 September 2006

Annex

Amendments to the Mortgages: Conduct of Business sourcebook

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

...

- 3.6.3 R (1) ...
- (2) A *non-real time qualifying credit promotion* which includes a comparison or contrast must:
- (a) compare ~~qualifying credit~~ credit meeting the same needs or which is intended for the same purpose;
 - (b) objectively compare one or more material, relevant, verifiable and representative features of ~~the qualifying credit~~ that credit, which may include price;

...

...

- 3.6.5 G In relation to *MCOB 3.6.3R*:
- ...
- (2) if a *non-real time qualifying credit promotion* includes information on the performance of the *firm*, on conditions in the market, interest rates, *APRs* or other *price information* this information should be relevant and recent. *Firms* should therefore avoid including this information in *qualifying credit promotions* which have a long shelf-life, ~~and where the information can become outdated;~~ and without a clear and prominent warning that the information can become outdated; and

...

...

- 3.6.13 R A *non-real time qualifying credit promotion* must, unless *MCOB 3.6.15R* (Transient advertising) applies, prominently contain one or more of the following statements in the circumstances described:

...

- (3) in all cases except (1) and (2): 'Your home may be repossessed if you do not keep up repayments on your mortgage.'; or if it refers in whole or in part to *qualifying credit* secured on property which is not the *customer's* home the statement may be amended but only to the extent

necessary in order to reflect that fact.

...

(6) where a *non-real time financial promotion* relates to both *qualifying credit* and credit which is not *qualifying credit* the statements required by (2) or (3) may be modified by replacing ‘mortgage’ with ‘mortgage or any other debt secured on it’.

...

5.6.9 R The amount referred to in *MCOB* 5.6.6R(2) is:

(1) ...

(2) where the *regulated mortgage contract* is a revolving credit agreement such as a secured overdraft or *mortgage credit card*;

(a) (if it provides for an initial drawdown and *linked borrowing facilities* that would allow the *customer* to increase the amount of the loan without any further approval from the *mortgage lender*) the amount of the initial drawdown; or

(b) (in all other cases) the total borrowing that the *firm* is willing to provide under the *regulated mortgage contract*; or

(3) ...

...

5.6.124 R (1) The following words must be prominently displayed in the *illustration*, after the contact details: ‘Your home may be repossessed if you do not keep up repayments on your mortgage’.

(2) If the loan may be secured on property which is not the *customer's* home the statement in (1) may be amended but only to the extent necessary in order to reflect that fact.

...

6.4.4 R The *illustration* provided as part of the *offer document* in accordance with *MCOB* 6.4.1R(1) must meet the requirements of *MCOB* 5.6 (Content of illustrations) with the following modifications:

...

~~(10) details of insurance which the *customer* has chosen to take out through the *firm*, whether or not this insurance was included in the *illustration* provided in accordance with *MCOB* 5 (Pre-application disclosure), must be included in Section 9 of the *illustration* that is part of the *offer document*;~~[deleted]

...

...

7.5.1 R Subject to *MCOB 7.5.2R*, a *firm* must provide the *customer* with a statement at least once a year (or, in relation to the first statement, within the first 13 months):

...

...

7.6.27 R ~~For the purposes of *MCOB 7.6.22R*, *MCOB 5.6.17R* is replaced with the following;~~

~~"Section 2: 'Which service are we providing you with?'~~

~~Under the section heading 'Which service are we providing you with?' the following text should be included:~~

~~'We are providing you with an illustration for the [addition/removal] of [a party/parties] to this mortgage. You must make your own choice about whether changing the parties to this mortgage is right for you.' [deleted]~~

...

9.4.13 R The amount referred to in *MCOB 9.4.6R(2)* is:

(1) ...

(2) where the *regulated lifetime mortgage contract* is a revolving credit agreement such as a secured overdraft or *mortgage credit card*;

(a) (if it provides for an initial drawdown and linked borrowing facilities that would allow the *customer* to increase the amount of the loan without any further approval from the *mortgage lender*) the amount of the initial drawdown; or

(b) (in all other cases) the total borrowing that the *firm* is willing to provide under the *regulated lifetime mortgage contract*; or

(3) ...

...

9.5.4 R The *illustration* provided as part of the *offer document* in accordance with *MCOB 6.4.1R(1)* must meet the requirements of *MCOB 9.4*, with the following modifications:

...

- (9) ~~details of insurance which the *customer* has chosen to take out through the *firm*, whether or not this insurance was included in the *illustration* provided in accordance with *MCOB 9*, must be included in Section 12 of the *illustration* that is part of the *offer document*;~~[deleted]

...

...

Addition or removal of a party to a contract

- 9.8.8 R For the purposes of *MCOB 7.6.22R*, *MCOB 9.4.19R* is replaced with the following:

~~"Section 2: 'Which service are we providing you with?'~~

~~Under the section heading 'Which service are we providing you with?' the following text should be included:~~

~~"We are providing you with an illustration for the addition/removal of a party/parties to this lifetime mortgage. You must make your own choice about whether changing the parties to this lifetime mortgage is right for you.";~~[deleted]

MCOB TP 1

MCOB Transitional Provisions

1 Transitional Provisions

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
...
<u>9</u>	<u><i>MCOB 5.6.9R</i></u> and <u><i>MCOB 9.4.13R</i></u>	<u>R</u>	<u>A <i>firm</i> may continue to comply with <i>MCOB 5.6.9R</i> and <i>MCOB 9.4.13R</i> as they applied before amendment by the <i>Mortgages: Conduct of Business Sourcebook (Amendment No 3) Instrument 2006</i></u>	<u>31 October 2006 to 31 October 2007</u>	<u>31 October 2006</u>

**SUPERVISION MANUAL (RETAIL MEDIATION ACTIVITIES RETURN)
(SUSPENSION) INSTRUMENT 2006**

Powers exercised

- A. The Financial Services Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):
- (1) section 138 (General rule-making power);
 - (2) section 156 (General supplementary powers); and
 - (3) section 157(1) (Guidance).
- B. The rule-making powers listed above are specified for the purpose of section 153(2) (Rule-making instruments) of the Act.

Commencement

- C. This instrument comes into force with immediate effect.

Amendments to the Supervision manual

- D. The commencement of the Supervision manual (Retail Mediation Activities Return) Instrument 2006 (FSA 2006/14) is suspended until the Financial Services Authority by subsequent instrument provides for the commencement of this instrument.

Citation

- E. This instrument may be cited as the Supervision manual (Retail Mediation Activities Return) (Suspension) Instrument 2006.

By order of the Board
28 September 2006

INCOMING EEA INSURANCE INTERMEDIARIES INSTRUMENT 2006**Powers exercised**

- A. The Financial Services Authority makes this instrument in the exercise of the powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”) referred to in:
- (1) Schedule 4 to the Conduct of Business sourcebook (COB) (Powers exercised); and
 - (2) Schedule 4 to the Insurance: Conduct of Business sourcebook (ICOB) (Powers exercised).
- B. The rule-making powers referred to above are specified for the purpose of section 153(2) (Rule-making instruments) of the Act.

Commencement

- C. This instrument comes into force on 6 October 2006.

Amendments to the Handbook

- D. The modules of the FSA Handbook of rules and guidance listed in column (1) below are amended in accordance with the Annexes to this instrument listed in column (2).

(1)	(2)
Conduct of Business sourcebook (COB)	Annex A
Insurance: Conduct of Business sourcebook (ICOB)	Annex B
Supervision manual (SUP)	Annex C

Citation

- E. This instrument may be cited as the Incoming EEA Insurance Intermediaries Instrument 2006.

By order of the Board
28 September 2006

Annex A

Amendments to the Conduct of Business sourcebook (COB)

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

Business with UK clients from non-UK offices

1.4.3 R This sourcebook applies in relation to activities not within *COB* 1.4.2R (UK establishments: general) carried on with or for a *client* in the *United Kingdom*, except in any of the following cases:

(1) ...; or

(2) ...

(c) ...; or

(3) (except as set out in (2) and in *COB* 1.4.12R (IMD passported activities)) when an *incoming EEA firm* is providing *cross-border services in the United Kingdom under the IMD*.

...

IMD passported activities

1.4.12 R ...

(3) ~~In addition to the situation in *COB* 1.4.3R, t~~The *IMD minimum implementation provisions* apply, on the basis outlined in (4), to an *incoming EEA firm* providing *cross-border services in the United Kingdom under the IMD* unless the *firm's Home State regulator* imposes measures which implement the articles for these activities.

(4) ...

(5) The only provisions in *COB* that apply to *passported activities* carried on by an *EEA firm* under the *IMD* from a *branch in the UK* are:

...

(a) the *IMD minimum implementation provisions*, on the basis in (4), unless the *firm's Home State regulator* imposes measures which implement articles 12 and 13 of the *IMD* for these activities;

(b) *COB* 1.4.5R (Financial promotions), *COB* 1.4.4R (Overseas business for UK private customers) and *COB* 1.4.10R (Electronic commerce activities and communications);

(c) the other provisions in *COB* relating to articles 12 and 13 of

the *IMD* (beyond the minimum required to implement these articles), unless the *firm's Home State regulator* imposes measures of like effect for those activities; and

- (d) (if the activities are in connection with a *distance contract* with a *retail customer*) the provisions in *COB* which implement the *DMD*, unless the *firm's Home State* imposes measures which implement, or correspond to obligations provided for by, the *DMD*.

Annex B

Amendments to the Insurance: Conduct of Business sourcebook (ICOB)

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

IMD passported activities

1.3.10 R ...

- (3) ~~In addition to ICOB 1.3.1R~~ Notwithstanding the other rules in this section, the only provisions in ICOB that apply to an incoming EEA firm carrying on passported activities under the IMD in the United Kingdom are:
- (a) ~~the provisions in ICOB 1.3.11R do not apply to an incoming EEA firm carrying on passported activities under the IMD from a branch in the United Kingdom if the firm's Home State regulator imposes minimum measures which implement articles 12 and 13 of the IMD for these activities~~ ICOB 1.3.8R (Electronic commerce activities and communications) and ICOB 3 (Financial promotion);
 - (b) ~~the provisions in ICOB 1.3.11R apply to an incoming EEA firm providing cross border services in the United Kingdom if the firm's Home State regulator does not impose minimum measures which implement articles 12 and 13 of the IMD for those activities; and~~
 - (c) ~~the other provisions in ICOB relating to articles 12 and 13 of the IMD (beyond the minimum required to implement these articles) apply to an incoming EEA firm providing cross-border services in the United Kingdom, unless the firm's Home State regulator imposes measures of like effect for those activities; and~~
 - (d) (if the activities are carried on from a branch in the UK and are in connection with a distance contract with a retail customer) the provisions in ICOB which implement the DMD in respect of a distance non-investment mediation contract, unless the firm's Home State imposes measures which implement, or correspond to obligations provided for by, the DMD.

Annex C

Amendments to the Supervision manual (SUP)

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

SUP 13A Annex 1G

Application of the Handbook to Incoming EEA Firms

...		
(1) Module of Handbook	(2) Potential application to an incoming EEA firm with respect to activities carried on from an establishment of the firm (or its appointed representative) in the United Kingdom	(3) Potential application to an incoming EEA firm with respect to activities carried on other than from an establishment of the firm (or its appointed representative) in the United Kingdom
...
<i>COB</i>	<p><u><i>COB</i> applies except that in respect of activities passported under the <i>IMD</i>, the only provisions that apply are:</u></p> <p>(1) <u><i>COB</i> 3 (Financial promotion), but see the territorial scope in <i>COB</i> 3.3 (Where?);</u></p> <p>(2) <u>unless the <i>firm's</i> Home State regulator imposes measures which implement articles 12 and 13 of the <i>IMD</i> for those activities:</u></p> <p style="padding-left: 20px;">(a) <u><i>COB</i> 4.3.19R to <i>COB</i> 4.3.25R save that the <i>firm</i> must also comply with those rules as if they also applied to a <i>firm</i> carrying out the activities in <i>COB</i> 4.3.19R(1) with or on behalf of all private customers;</u></p> <p style="padding-left: 20px;">(b) <u><i>COB</i> 5.2.12R to</u></p>	<p>Where the activity:</p> <p>(1) (a) would fall within the <i>overseas persons</i> exclusions in article 72 of the <i>Regulated Activities Order</i>; or</p> <p style="padding-left: 40px;">(b) would not be regarded as carried on in the <i>United Kingdom</i>; or</p> <p style="padding-left: 40px;">(c) is not carried on with or for a <i>client</i> in the <i>United Kingdom</i>;</p> <p>then, unless the activity is passported under the <i>IMD</i>, only the following apply:</p> <p style="text-align: center;">...</p> <p style="padding-left: 40px;">(g) [deleted](i) <i>COB</i> 4.3.19R to <i>COB</i> 4.3.25R save that the <i>firm</i> must also comply with those rules as if they also applied to a <i>firm</i> carrying out the activities in <i>COB</i> 4.3.19R(1) with or on</p>

	<p style="text-align: center;"><u>COB 5.2.14R; and</u></p> <p>(c) <u>COB 5.3.14R(1) and COB 5.3.18AR to COB 5.3.18CR;</u></p> <p>(3) <u>unless the firm's Home State regulator imposes measures of like effect for those activities:</u></p> <p>(a) <u>COB 4.3.5R to COB 4.3.11R (Fees and commission statement and initial disclosure document); and</u></p> <p>(b) <u>COB 4.3.21R(9), COB 4.3.22R, COB 4 Annex 4R(8) and COB 4 Annex 5R(8) (Information on compensation); and</u></p> <p>(4) <u>in the case of a distance contract with a retail customer, unless the firm's Home State imposes measures which implement or correspond to obligations of the DMD:</u></p> <p>(a) <u>COB 2.5.3R (Limits on the exclusion of liability: designated investment business);</u></p> <p>(b) <u>COB 2.6 (General provisions related to distance marketing)</u></p> <p>(c) <u>COB 4.2.5R to COB 4.2.6AG, COB 4.2.10R and</u></p>	<p><u>behalf of all private customers;</u></p> <p>(ii) <u>COB 5.2.12R to COB 5.2.14R; and</u></p> <p>(iii) <u>COB 5.3.18R(1) and COB 5.3.18AR to COB 5.3.18CR; but only in relation to activities passported under the IMD (see COB 1.4.12R(3));</u></p> <p>(2) ...</p> <p>(b) ... ;</p> <p>(3) <u>is passported under the IMD, only the following apply:</u></p> <p>(a) <u>COB 4.3.19R to COB 4.3.25R save that the firm must also comply with those rules as if they also applied to a firm carrying out the activities in COB 4.3.19R(1) with or on behalf of all private customers;</u></p> <p>(b) <u>COB 5.2.12R to COB 5.2.14R;</u></p> <p>(c) <u>COB 5.3.18R(1) and COB 5.3.18AR to COB 5.3.18CR; and</u></p> <p>(d) <u>COB 5.5.7R (Overseas business for UK private customers).</u></p> <p>Otherwise, as column (2), (COB 1.4.3R).</p>
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	<p><u>COB 4 Ann 1R</u> (Terms of business and client agreements with customers);</p> <p>(d) <u>COB 6.1.5R(1)</u> (Quality and production of key features);</p> <p>(e) <u>COB 6.2.2R, COB 6.2.7R, COB 6.2.12R(2), COB 6.2.14R, COB 6.2.16R(2), COB 6.2.18R(2), COB 6.2.21R and COB 6.4.27R to COB 6.4.31R</u> (Provision of key features);</p> <p>(f) <u>COB 6.5.2R(6), COB 6.5.3R</u> (Content of key features and important information: life policies, schemes, ISA and CTF cash deposit components and stakeholder pension schemes);</p> <p>(g) <u>COB App 1</u> (Required information for certain terms of business, key features and direct offer financial promotions).</p>	
<p><i>ICOB</i></p>	<p><i>ICOB</i> applies <u>As column (3) plus, in the case of a <i>distance contract</i> with a <i>retail customer</i>, unless the <i>firm's Home State</i> imposes measures which implement or correspond to obligations of the <i>DMD</i>:</u></p>	<p>Only the following provisions of <i>ICOB</i> apply:</p> <p>(a)(1) <i>ICOB</i> 3 (Financial promotion), but see the territorial scope in <i>ICOB</i> 3.4 (Application: where?);</p>

	<p>(1) <u>ICOB 2.2.3R(1) (Clear, fair and not misleading communication);</u></p> <p>(2) <u>ICOB 2.5 (Exclusion of liability);</u></p> <p>(3) <u>ICOB 2.7 (General provision related to distance contracts);</u></p> <p>(4) <u>ICOB 4.7 (Unsolicited services); and</u></p> <p>(5) <u>ICOB 8 (Distance non-investment mediation contracts with retail customers).</u></p>	<p>(2) <u>ICOB 4.2.19R (Overseas business for UK retail customers);</u></p> <p>(b)(3) ...</p> <p>(e)(4) ...</p> <p>(d)(5) ...;</p> <p>(6) <u>unless the firm's Home State regulator has implemented articles 12 and 13 of the IMD for those activities:</u></p> <p>(a) <u>ICOB 4.2.2R to ICOB 4.2.8R, ICOB 4.2.11R, ICOB 4.2.14R and ICOB 4.2.20R (Status disclosure);</u></p> <p>(b) <u>ICOB 4.3 (Suitability);</u></p> <p>(c) <u>ICOB 4.4 (Statement of demands and needs) except ICOB 4.4.7R;</u></p> <p>(d) <u>ICOB 4.8.1R (Language of the information provided to customers); and</u></p> <p>(7) <u>unless the firm's Home State regulator imposes measures of like effect that apply to those activities:</u></p> <p>(a) <u>ICOB 2.10 (Excessive charges to retail customers);</u></p> <p>(b) <u>ICOB 4.2.8R(9) (Information on compensation);</u></p> <p>(c) <u>ICOB 4.4.7R (Record keeping where a personal recommendation is made);</u></p>
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		<p>(d) <u>ICOB 4.2.15R (Fees other than product related fees); and</u></p> <p>(e) <u>ICOB 4.6 (Commission disclosure for commercial customers).</u></p>
...

GIBRALTAR (PASSPORTING) INSTRUMENT 2006

Powers exercised

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

Commencement

- B. This instrument comes into force on 6 October 2006.

Amendments to the Handbook

- C. The Supervision manual (SUP) is amended in accordance with the Annex to this instrument.

Citation

- D. This instrument may be cited as the Gibraltar (Passporting) Instrument 2006.

By order of the Board
28 September 2006

Annex

Amendments to the Supervision manual (SUP)

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

...

- 13.1.2 G ...So, references in this chapter to an *EEA State* or an *EEA right* include references to Gibraltar and the entitlement under the ~~Gibraltar Order~~ Gibraltar Order respectively.
- 13A.1.3 G (1) Under the ~~Gibraltar Order~~ Gibraltar Order made under section 409 of the *Act* (~~Gibraltar Order~~), a Gibraltar firm is treated as an *EEA firm* under Schedule 3 to the *Act* if it is:
- (a) authorised in Gibraltar under the *Insurance Directives*; or
 - (b) authorised in Gibraltar under the *Banking Consolidation Directives*; or
 - (c) authorised in Gibraltar under the *Insurance Mediation Directive*; or
 - (d) authorised in Gibraltar under the *Investment Services Directive*.
- (1A) Similarly, an *EEA firm* which:
- (a) has satisfied the Gibraltar establishment conditions and has established a *branch* in the *UK*; or
 - (b) has satisfied the Gibraltar service conditions and is providing *cross border services* into the *UK*;
- is treated as having satisfied the *establishment conditions* or *service conditions* (as appropriate) under Schedule 3 to the *Act*. Regulations 4 to 7 of the *EEA Passport Rights Regulations* will apply to the establishment of the *branch* or the provision of *cross border services*.
- (2) ~~A Gibraltar insurance company companies, credit institutions, insurance intermediaries and investment firms is are~~ allowed to passport ~~its their~~ services into the *United Kingdom* if ~~it complies they~~ comply with the relevant notification procedures. ~~Similarly, a Gibraltar credit institution is allowed to passport into the United Kingdom to provide banking services provided those services fall within items 1 to 6 in Annex 1 to the *Banking Consolidation*~~

~~Directive.~~ So, any references in this chapter to *EEA State* or *EEA right* include references to Gibraltar and the entitlement under the ~~Gibraltar Order~~ Gibraltar Order where appropriate.

- (3) ~~The entitlement in the Gibraltar Order does not, however, extend to investment services as Gibraltar investment firms have not been granted the right to passport into the United Kingdom. [deleted]~~

...

14.1.3 G (1) Under the ~~Gibraltar Order~~ Gibraltar Order made under section 409 of the *Act*, a Gibraltar firm is treated as an *EEA firm* under Schedule 3 to the *Act* if it is:

- (a) authorised in Gibraltar under the *Insurance Directives*; or
- (b) authorised in Gibraltar under the *Banking Consolidation Directive*; or
- (c) authorised in Gibraltar under the *Insurance Mediation Directive*; or
- (d) authorised in Gibraltar under the *Investment Services Directive*.

(1A) Similarly, an *EEA firm* which:

- (a) has satisfied the Gibraltar establishment conditions and has established a *branch* in the *UK*; or
- (b) has satisfied the Gibraltar service conditions and is providing *cross border services* into the *UK*;

is treated as having satisfied the *establishment conditions* or *service conditions* (as appropriate) under Schedule 3 to the *Act*.

- (2) ~~A Gibraltar insurance company companies, *credit institutions*, *insurance intermediaries* and *investment firms* is are allowed to passport its their services into the *United Kingdom* if it complies they comply with the relevant notification procedures. Similarly, a Gibraltar *credit institution* is allowed to passport into the *United Kingdom* to provide banking services provided those services fall within items 1 to 6 in Annex 1 to the *Banking Consolidation Directive*.~~ So, any references in *SUP 14* to *EEA State* or *EEA right* include references to Gibraltar and the entitlement under the ~~Gibraltar Order~~ Gibraltar Order where appropriate.

...

**COMPLAINTS AGAINST THE FSA SCHEME (AMENDMENT NO 3)
INSTRUMENT 2006**

Powers exercised

- A. The Financial Services Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000:
- (1) section 157(1) (Guidance); and
 - (2) paragraph 7 of Schedule 1.

Commencement

- B. This instrument comes into force on 6 October 2006.

Amendments to the Handbook

- C. The Complaints against the FSA sourcebook (COAF) is amended in accordance with the Annex to this instrument.

Citation

- D. This instrument may be cited as the Complaints against the FSA Scheme (Amendment No 3) Instrument 2006.

By order of the Board
28 September 2006

Annex

Amendments to the Complaints against the FSA sourcebook (COAF)

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

- 1.3.2 G (1) The *Complaints Commissioner* is appointed for a period of three years and may be dismissed from office only for reason of becoming:
- (a) incapacitated by physical or mental illness; or
 - (b) otherwise unfit to discharge the functions of his office;
- and subject in either event to the approval of the Treasury.
- (2) ~~No person who has attained the age of 70 years is eligible to be or to remain a *Complaints Commissioner*.~~[deleted]
- (3) The *Complaints Commissioner* must not be an employee of the *FSA* and is required to act independently of, and without favouring, the *FSA*.

...

- 1.4.7 G The *FSA* will not make any charge to complainants ~~in relation to~~ for the operation of the *complaints scheme*.

...

- 1.5.2A G In carrying out the investigation, the suitably senior member of staff will undertake a paper-based review of the complaint, by considering any documents supplied initially by the complainant, and any relevant *FSA* documents, or following communications from the *FSA* under *COAF* 1.5.1CG. The investigation will not involve an interview of the complainant.

...

Time limit for the referral of a matter to the Complaints Commissioner

- 1.5.6A G (1) When the *FSA* writes to a complainant with its final report of its investigation, or explaining that it will not investigate a complaint under the *complaints scheme* under *COAF* 1.5.1BG, the *FSA* will inform the complainant that, if he is dissatisfied, he must refer the *FSA's* decision to the *Complaints Commissioner* within three months of the date of that letter.
- (2) If the *Complaints Commissioner* receives a referral of a matter outside the three months time limit, it will be for the *Complaints*

Commissioner to decide whether there is a good reason why the matter should be considered out of time.

...

- 1.5.19A G (1) The *Complaints Commissioner* will send a preliminary report, with a time limit within which the *FSA* and the complainant may indicate in writing any disagreement with or comments on the preliminary report.
- (2) At the end of this time limit, the *Complaints Commissioner* will produce a final report after taking into account, at his discretion, any disagreements or comments notified to him. The final report will be the conclusion of the investigation procedure set out in *COAF* 1.5 and the complaint will then be regarded as closed by the *Complaints Commissioner* and the *FSA*.

2 Transitional complaints scheme

...

2.3 Coverage and scope of the scheme

...

2.3.7 G The *FSA* will not make any charge to complainants ~~in relation to~~ for the operation of the *transitional complaints scheme*.

...

2.4.2A G In carrying out the investigation, the suitably senior member of staff will undertake a paper-based review of the complaint, by considering any documents supplied initially by the complainant, and any relevant *FSA* documents, or following communications from the *FSA* under *COAF* 2.4.1BG. The investigation will not involve an interview of the complainant.

...

Time limit for the referral of a matter to the *Complaints Commissioner*

- 2.4.6A G (1) When the *FSA* writes to a complainant with its final report of its investigation, or explaining that it will not investigate a complaint under the *complaints scheme* under *COAF* 2.4.1AG, the *FSA* will inform the complainant that, if he is dissatisfied, he must refer the *FSA*'s decision to the *Complaints Commissioner* within three months of the date of that letter.
- (2) If the *Complaints Commissioner* receives a referral of a matter outside the three months time limit, it will be for the *Complaints Commissioner* to decide whether there is a good reason why the

matter should be considered out of time.

...

- 2.4.18A G (1) The *Complaints Commissioner* will send a preliminary report, with a time limit within which the *FSA* and the complainant may indicate in writing any disagreement with or comments on the preliminary report.
- (2) At the end of this time limit, the *Complaints Commissioner* will produce a final report after taking into account, at his discretion, any disagreements or comments notified to him. The final report will be the conclusion of the investigation procedure set out in *COAF 2.4* and the complaint will then be regarded as closed by the *Complaints Commissioner* and the *FSA*.

**NEW COLLECTIVE INVESTMENT SCHEMES SOURCEBOOK
(DUAL PRICING) INSTRUMENT 2006**

Powers Exercised

- A. The Financial Services Authority makes this instrument in the exercise of the following powers and related provisions:
- (1) the following sections of the Financial Services and Markets Act 2000 (“the Act”):
 - (a) section 138 (General rule-making power);
 - (b) section 140 (Restriction on managers of authorised unit trust schemes);
 - (c) section 156 (General supplementary powers);
 - (d) section 157 (Guidance);
 - (e) section 238(5) (Restrictions on promotion);
 - (f) section 242 (Applications for authorisation of unit trust schemes);
 - (g) section 247 (Trust scheme rules); and
 - (h) section 248 (Scheme particulars rules); and
 - (2) regulation 6 (FSA rules) of the Open-Ended Investment Companies Regulations 2001 (SI 2001/1228).
- B. The rule-making powers and related provisions listed above are specified for the purpose of section 153(2) of the Act (Rule-making instruments).

Commencement

- C. This instrument comes into force on 6 October 2006, except that text in Annex A which is placed in bold square brackets is deleted with effect from 12 February 2007.

Amendments to the Handbook

- D. The modules of the FSA's Handbook of rules and guidance listed in column (1) below are amended in accordance with the Annexes to this instrument listed in column (2).

(1)	(2)
Glossary of definitions	Annex A
New Collective Investment Schemes sourcebook (COLL)	Annex B

Citation

- E. This instrument may be cited as the New Collective Investment Schemes Sourcebook (Dual Pricing) Instrument 2006.

By order of the Board
28 September 2006

Annex A

Amendments to the Glossary of definitions

In this Annex underlining indicates new text and striking through indicates deleted text. However, Handbook text in this Annex placed in bold square brackets is deleted with effect from 12 February 2007 but is not shown struck through.

Amend the following definitions as shown:

...

bid price the price ~~price~~ at which a person could sell a unit in a dual-priced authorised fund AUF or a security.

...

cancellation price (in *COLL*)
(in relation to the *cancellation of units in a dual-priced authorised fund*) the price for each unit payable by the depositary to the authorised fund manager on that cancellation.

...

dilution (in *COLL* [and *CIS*]) the amount of *dealing* costs incurred, or expected to be incurred, by ~~an ICVC~~ or for the account of a *single-priced authorised fund AUF* to the extent that these costs may reasonably be expected to result, or have resulted, from the acquisition or disposal of *investments* by ~~the ICVC~~ or for the account of the *single-priced authorised fund AUF* as a consequence (whether or not immediate) of the increase or decrease in the cash resources of the ~~ICVC or single-priced authorised fund AUF~~ resulting from the *issue* or *cancellation* of units over a period;

for the purposes of this definition, *dealing* costs include both the costs of *dealing* in an *investment*, professional fees incurred, or expected to be incurred, in relation to the acquisition or disposal of ~~an immovable approved immovables~~ and, where there is a spread between the *buying* and *selling* prices of the *investment*, the indirect cost resulting from the differences between those prices ~~prices~~.

...

dilution adjustment an adjustment to the price ~~price~~ of a unit determined by the ~~ACD, or the authorised fund manager~~ of a *single-priced authorised fund AUF*, under *COLL* 6.3.8 R (Dilution) [or, as the case may be, *CIS* 4.6.4R (Dilution adjustment)] for the purpose of reducing *dilution*.

...

dilution levy a charge of such amount or at such rate as is determined by ~~the an ACD of an ICVC or a~~ authorised fund manager of a *single-priced authorised fund AUF* to be made for the purpose of reducing the effect of *dilution*.

...

*dual-priced
AUT* [an *AUT* that is not a *single-priced-AUT*.]

...

*dual-priced
authorised
fund* an *authorised fund* or, in the case of an *umbrella*, a *sub-fund* (if it were a separate *fund*), that is not a *single-priced authorised fund*.

...

initial price (in *COLL* [and *CIS*])

in relation to a *unit* of any *class*:

(a) ~~(in relation to a share of an *ICVC* or a unit in a single priced *AUT* *single-priced authorised fund*,)~~ the price to be paid for a unit of any class during the period of the initial offer under *COLL* 6.2.3R (Initial offers) or, as the case may be, *CIS* 4.2.4 R (*Issue of units: initial offer*); or

(b) ~~(in relation to a unit in a dual-priced *authorised fund, AUT*)~~ such the amount as may be agreed by the *depository trustee* and *authorised fund manager* as being the maximum amount price, inclusive of the manager's preliminary charge, if any *preliminary charge*, which that may be paid to the *authorised fund manager*; ~~for units on an initial offer.~~

during the period of the *initial offer* under *COLL* 6.2.3R (Initial offer) [or, as the case may be, *CIS* 4.2.4R (*Issue of units: initial offer*) or *CIS* 15.2.4R and 15.2.5R (*Issue of units: initial offer*)].

...

issue price (in relation to the *issue of units* of a *dual-priced AUT authorised fund*) the ~~price~~ price for each unit payable by the *authorised fund manager* to the *trustee depository* on that *issue*.

...

large deal [(in *CIS*) a *transaction* (or *series of transactions* in one *dealing period*) by any person to buy, sell or exchange units in an *authorised fund* at a total value of £15,000 or its equivalent in the *base currency* of the *authorised fund*, or;

(a) for the purpose of *SDRT provision*, such other value; or

(b) for all or any other specified purposes, such greater value;

as may be specified in the *prospectus*;]

(in *COLL*) a transaction (or ~~series of transactions~~ *series of transactions* in one *dealing period*) by any person to buy, sell or exchange units in an *authorised fund*, of any value as set out in the *prospectus*, for the purposes of:

(a) an *SDRT provision*;

(b) a *dilution levy*; ~~or~~

(c) a *dilution adjustment*; or

(d) calculating the prices, for a dual-priced authorised fund, at which units may be sold or redeemed.

...

offer price the price at which a *person* could purchase a *unit* in a *dual-priced authorised fund AUT* or a *security*.

...

price [(in CIS)

(in relation to a ~~unit~~ *unit* in an ~~ICVC~~ *ICVC* or a ~~single-priced AUT~~ *single-priced AUT*) the ~~price~~ *price* of the *unit* calculated in accordance with ~~COLL 6.3 (Valuation and pricing)~~ or, as the case may be, ~~CIS~~ *CIS* 4 (Single ~~pricing~~ *pricing* and ~~dealing~~ *dealing*).]

(in COLL)

(in relation to a unit in an authorised fund) the price of the unit calculated in accordance with COLL 6.3 (Valuation and pricing).

...

redemption price [(in CIS)

the ~~authorised fund manager's price~~ *authorised fund manager's price* for *redemption* under ~~CIS~~ *CIS*.15.4.9R (Redemption price parameters).]

(in COLL)

the price payable by the authorised fund manager for each unit it redeems from a unitholder, calculated in accordance with COLL 6.3 (Valuation and pricing).

...

sale price (in COLL)

the price payable to the authorised fund manager for each unit it sells to a unitholder, calculated in accordance with COLL 6.3 (Valuation and pricing).

...

single-priced AUT [an *AUT* for the *units* of which there is only one *price* applicable by reference to a *valuation point*.]

...

single-priced authorised fund an authorised fund or, in the case of an umbrella, a sub-fund (if it were a separate fund), for the units of which there is only one price applicable by reference to a valuation point.

...

unitisation arrangements for a newly formed ~~dual-priced~~ AUT under which:

(a) the whole or part of the property of a *body corporate* (or a *collective investment scheme*) becomes the first property to be held on the trusts of the AUT; and

(b) the *holders* of :

(i) shares (or units) in the body corporate (or collective investment scheme) being wound up; or

(ii) units in the collective investment scheme, the property of which is being transferred;

become the first *participants* in the AUT.

...

Annex B

Amendments to the New Collective Investment Schemes sourcebook

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

Table: contents of the prospectus

4.2.5 R ...

Valuation and pricing of scheme property

16 In relation to the valuation ~~and pricing~~ of *scheme property* and pricing of units:

(a) either:

(i) in the case of a *single-priced authorised fund*, a provision that there must be only a single *price* for any *unit* as determined from time to time by reference to a particular *valuation point*; ~~or~~

(ii) in the case of a *dual-priced authorised fund*, the *authorised fund manager's policy* for determining *prices* for the sale and redemption of *units* by reference to a particular *valuation point* and an explanation of how those *prices* may differ;

(b) ...

(iii) where relevant, how the *price* of *units* of each *class* will be determined for *dealing* purposes; ~~and~~

...

(v) where relevant in the case of a *dual-priced authorised fund*, the *authorised fund manager's policy* in relation to *large deals*; and

...

Dilution

18 In the case of a *single-priced authorised fund*, ~~the~~ details of what ...

...

Guidance on contents of the prospectus

4.2.6 G ...

(4) In relation to *COLL 4.2.5R (16)(a)*, where the *prospectus* includes provisions for both a *single-priced authorised fund* and a *dual-priced authorised fund*, it should state prominently which method of *pricing* is applicable to which *authorised fund*, and explain how

the differences between them may affect unitholders (for example if a unitholder exchanges units in a single-priced authorised fund for units in a dual-priced authorised fund, or vice versa).

...

Guidance on significant changes

4.3.7 G ...

(2) ...

(b) ... allocation of payments policy; or

(c) ... purchased through a group savings plan; or

(d) a change in the pricing arrangements for units of the scheme so as to cause a single-priced authorised fund to become a dual-priced authorised fund, or vice versa.

...

Valuation

5.2.5 R ...

(3) When valuing the scheme property of a dual-priced authorised fund, the cancellation basis of valuation referred to in COLL 6.3.3R (2) (Valuation) is to be applied.

...

Explanation of this chapter

6.1.3 G ...

(3) ... and to oversee certain functions of ~~the~~ the authorised fund manager ...

...

Application

6.2.1 R This section applies to an *authorised fund manager*, a *depository*, an *ICVC* and any other *directors* of an *ICVC*.

...

Initial offers

6.2.3 R ...

(3) The *authorised fund manager* must, ... pay the *depository* ~~the~~ initial price in respect of any unit it has agreed to sell during the period of the initial offer;

- (a) in the case of a *single-priced authorised fund*, the *initial price* of that *unit*; or
- (b) in the case of a *dual-priced authorised fund*, the *initial price* of that *unit* less, where relevant, an amount not exceeding the amount of any *preliminary charge* stated in the *prospectus*.

...

...

Controls over the issue and cancellation of units

6.2.8 R ...

(2) ...

- (a) for an *AUT*, when giving instructions to the ~~*depository trustee*~~ for the *issue* or *cancellation* of *units*; or

...

do, or omit to do, anything ~~which that~~ would, or might, confer on ~~himself itself~~ or an *associate* a benefit or advantage at the expense of a *unitholder* or a potential *unitholder*.

...

Controls over the issue and cancellation of units - guidance

6.2.9 G ...

- (3) ... the *price* of the *units* should be calculated at the ~~valuation point~~ *valuation point* before or after the instruction ...

...

Box management errors guidance

6.2.12 G ...

Correction of box management errors

...

2 Controls by depositaries

- (1) ... should take reasonable care to ensure that a ~~scheme~~ *scheme* is managed in accordance with ...

...

Payments for units issued

6.2.13 R (1) The *authorised fund manager* must, by the close of business on the fourth *business day* following the *issue* of any *units*, arrange for

payment to the *trustee* or the *ICVC* of :

- (a) in the case of a *single-priced authorised fund*, the ~~value price~~ price of the *units issued* and any payments required under *COLL* 6.3.7R (SDRT provision) and *COLL* 6.3.8R (Dilution) ; or
- (b) in the case of a *dual-priced authorised fund*, the *issue price* of the *units* and any payment required under *COLL* 6.3.7R.

to the *trustee* or the *ICVC*.

...

Payment for cancelled units

- 6.2.14 R (1) On *cancelling units* the *authorised fund manager* must, before the expiry of ... , require the *depository* to pay:
- (a) in the case of a *single-priced authorised fund*, the *price* of the *units* (less any deductions required under *COLL* 6.3.7R and *COLL* 6.3.8R); or
 - (b) in the case of a *dual-priced authorised fund*, the *cancellation price* of the *units* (less any deduction required under *COLL* 6.3.7R);

to the *authorised fund manager*, or ...

...

In specie issue and cancellation

- 6.2.15 R The *depository* may take into or pay out of *scheme property* assets other than ~~*cash*~~ *cash* as payment for the *issue* or *cancellation* of ~~*units*~~ *units* but only if:

...

Sale and redemption

- 6.2.16 R ...
- (2) ...
- (b) the ~~*issue*~~ *issue* of ~~*units*~~ *units* is prevented under *COLL* 6.2.18R (Limited issue).
- ...
- (6) ... for the purposes of ~~*buying or selling*~~ *dealing in units* if later ...
 - (7) ... must *sell* or *redeem units* at a ~~*price*~~ *price* determined no later than ...
 - (8) ~~The *authorised fund manager* must not *sell a unit* for more than the *price* of a *unit* of the relevant *class* at the relevant *valuation point*, to which may be added any *preliminary charge* permitted and any~~

payment required under ~~COLL 6.3.7R~~ and ~~COLL 6.3.8R~~. [deleted]

(9) The ~~authorised fund manager~~ must not redeem a *unit* for less than the ~~price~~ of a *unit* of the relevant *class* at the relevant *valuation point*, less any ~~redemption charge~~ permitted and any deduction under ~~COLL 6.3.7R~~ and ~~COLL 6.3.8R~~. [deleted]

(10) Paragraphs (4), (5) and ~~(9)~~ COLL 6.3.5AR (2) (Sale and redemption prices for single-priced authorised funds) do not apply where the *authorised fund manager* is buying ~~units~~ units as *principal* ...

Sale and redemption: guidance

6.2.17 G (1) ... after which it will not accept instructions to *sell* or *redeem* ~~units~~ units at that *valuation point*. ...

...

Limited issue

6.2.18 R ...

(2) ... for the further *issue* of *units* unless, at the time of the ~~issue~~ issue, he it is satisfied on reasonable grounds ...

...

Limited redemption

6.2.19 R (1) .. and the *prospectus* of a *non-UCITS retail fund scheme* that invests substantially in ~~approved immovables~~ immovables or whose investment objective ...

...

Deferred redemption

6.2.21 R ...

(2) ...

(a) the consistent treatment of all *unitholders* who have sought to ~~redeem~~ redeem *units* at any *valuation point* at which ~~redemptions~~ redemptions are deferred; and

...

...

Purpose

6.3.2 G ...

(2) ... This section protects *clients* by:

- (a) setting out ~~rules and guidance~~ guidance to ensure the prices of units in ~~an~~ both a single-priced authorised fund and a dual-priced authorised fund ~~is~~ are calculated fairly and regularly;
 - (b) allowing for... scheme property caused by:
...
 - (c) making appropriate provision to ensure clients are treated fairly where units are being ~~dealt with~~ dealt in at a known (~~historie~~ historic) price; and
 - (d) ensuring that ~~the prices~~ is are made public in an appropriate manner.
- (3) ... instead of the base currency of the umbrella. Consequently different methods of pricing units may be applied by an authorised fund manager to different sub-funds of an umbrella.
- (4) The authorised fund manager must follow the same method of pricing for each class of units in an authorised fund, or in a sub-fund of an umbrella.

Valuation

- 6.3.3 R (1) To determine the price of units the authorised fund manager must carry out a fair and accurate valuation of all the scheme property in accordance with the instrument constituting the scheme and the prospectus.
- (2) For a dual-priced authorised fund, each valuation of the scheme property must consist of two parts, carried out on an issue basis and a cancellation basis respectively.

Valuation points

- 6.3.4 R ...
- (8) The authorised fund manager may determine to have an additional valuation point for an authorised fund as a result of market movement under COLL 6.3.9 (Forward and historic pricing) or otherwise, in which case ~~he~~ it must inform the depository.

Price of a unit

- 6.3.5 R (1) An authorised fund manager must ensure that the ~~The~~ price of a unit of any class ~~must be~~ is calculated :
- (a) by reference to the net value of the scheme property; and
 - (b) ~~must be calculated~~ in accordance with the provisions of both the instrument constituting the scheme and the prospectus.

...

- (3) For each class of units in a single-priced authorised fund, a single price must be calculated at which units are to be issued and cancelled.
- (4) For each class of units in a dual-priced authorised fund, an issue price and a cancellation price must be calculated by reference to the respective parts of the valuation carried out under COLL 6.3.3R (2).

Sale and redemption prices for single-priced authorised funds

6.3.5A R The authorised fund manager of a single-priced authorised fund must not:

- (1) sell a unit for more than the price of a unit of the relevant class at the relevant valuation point, to which may be added any preliminary charge permitted and any payments required under COLL 6.3.7R and COLL 6.3.8R; or
- (2) redeem a unit for less than the price of a unit of the relevant class at the relevant valuation point, less any redemption charge permitted and any deductions under COLL 6.3.7R and COLL 6.3.8R.

Sale and redemption price parameters for dual-priced authorised funds

6.3.5B R (1) The authorised fund manager of a dual-priced authorised fund must not:

- (a) sell a unit for more than the maximum sale price of a unit of the relevant class at the relevant valuation point, to which may be added any payment required under COLL 6.3.7R; or
 - (b) redeem a unit for less than the cancellation price of a unit of the relevant class at the relevant valuation point, less any redemption charge permitted and any deduction under COLL 6.3.7R.
- (2) The maximum sale price of units under (1)(a) is the total of:
- (a) the issue price; and
 - (b) the current preliminary charge.
- (3) The sale price of units under (1)(a) must not be less than the relevant redemption price under (1)(b).
- (4) The redemption price under (1)(b) must not exceed the relevant issue price of the relevant units.
- (5) Subject to COLL 6.7.9R (Charges for the exchange of units in an umbrella), in the case of an umbrella:
- (a) the maximum price at which units in one sub-fund that is a dual-priced authorised fund may be acquired in exchange for units in another sub-fund must not exceed the relevant maximum sale price (less any preliminary charge) of the new units; and

- (b) the minimum price at which the old units in a sub-fund that is a dual-priced authorised fund may be taken in exchange must not be less than the equivalent cancellation price.

6.3.5C G The prospectus may make provision for large deals to be carried out at a higher sale price or a lower redemption price than those published, provided they do not exceed the relevant maximum and minimum parameters.

Valuation and pricing guidance

6.3.6 G Table: This table belongs to *COLL 6.3.2G (2)(a)* and *COLL 6.3.3R (Valuation)*

...

1 The valuation of scheme property

...

- (2) ~~An investment for which different prices are quoted according to whether it is being bought or sold should be valued at its mid-market price. The instrument constituting the scheme should set out the valuation method that will apply where a single price for buying and selling a security is quoted.~~

For some or all of the investments comprising the scheme property, different prices may be quoted according to whether they are being bought (offer prices) or sold (bid prices). The valuation of a single-priced authorised fund should reflect the mid-market value of such investments. In the case of a dual-priced authorised fund, the issue basis of the valuation will be carried out by reference to the offer prices of investments and the cancellation basis by reference to the bid prices of those same investments. The prospectus should explain how investments will be valued for which a single price is quoted for both buying and selling.

...

- (5) (a) no reliable price exists for a ~~security~~ security at a valuation point; or

...

(7) ...

- (c) the basis and reliability of the alternative ~~price~~ price used; and

...

...

2 The pricing controls of the authorised fund manager

...

(2) ...

(b) ~~investment~~ investment transactions are accurately and promptly reflected in valuations;

(c) the components of the valuation (including stock, cash and ~~units in issue~~ issue) are regularly reconciled to their source or prime records and any reconciling items resolved promptly and debtors reviewed for recoverability;

...

(f) dividends are accounted for as soon as ~~stocks~~ securities are quoted ex-dividend (unless it is prudent to account for them on receipt):

(g) fixed interest dividends, interest and expenses are accrued at each ~~valuation point~~ valuation point;

...

(3) ... and may choose a longer interval, if appropriate, given the level of activity on the ~~fund~~ authorised fund or the materiality of any effect on the *price*.

...

(6) Where the ~~pricing~~ pricing function is delegated to a third party, ■ COLL 6.6.15 R (1) (Committees and delegation) will apply.

...

3 The depositary's review of the authorised fund manager's systems and controls

(1) ...These checks also apply where an *authorised fund manager* has delegated all or some of its ~~pricing~~ pricing functions to a third party.

...

(5) ...verifying, on a sample basis, if necessary, the assets, liabilities, accruals, ~~units in issue~~ issue, *securities* prices ...

...

4 The recording and reporting of instances of incorrect pricing

...

(3) A *depositary* should also report to the *FSA* immediately any instance of incorrect ~~pricing~~ pricing where the error is 0.5% or more of the *price* of a

unit, ...

- (4) In accordance with ~~SUP~~ SUP 16.6.8R, a *depository* should also make a return to the *FSA* on a quarterly basis which summarises the number of instances of incorrect ~~pricing~~ pricing during a particular period.

5 The rectification of pricing breaches

- (1) ... and the *scheme* itself, for instances of incorrect ~~pricing~~ pricing, except if it appears to the *depository* that the breach is of minimal significance.

- (2) A *depository* may consider that the instance of incorrect ~~pricing~~ pricing is of minimal significance if:

...

- (b) the error in ~~pricing~~ pricing of a *unit* is less than 0.5% of the correct *price*.

- (3) In determining (2), if the instance of incorrect ~~pricing~~ pricing is due to one or more factors or exists over a period of time, each *price* should be considered separately.

...

- (5) The *depository* should satisfy itself that any payments required following an instance of incorrect ~~pricing~~ pricing are accurately and promptly calculated and paid.

...

Forward and historic pricing

6.3.9 R ...

- (2) If *forward prices* only are to be used, all ~~deals~~ deals must be at a *forward price*.

- (3) ...

- (b) where the regular *valuation points* are more than one *business day* apart;

- (c) If the request to ~~deal~~ deal reaches the *authorised fund manager* through the post or by any similar form of non-interactive communication;

...

- (6) All *sub-funds* of a *scheme* which is ~~an~~ an *umbrella* must adopt the same pricing basis, ...

...

Publication of prices

6.3.11 R Where the *authorised fund manager* is prepared to ~~deal~~ deal in *units*, or is willing to *issue* or ~~cancel~~ cancel *units*,—under *COLL* 6.2.7, it must make the ~~dealing~~ dealing *prices* public in an appropriate manner.

Manner of price publication

- 6.3.12 G (1) ...
- (c) publication is consistent with the manner and frequency at which the *units* are ~~sold~~ dealt in;
- ...

...

Valuation, pricing and dealing

- 8.5.9 R ...
- (8) ~~Immediately after completing a valuation under (6), the *authorised fund manager* must notify the *depository* of:~~
- (a) ~~the price in the relevant currency of each type of *unit* as determined for the relevant *valuation point*; and~~
- (b) ~~the basis of any adjustment applied in relation to that *valuation point*. [deleted]~~
- (9) The *authorised fund manager* must publish in an appropriate manner the ~~price~~ price of any type of *unit* based on the ~~notification to the *depository* in (8)(a)~~ valuation carried out in accordance with (6).

...

PERIMETER GUIDANCE (PERSONAL PENSION SCHEMES) INSTRUMENT 2006

Powers exercised

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

Commencement

- B. Annex A of this instrument comes into force on 6 October 2006.
- C. Annex B of this instrument comes into force on 6 April 2007.

Amendments to the Perimeter Guidance manual (PERG)

- D. PERG is amended in accordance with Annex A and B. The general guidance in PERG does not form part of the Handbook.

Citation

- E. This instrument may be cited as the Perimeter Guidance (Personal Pension Schemes) Instrument 2006.

By order of the Board

28 September 2006

ANNEX A

Amendments to the Perimeter Guidance manual

In this Annex, underlining indicates new text and striking through indicates deleted text, with the exception of Chapter 12 which represents new text.

1.4.2 G Table: list of general guidance to be found in *PERG*.

Chapter:	Applicable to:	About:
...		
<u>PERG 12:</u> <u>Running or advising on personal pension schemes</u>	<u>any person who needs to know whether his activities in relation to establishing, running, advising on or marketing personal pension schemes will amount to regulated activities</u>	<u>the regulated activities that arise in connection with establishing, running, advising on or marketing personal pension schemes and any exclusions that may be relevant</u>

2.5.5 G For *persons* who are *investment firms*, the activities ...

- (1) ...
- (6) groups and joint enterprises (see *PERG 2.9.9G*); ~~and~~
- (7) sale of a *body corporate* (see *PERG 2.9.11G*); ~~and~~
- (8) business angel-led enterprise capital funds (see *PERG 2.9.20G* to *PERG 2.9.22G*).

...

2.8.4C G The exclusions referred to in *PERG 2.8.4G*(1), (2), (5) and (6)(b), (c) and (d) will not be available to *persons* who, in carrying on the activity of *dealing in investments as principal*, are *investment firms* (see *PERG 2.5.4G* (*Investment services and activities*)).

Dealing in investments as agent

2.8.5 G The *regulated activity* of *dealing in investments as agent* applies to ...

...

(3) ...

(i) that involves a *contract of insurance* covering large risks situated outside the *EEA* (see *PERG 2.9.19G*);

(j) on behalf of the participants of a business angel-led enterprise capital fund and that person is a *body corporate* as specified in article 72E(7) of the *Regulated Activities Order*.

...

2.8.5A G The exclusions referred to in *PERG 2.8.5G* (1), (2) and (3)(b), (c), (d) and (j) will not be available to *persons* who, in carrying on the activity of *dealing in investments as agent*, are *investment firms* (see *PERG 2.5.4G* (*Investment services and activities*)).

Arranging deals in investments and arranging regulated mortgage contracts

2.8.6 G The exclusions in relation to the *regulated activities* of *arranging* are ...

...

(13) ...

(k) that involve a *contract of insurance* covering large risks situated outside the *EEA* (see *PERG 2.9.19G*);

(l) for or with a view to transactions to be entered into by or on behalf of the participants of a business angel-led enterprise capital fund and that person is a *body corporate* as specified in article 72E(7) of the *Regulated Activities Order*.

...

2.8.6A G The exclusions referred to in *PERG 2.8.6G*(4) and (13)(c), (d), (e) and (l) will not be available to *persons* who, in carrying on an *arranging* activity, are *investment firms* (see *PERG 2.5.4G* (*Investment services and activities*)).

Managing investments

2.8.7 G The activities of *persons* appointed under a power of attorney are excluded under article 38 of the *Regulated Activities Order*, from the *regulated activity of managing investments*, if specified conditions are satisfied. The exclusion only applies where a *person* is not carrying on *insurance mediation* or *reinsurance mediation* and is subject to further limitations discussed below. In addition, the following exclusions (outlined in *PERG 2.9*) apply in specified circumstances where a *person* manages assets:

- (1) ...
- (4) as an *incoming ECA provider* (see *PERG 2.9.18G*); or
- (5) belonging to the participants of a business angel-led enterprise capital fund and that person is a *body corporate* as specified in article 72E(7) of the *Regulated Activities Order*.

The exclusion in article 38 of the *Regulated Activities Order* and the exclusions referred to in *PERG 2.8.7G* (2), (3) and (5) will not be available to *persons* who, in carrying on the activity of *managing investments*, are *investment firms* (see *PERG 2.5.4G* (Investment services and activities)).

Safeguarding and administering investments

2.8.8 G The exclusions from the *regulated activity of safeguarding and administering investments* are as follows.

- (1) ...
- (4) ...
- (f) as an *incoming ECA provider* (see *PERG 2.9.18G*); ~~and~~
- (g) that are *contracts of insurance* and, in so doing, provides information to *policyholders* or potential *policyholders* on an incidental basis in the course of his carrying on a business or profession not otherwise consisting of *regulated activities* (see *PERG 2.9.19G*(2)); and
- (h) belonging to the participants in a business angel-led enterprise capital fund, but only where such safeguarding and administration is carried on by a *body corporate* as specified in article 72E(7) of the *Regulated Activities Order*.

...

Advising on investments

2.8.12 G ...

(2) The following exclusions apply in specified circumstances where a person is ~~advising on~~ advising on investments:

(a) ...

(f) that are *contracts of insurance* covering large risks situated outside the *EEA* (see *PERG 2.9.19G*);

(g) to be made by or on behalf of the participants of a business angel-led enterprise capital fund, when the advice is given to the participants in that fund and that person is a *body corporate* as specified in article 72E(7) of the *Regulated Activities Order*.

...

2.9.8 G ... in relation to rights under a *contract of insurance* or units in a *collective investment scheme* (or rights to, or interests in, either). The exclusions are also disappplied for persons who, in carrying on the relevant regulated activity, are investment firms (see *PERG 2.5.4G (Investment services and activities)*).

...

2.9.10 G ... *Guidance* on exclusions relevant to *insurance mediation activities* is in *PERG 5 (Insurance mediation activities)*. The exclusions are also disappplied for persons who, in carrying on the relevant regulated activity, are investment firms (see *PERG 2.5.4G (Investment services and activities)*).

...

2.9.12 G ... The exclusions in *PERG 2.9.11G(2), (3) and (4)* are disappplied where they concern a *contract of insurance*. *Guidance* on exclusions relevant to *insurance mediation activities* is in *PERG 5 (Guidance on insurance mediation activities)*. The exclusions are also disappplied for persons who, in carrying on the relevant regulated activity, are investment firms (see *PERG 2.5.4G (Investment services and activities)*).

...

2.9.22 The exclusions for business angel-led enterprise capital funds are also disappplied for persons who, in carrying on the relevant regulated activity, are investment firms (see *PERG 2.5.4G (Investment services and activities)*).

...

10 Guidance on activities related to pension schemes

10.1 Background

Q1. ...

The Q&As complement the general *guidance* on regulated activities in Chapter 2 of our Perimeter Guidance Manual ('PERG'), the general guidance on insurance mediation activities in Chapter 5 of PERG (PERG 5) and the relevant legislation. In addition, Chapter 12 of PERG (PERG 12) has further guidance about the regulated activities relating to the operation and sale of personal pension schemes that come into force on 6 April 2007.

The Q&As that follow are set out in sections:

...

- issues for pension scheme service providers other than trustees (PERG 10.4); and
- the application of EU Directives (PERG 10.4A); and
- issues for employers ...

...

10.3 Pension Scheme Trustees

Q30. ~~[Deleted] As a professional trustee of a pension scheme, am I affected by the implementation of the Insurance Mediation Directive (IMD)?~~

~~No. A pension scheme trustee may perform tasks on behalf of the other trustees (such as signing proposal forms or giving dealing instructions to insurers or brokers or notifying claims on the death of a scheme member). But he will not be providing an insurance mediation service to them. This is because, under the policy, he will share equal rights and equal responsibility with his co-trustees and so may be regarded as acting solely in the capacity of policyholder rather than intermediary. Also, the pension scheme trustee will not be providing an insurance mediation service on behalf of the members as the members will not be policyholders.~~

10.4A The application of EU Directives

Q41A. Are pension scheme trustees and administration service providers likely to be subject to authorisation under the Investment Services Directive or subject to the Capital Adequacy Directive?

This is possible, but in many instances it is likely that pension scheme

trustees and service providers will either not be providing an investment service for the purposes of, or otherwise be exempt under article 2.2 of, the *Investment Services Directive*. The following table expands on this in broad terms.

As for the *Capital Adequacy Directive*, this will only apply to persons who are *ISD investment firms* or *BCD credit institutions*.

<u>Activity</u>	<u>Potential ISD investment service?</u>	<u>Potential application of ISD or of an ISD article 2.2 exemption?</u>
<u>Dealing in scheme assets as trustee</u>	<u>Dealing in investments for own account</u>	<p><u>ISD will not apply provided the trustees are either not acting by way of business or otherwise are not holding themselves out as persons who provide a dealing service to third parties. This is because the trustees would not be regarded as providing an investment service to third parties on a professional basis</u></p> <p><u>Where the pension scheme is a collective investment undertaking, the trustee should be exempt under article 2.2(h) as depositary of the scheme</u></p>
<u>Issuing rights under a stakeholder pension scheme to members</u>	<u>None – the rights are not ISD investments</u>	<u>ISD does not apply</u>
<u>Pension scheme service provider:</u> <u>a. dealing in scheme assets as agent for the trustees</u> <u>b. arranging deals in scheme assets</u>	<u>a. Executing orders other than for own account</u> <u>b. Receiving and transmitting orders</u>	<p><u>ISD will potentially apply where the investments are ISD financial instruments (such as shares, debt securities or units)</u></p> <p><u>However, many pension schemes will be employee participation schemes, the administration of which is exempt under article 2.2(d)</u></p> <p><u>Where the service provider is providing services exclusively for the benefit of a corporate trustee who is a member of its group, the exemption in article 2.2(b)</u></p>

		<p><u>should apply</u></p> <p><u>Where the activity is receiving and transmitting orders, the intermediaries exemption in article 2.2(g) may apply</u></p> <p><u>Where the pension scheme is a collective investment undertaking, the scheme administrator may be exempt under article 2.2(h) as manager of the scheme</u></p>
<u>Managing the assets of the scheme</u>	<u>Investment management</u>	<p><u>ISD will not apply to trustees provided they are either not acting by way of business or otherwise are not holding themselves out as, or additionally remunerated for, providing investment management services. This is because the trustees would not be regarded as providing an investment service to third parties on a professional basis</u></p> <p><u>Also, where the pension scheme is a collective investment undertaking, the scheme administrator may, and the trustee will, be exempt under article 2.2(h) in respect of anything they do in the capacity of manager or depositary of the scheme respectively</u></p>
<u>Safeguarding and administering the scheme assets</u>	<u>None</u>	<u>Safekeeping and administration of investments is an ISD non-core service</u>
<u>Establishing, operating or winding up a stakeholder pension scheme</u>	<u>None</u>	<u>ISD does not apply</u>
<u>Advising trustees or members or prospective members</u>	<u>Investment advice</u>	<u>Investment advice is an ISD non-core service</u>

Q41B. Will the implementation of the Markets in Financial Instruments Directive be likely to affect the current position of pension scheme trustees and administration service providers under the Investment Services Directive and the Capital Adequacy Directive?

This is unlikely to be the case. The position under the Markets in Financial Instruments Directive should not be materially different to the position under the Investment Services Directive (or, as a result, the Capital Adequacy Directive) as regards the usual activities of pension scheme trustees and administration service providers. The one possible exception to this concerns investment advice which will become an investment service for the first time under the Markets in Financial Instruments Directive. This will not apply to advice given to scheme members about their rights under the scheme as those rights will not be financial instruments for the purposes of the Directive. But the Directive will apply to advice in the form of a recommendation to scheme trustees or members about their buying or selling a particular financial instrument for the purposes of the scheme. Financial instruments will include shares, debt securities and units in a collective investment scheme but not life policies or deposits. This will be subject to the possible availability of an exemption in article 2.1 of the Directive.

Draft guidance on the changes in regulatory scope that will be caused by the implementation of the Markets in Financial Instruments Directive and its effect on the application of the Capital Adequacy Directive was issued as Annex 5 to Consultation Paper 06/9 (Organisation systems and controls) and will, in due course, form Chapter 13 to PERG.

Q41C. As a professional trustee of a pension scheme, am I affected by the implementation of the Insurance Mediation Directive?

No. A pension scheme trustee may perform tasks on behalf of the other trustees (such as signing proposal forms or giving dealing instructions to insurers or brokers or notifying claims on the death of a scheme member). But he will not be providing an insurance mediation service to them. This is because, under the policy, he will share equal rights and equal responsibility with his co-trustees and so may be regarded as acting solely in the capacity of policyholder rather than intermediary. Also, the pension scheme trustee will not be providing an insurance mediation service on behalf of the members as the members will not be policyholders.

Q41D. As a pension scheme administration service provider, am I affected by the implementation of the Insurance Mediation Directive?

You may be. Detailed guidance about the potential effect of the *Insurance Mediation Directive* on the normal activities of administration service providers is in Q31 to Q41 and the table in Annex 3.

...

...

New text to be added as Chapter 12

12 Guidance for persons running or advising on personal pension schemes

12.1 Background

Q1. What is the purpose of these questions and answers ('Q&As') and who should be reading them?

These Q&As are aimed at, and should be read by, *persons* involved in the running of a *personal pension scheme* and those who give advice about or provide services to such schemes. They are intended to help such persons understand whether they will be carrying on a *regulated activity* and need *authorisation* or exemption under section 19 of the Financial Services and Markets Act 2000 following the changes to pension legislation that are proposed to take effect on 6 April 2007. Under the proposed changes, establishing, operating or winding up a personal pension scheme will become a *regulated activity* and rights under a personal pension scheme will become a *specified investment*. The Q&As complement the general *guidance* on regulated activities which is in Chapter 2 of our Perimeter Guidance manual ('PERG') and the general guidance about pensions-related activities which is in Chapter 10 of PERG.

The Q&As are set out under five sections:

- the scope of the proposed new regulated activity of *establishing, operating or winding up a personal pension scheme* (PERG 12.2);
- the implications of the proposed new specified investment of rights under a *personal pension scheme* (PERG 12.3);
- the application of EU Directives (PERG 12.4)
- *financial promotion* issues (PERG 12.5); and
- practical transitional considerations (PERG 12.6).

12.2 Establishing, operating or winding up a personal pension scheme

Q2. What is a personal pension scheme for the purposes of this regulated activity?

The term is defined in the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (the *Regulated Activities Order*) as any scheme other than an *occupational pension scheme* (OPS) or a *stakeholder pension scheme* that is to provide benefits for people:

- (1) on retirement; or
- (2) on reaching a particular age; or
- (3) on termination of service in an employment.

Although the definition does not expressly say so, it is, in the FSA's view, clear from the context in which the term is applied, that such a scheme will be one that is intended to be registered with The Pensions Regulator and to be eligible for tax relief relating to pension schemes.

This will include *self-invested personal pension schemes* ('SIPPs') as well as personal pensions provided to consumers by product companies such as insurers, unit trust managers or deposit takers (including free-standing voluntary contribution schemes).

To determine whether a pension scheme is a personal pension scheme it is first necessary to determine whether it is an OPS. An OPS is defined in the Regulated Activities Order by reference to an OPS as defined in section 1 of the Pensions Schemes Act 1993 but without including paragraph (b) of that section. This means that a pension scheme is an OPS if, broadly speaking, it is a pension scheme:

- that is established:
 - for the purpose of providing benefits to, or in respect of, people with service in employments of a description; or
 - for that purpose and also for the purpose of providing benefits to, or in respect of, other people,

by persons who are, or who include, employees of that kind or their employers, or persons representing the interests of either, at the time the scheme is established; or

- that is prescribed or is of a prescribed description (such as a scheme that is prescribed under the Pension Schemes (Categories) Regulations 2005 (SI 2005/2401)).

The effect of omitting paragraph (b) from the Pensions Schemes Act definition of an OPS is that a pension scheme that would otherwise be an OPS but for the fact that its main administration takes place in another *EEA State* will be an OPS for the purposes of the Regulated Activities Order and this guidance.

Q3. What is involved in establishing a personal pension scheme?

The establisher of a *personal pension scheme* is the *person* responsible for putting in place the arrangements founding the scheme. With a trust-based scheme, this will usually be the person

who executes the trust as provider. In a scheme established by deed poll, it will be the person who enters into the deed poll. There will usually only be one person who establishes the scheme. Any professional firms that they may employ to act as their agent (such as solicitors) would not be establishing the scheme. The establisher may also be the operator but need not be. An employer will not be establishing a personal pension scheme (such as a *group personal pension scheme*) purely as a result of them having chosen such a scheme to offer to their employees.

The activity of establishing a personal pension scheme ceases once the scheme is established. This means that persons who have established schemes prior to 6 April 2007 will not require authorisation for establishing a personal pension scheme unless they intend to establish a new scheme after that date.

Q4. What is involved in operating a personal pension scheme?

The 'operator' is the *person* responsible to the members for managing and administering the assets and income of, and the benefits payable under, the scheme in accordance with relevant pensions and tax legislation, the scheme's constitution and the *regulatory system*. In this respect, the responsibilities that are placed under Part 4 of the Finance Act 2004 on a pension scheme administrator (as defined in section 270(1) of that Act) will mean that he is likely to be the operator of the scheme. In trust-based schemes, the trustees may act as scheme administrator or there may be a separate person who acts in that capacity. Where there are separate trustees, it may be the case that they are operating the scheme jointly with the scheme administrator by virtue of the responsibilities they assume under the trust deed for the management and administration of the scheme assets. However, in situations where the trustees' role is merely to act as a bare trustee holding the scheme assets, it is the scheme administrator who is likely to be the sole operator of the scheme. The scheme may be established by an *authorised person* who acts as a provider of investment products or services to the scheme. This does not make that person the operator of the scheme if, as a matter of fact, he has appointed another person to be responsible to the members for carrying out all the operator's functions as scheme administrator or as trustee, or both as the case may be. But a person to whom activities may be outsourced by the operator will not, thereby, become an operator of the scheme (see further guidance in Q6).

The fact that a member of a SIPP has the right to direct which investments are to be held for his benefit does not mean that he is to be regarded as operating the scheme as a result of exercising that right.

Q5. What is involved in winding up a personal pension scheme?

The *person* who winds-up a *personal pension scheme* will be the person who is responsible for putting in place the arrangements for bringing the scheme to an end in a way that complies with the relevant provisions of the instrument that established the scheme and any relevant rules under pensions or tax legislation. This will, more often than not, be the operator of the scheme.

Q6. What is my position as an operator of a personal pension scheme if I delegate day-to-day functions such as administration of the scheme or the management or custody of the scheme assets to another person?

As explained in Q4, the operator of a *personal pension scheme* is the person who is responsible to the members of the scheme for ensuring that the scheme is operated in accordance with relevant pensions and tax legislation, the scheme's constitution and the *regulatory system*. Provided he remains responsible to the members for such matters, he will remain the operator even though he may delegate or out-source the day-to-day carrying out of his functions as operator to another person. That other person will not become an operator of the scheme purely as a result of carrying out such functions on behalf of the operator. However, he may be carrying on other regulated activities in performing his delegated or out-sourced tasks (such as *arranging* or *managing investments*) in which case he will be subject to regulation for those activities.

Chapter 10.4 of PERG has general guidance about the circumstances in which persons who administer pension schemes on behalf of the operator or trustees may be carrying on a regulated activity including an *insurance mediation activity*.

Q7. As the operator of a personal pension scheme, is my position affected by whether the underlying property of the scheme is comprised of physical assets such as commercial property rather than investments such as shares or life policies?

No. It is the establishment, operation and winding up of the scheme that is regulated under the new activity – regardless of the type of assets the scheme will hold.

Q8. Will I need to be authorised for managing the assets of a personal pension scheme which is invested solely in physical assets such as commercial property on behalf of the operator?

No. Such assets will not become *designated investments*. However, the operator of the scheme will remain responsible for the management and administration of the assets as these are part of the regulated activity of operating the scheme.

Q9. Will I satisfy the 'by-way-of-business' test that is necessary for authorisation to be required?

The application of the by-way-of-business test to any particular *person* will always depend on that person's individual circumstances. A number of factors need to be taken into account in determining whether the test is met. These include:

- the degree of continuity;
- the existence of a commercial element;
- the scale of the activity;

- the proportion which the activity bears to other activities carried on by the same person but which are not regulated; and
- the nature of the particular *regulated activity* that is carried on.

In very broad terms, it is likely that any corporate body (including corporate trustees) that operates a *personal pension scheme* would be carrying on that activity by way of business. Chapter 10.5 of PERG has specific guidance about the limited circumstances in which employers may be likely to satisfy the by-way-of-business test when advising on or arranging pension benefits for their employees.

Q10. Can there be more than one person who operates a personal pension scheme?

Yes. For example, the *person* establishing a scheme may appoint a trustee and an administrator to operate the scheme jointly (see Q4). In this case, both the trustee and the administrator will need to be *authorised*. Or there could be two or more trustees who are jointly responsible for operating the scheme, in which case each will need to be *authorised* if they are doing so by way of business.

Q11. I am a trustee operating a self-invested personal pension scheme ('SIPP'). Can I continue to rely on the various exclusions available to trustees for other regulated activities such as dealing in investments, managing investments and safeguarding and administering investments?

Yes, you may continue to rely on existing exclusions for those activities. No changes are being made to those exclusions. Guidance on the exclusions is given in Chapter 10 (Q23) of PERG.

Q12. Do the same principles apply to establishing, operating or winding up a stakeholder pension scheme?

Yes. In principle, the answers given to other questions apply equally to *stakeholder pension schemes*. Establishing, operating and winding up a stakeholder pension scheme are already regulated activities. Guidance on these activities is given in Chapter 10 (Q24 to Q28) of PERG.

Q13. Does the regulated activity of establishing, operating or winding-up a personal pension scheme have any effect on occupational pension schemes?

No. But the establishment, operation and winding up of *occupational pension schemes* that are *stakeholder pension schemes* are regulated activities in their own right.

Q14. I intend to operate a personal pension scheme under which members will acquire benefits derived from the management of a pool of assets. Will the scheme become a collective investment scheme?

No. *Personal pension schemes* (along with *stakeholder pension schemes*) are specifically exempted from being *collective investment schemes*. However, where a personal pension scheme invests in a pooled investment vehicle of some kind, that vehicle may itself be a collective investment scheme unless another exemption applies to it.

12.3 Rights under a personal pension scheme

Q15. I am a financial intermediary dealing with pensions. Am I affected by the fact that rights under a personal pension scheme are a specified investment?

Yes. The *specified investment* of rights under a *personal pension scheme* is a *security*. This means that the following regulated activities apply in relation to such rights:

- *dealing*;
- *arranging*;
- *managing investments*;
- *safeguarding and administering investments*; and
- *advising on investments*.

Q16. What are the rights under a personal pension scheme that are specified investments and securities?

These are all the rights that membership of the scheme confers on a member. This may vary (for example, where the scheme is a SIPP) but is likely to include some or all of the following rights:

- to make payments to the scheme;
- to withdraw sums from the scheme in certain circumstances;
- to transfer value to another pension scheme;
- to receive benefits arising from the capital value of or income derived from particular assets or from the performance of a unitised fund;
- to place certain types of property (for example, commercial property) in the scheme;
- to instruct the operator which assets to buy or sell for the purposes of the scheme;
- to instruct the operator to switch funds from one managed or unitised fund to another;

- to appoint a *person* to manage the assets or to give instructions to the operator about which assets to buy or sell on behalf of the member; and
- to instruct the operator to borrow money to purchase assets (for example, to take out a mortgage on a commercial property).

Q17. Regulated activities such as dealing and arranging deals in, and advising on, investments relate to transactions involving the buying or selling of certain specified investments including securities. When will rights under a personal pension scheme be bought or sold so as to trigger these regulated activities?

The terms ‘bought’ and ‘sold’ are given a wide meaning and include any acquisition or disposal for valuable consideration. The term disposal is also given a wide meaning and, in relation to an investment comprising rights under a contract, includes surrendering, assigning or converting such rights. Taking these facts into account, the circumstances in which rights under a *personal pension scheme* may be bought or sold include:

- when the member first joins the scheme and acquires all the rights that the scheme provides to its members (since he has bought those rights);
- when the member makes regular or occasional additional payments to the scheme (since he has bought further rights being rights to an increased entitlement to benefits);
- when income withdrawals are made or benefits are transferred to another scheme or benefits are released to permit the purchase of an annuity (since the rights giving entitlement to benefits represented by the sums moved out of the scheme are surrendered and so sold);
- where the member or his agent instructs the operator to buy assets of any kind either from existing cash holdings or from the proceeds of selling existing assets (since, in switching the assets, the member is converting his rights from an entitlement to benefits from the performance of certain assets to an entitlement to benefits from the performance of other assets – the former rights are sold and the latter are bought); and
- where the member exercises his right to switch between managed or unitised funds (since, in switching funds, the member is converting his rights from an entitlement to benefits from the performance of one fund to an entitlement to benefits from the performance of another fund – again, the former rights are sold and the latter are bought).

The operator of a personal pension scheme will also be selling rights when he grants rights to a member.

Q18. The members of the personal pension scheme that I operate acquire rights to or interests in specified investments such as units or life policies. Such rights or interests are usually specified investments in their own right and arranging or advising on them is a regulated activity. Does the fact that rights under the personal pension scheme are themselves a specified investment affect this?

In certain circumstances this may be the case, but, in practice, the effect will be largely academic. Where the rights or interests would form part of the rights under a *personal pension scheme*, they will fall under that category of specified investment and will not be a specified investment in their own right. But where, for example, advice is being given on the merits of

acquiring rights to or interests in specified investments for the purpose of their being held under a personal pension scheme but not any one particular scheme, the rights or interests will remain specified investments in their own right. This is because there are no rights under a personal pension scheme at that stage.

This will only affect the rights that the member obtains. It does not alter the nature of any asset that is held by or on behalf of the operator for the purpose of providing benefits to the scheme member. So, any person who arranges for the scheme operator (or trustee as the case may be) to acquire assets is likely to be carrying on the regulated activity of *arranging* where those assets are *securities* or *relevant investments* but not where they involve other property such as real estate. This contrasts with a person who is arranging for scheme members to acquire rights under the scheme which will be a regulated activity regardless of the nature of the underlying property.

Q19. For advice to be regulated, it needs to relate to the merits of buying or selling a particular investment. When do rights under a personal pension scheme become ‘particular’ rights and so particular investments?

It is the rights under a *personal pension scheme* that must be a particular investment. This means that the rights must arise under a particular personal pension scheme. So, provided the rights on which advice is given relate to rights conferred, or to be conferred, by a particular scheme, they will be particular rights and advice on the merits of buying or selling them is likely to be regulated. This is the case, whatever the nature of the rights or of the underlying assets or prospective underlying assets. Conversely, if there is no particular personal pension scheme, there cannot be any particular rights.

As for advice to a prospective member on the merits of buying particular assets at a stage where there are no particular rights under a personal pension scheme, such advice is likely to be regulated where the assets are *securities* or *relevant investments* (as being advice on the merits of buying rights to or interests in those investments). But such advice will not be regulated where the assets are not investments of that kind (such as commercial property).

A person may be asked to advise a client on the merits of his acquiring a commercial property for holding it under a SIPP in circumstances where the client has an existing SIPP of which the adviser may or may not be aware. Provided the adviser has not been asked to, and it is reasonable for him to believe that he would not be expected to, advise his client on the merits of his holding the property under the particular SIPP, the advice may remain generic as respects rights under a personal pension scheme and so would not be subject to regulation.

Q20. Can you provide examples of when the regulated activities of advising on and arranging deals in investments are likely to arise in typical situations involving rights under a personal pension scheme?

Yes. The following table indicates whether certain typical scenarios are likely to involve regulated advising or arranging activities.

Scenario – advice given to a member or prospective member of a personal pension	Is the advice likely to be regulated (subject to any exclusion applying)?	Is arranging the transaction to which the advice relates likely to be regulated
---------------------------------------------------------------------------------	---------------------------------------------------------------------------	---------------------------------------------------------------------------------

scheme on the merits of ...		(subject to any exclusion applying)?
his joining a <i>personal pension scheme</i> (PPS) either generally or of a particular kind (such as a <i>self-invested personal pension scheme</i> (SIPP))	No – this would be generic advice	N/A
his joining a particular PPS that is already established	Yes – the rights are particular rights as the PPS already exists and offers specific rights	Yes – rights are being bought
establishing a PPS (typically a SIPP) intended solely for the prospective member's benefit	Yes – because the advice will concern establishing a particular scheme which will offer the investor particular rights (such as the right to make payments and direct investment)	Yes – rights are being bought
acquiring, for the purpose of holding under a PPS (typically a SIPP), but not any particular PPS, physical property of a particular description (such as commercial property) or particular physical property	No – there are no particular rights under a PPS at that stage, so the advice is generic as respects the acquiring of such rights	No
acquiring, for the purpose of holding under a PPS (typically a SIPP), but not any particular PPS, <i>securities</i> or <i>relevant investments</i> of a particular description or particular investments of that kind	<p>Yes, where the advice relates to acquiring particular investments of that kind – whilst the rights under the PPS may remain generic, the advice relates to acquiring rights to or interests in particular securities or relevant investments. Those rights or interests are themselves a particular investment</p> <p>No, where the advice only relates to acquiring a</p>	Yes – rights to or interests in specified investments are being bought

	particular type of investment – both the rights under the PPS and the investment remain generic	
acquiring a particular property for the purpose of holding it in a particular SIPP but where the advice to be given is limited to the tax or legal consequences of doing so	No. Although the advice relates to the merits of buying particular rights, provided the advice may reasonably be regarded as a necessary part of the service of providing tax or legal advice it should be excluded from the scope of regulation (see Q21)	No, provided the arranging is undertaken as a necessary part of providing tax or legal services. This may be more likely to arise in practice where, for example, a legal adviser goes on to arrange the conveyancing of the property as a necessary part of legal services. There may be limited circumstances in which it would be necessary for a tax adviser to go on to arrange for the client to acquire the rights under the PPS having given tax advice on the merits of doing so.
making additional payments into a particular PPS, either for investment in line with pre-existing arrangements or in accordance with instructions to be given to the operator, or of not making such additional payments	Yes – the advice relates to the merits of acquiring further particular rights	Yes – rights are to be bought
appointing a fund manager to manage the PPS assets on behalf of the member(s) or changing an existing fund manager	No – the advice is about the merits of exercising rights but not for the purpose of buying or selling particular investments – and no rights are being bought or sold	No, where the assets do not include <i>securities</i> or <i>relevant investments</i> Possibly, where the assets do include investments of that kind (because the arrangements are made with a view to the fund

		manager buying and selling, and possibly safeguarding and administering, investments)
changing the investment objectives with which the fund manager appointed to manage the PPS assets on behalf of the member(s) is instructed to comply	No – the advice is about the merits of exercising rights but not for the purpose of buying or selling particular specified investments – and no rights are being bought or sold	No
<p>placing particular assets or assets of a particular description, into a particular PPS, or of instructing the operator to purchase such assets, either:</p> <ul style="list-style-type: none"> • by means of funds to be made available by selling existing assets or of existing cash holdings within the PPS; or • from new funds to be provided by the member 	<p>Yes – the advice relates to either:</p> <ul style="list-style-type: none"> • disposing of particular rights and acquiring new particular rights; or • acquiring new particular rights 	Yes – rights are being bought or sold or both
instructing the operator to dispose of particular assets or assets of a particular description, to raise funds for purchasing other assets of any kind or to form a cash holding	Yes – the advice relates to disposing of particular rights as well as acquiring new particular rights	Yes – rights are being bought and sold
instructing the operator to realise an investment in a managed or unitised fund and re-invest the sums in another such fund	Yes – the advice relates to disposing of particular rights and acquiring new particular rights	Yes – rights are being bought and sold
withdrawing cash sums (income withdrawal)	Yes – the advice relates to disposing of particular	Yes – rights are being sold

	rights	
transferring existing assets of any kind or their cash value to another PPS	<p>Yes – the advice relates to disposing of particular rights</p> <p>There may also be regulated advice on the merits of acquiring rights under the new PPS</p>	Yes – rights are being sold and rights in the new PPS are being bought
instructing the operator/trustee to obtain a mortgage to purchase a particular commercial property to be held under the PPS	<p>Yes – the advice relates to acquiring new rights under the PPS in the form of the borrowed money or the property to be acquired with it</p> <p>But the advice given to the member on the mortgage itself is not regulated as the mortgage would not be a <i>regulated mortgage contract</i> (because, under tax rules, a member of a PPS cannot hold property under the scheme if he intends to make personal use of it).</p>	<p>Yes – rights are being bought</p> <p>Arranging for a personal pension scheme trustee to take out a mortgage will not be regulated as it will not be a <i>regulated mortgage contract</i></p>

Q21. What exclusions may be available for advising on investments in connection with acquiring or disposing of rights under a personal pension scheme?

The usual exclusions for *advising on investments* will potentially be available. In particular, article 67 of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (the *Regulated Activities Order*):

- may permit firms such as solicitors or licensed conveyancers to advise on the implications of transferring title to real property to the operator of a particular *personal pension scheme*;
- may permit tax advisers or solicitors to advise their clients on the tax or legal consequences of holding property of any description, or of acquiring or exercising rights, under a particular personal pension scheme; and
- may permit firms such as surveyors or estate agents to advise on the merits of acquiring commercial property which is intended to be held under a particular personal pension scheme.

This is, in each case, so long as it may reasonably be regarded as necessary for them to provide the advice in order to provide their professional services and they are not remunerated for *advising on investments* separately from any remuneration they receive for providing their professional services.

If the rights relate to a contract of insurance, the adviser can still make use of the exclusion so long as he is not carrying on an activity that requires him to be regulated under the *Insurance Mediation Directive*. And that is only likely to be the case if the advice relates to the merits of his client directly acquiring rights under a contract of insurance (for example, because he is also a trustee of the scheme). Advice about acquiring a beneficial interest in a contract of insurance held under trust will not be subject to regulation under the Directive.

Q22. What exclusions may be available for arranging deals in investments in connection with acquiring or disposing of rights under a personal pension scheme?

The usual exclusions for *arranging* will potentially be available. The following exclusions may be particularly relevant.

Article 29 of the *Regulated Activities Order* will apply where the arranging is done with or through an *authorised person* and, broadly speaking, the arranger:

- is an *unauthorised person*;
- does not advise on the merits of the member or prospective member entering into the transaction; and
- is not rewarded other than by their client (the member).

This exclusion should mean that many firms providing professional services to members of the scheme (such as estate agents, surveyors, property developers and experts on valuing or appraising the particular type of asset that is to be acquired for the personal pension scheme) would be able to arrange for the property to be held under the scheme without needing *authorisation* or exemption. This is because the operator of the scheme will be an *authorised person* and the firm is likely to be paid by its client and not by the scheme operator.

Article 29 does not apply where the arrangements relate to a contract of insurance. But this will only affect the availability of the exclusion as it applies to personal pension schemes where either:

- the member is himself directly acquiring rights under the contract of insurance (for example, because the member is also a trustee of the scheme); or
- the rights which the member is acquiring (or disposing of) relate directly to rights under a contract of insurance that is or is to be held by or on behalf of the operator for the purpose of providing benefits to that member.

Article 33 of the *Regulated Activities Order* will allow *persons* such as estate agents, surveyors or property developers (whether or not they are *authorised*) to refer clients to an *authorised* or

exempt person for independent advice on the merits of their placing a commercial property in a particular personal pension scheme. Article 33 may also apply where a person arranges for an independent fund manager to be appointed to manage the assets of a personal pension scheme or for members or potential members to obtain independent advice in relation to their rights under the scheme. As with article 29, the article 33 exclusion does not apply where the introductions relate to a contract of insurance.

Article 67 of the *Regulated Activities Order* may permit firms such as solicitors and licensed conveyancers to arrange for the title to property to be transferred to the operator of the personal pension scheme. The exclusion could also apply to firms such as surveyors or estate agents arranging the transfer of title to commercial property. This is so long as it is necessary for them to arrange the transaction in order to provide their professional services and they are not separately remunerated for doing it.

Q23. I am an exempt professional firm. Will I be able to advise on, and arrange deals in, rights under personal pension schemes without needing FSA authorisation?

Rights under a personal pension scheme will be securities. This means that, subject to your being able to satisfy the general requirements of Part XX of the FSMA:

- you will be limited in your ability to give advice without authorisation; but
- you will be able to arrange deals in such rights without authorisation.

The limitation on your being able to give advice, as an exempt professional firm, to a member of a personal pension scheme will be, in broad terms, that:

- the advice must not consist of a recommendation to acquire or dispose of rights (unless it endorses a corresponding recommendation that has been given to the member by a suitably authorised or exempt person); and
- if, in addition, the advice relates to a contract of insurance, you must be a firm that is included in the FSA Register of Exempt Professional Firms.

12.4 Application of EU Directives

Q24. Do the changes in the scope of regulated activities concerning pension schemes that take effect on 6 April 2007 have any implications for pension scheme trustees or service providers under the Investment Services Directive (or, in future, the Markets in Financial Instruments Directive) or the Insurance Mediation Directive?

In general terms, if a pension scheme trustee or service provider does not need to be authorised under the *Investment Services Directive* prior to 6 April 2007 he should not need to be authorised for carrying on the same activities after that date. This is because rights under a personal pension scheme are not a financial instrument under the Directive and establishing, operating or winding up a personal pension scheme is not an investment service under the Directive. This will also be the case under the Markets in Financial Instruments Directive when it replaces the Investment Services Directive later in 2007. But this is subject to the fact that investment advice will become an investment service for the first time. Guidance on the application of the Investment Services Directive to the activities of pension scheme trustees and service providers generally is

in Chapter 10.4A of PERG. Draft guidance on the changes in regulatory scope that will be caused by the implementation of the Markets in Financial Instruments Directive was issued as Annex 5 to Consultation Paper 06/9 (Organisation systems and controls) and will form Chapter 13 to PERG.

Similarly, a pension scheme trustee or service provider who is not subject to regulation under the *Insurance Mediation Directive* prior to 6 April 2007 will not become subject to regulation purely as result of the changes in regulatory scope that take effect on 6 April 2007. Detailed guidance on the application of that Directive to pension scheme trustees and service providers is in Chapters 10.4 and 10.4A of PERG.

12.5 Financial promotion issues

Q25. Will the financial promotion restriction in section 21 of the Financial Services and Markets Act 2000 apply to promotions that invite or induce persons to become members of a personal pension scheme?

Yes, because they will be inviting or inducing persons to buy an investment in the form of the rights under the scheme that they would acquire by becoming a member.

Q26. Will the financial promotion restriction apply to a promotion of commercial property that is held out as being suitable for holding under a SIPP (but not any particular SIPP)?

Yes, if the promotion is an inducement to acquire the right to receive benefits derived from the performance of that property when it is held under a *personal pension scheme*. However, provided the promotion does not identify any particular scheme or scheme provider or person who can arrange or advise on the placing of the property into the scheme, the promotion should be exempt as a generic promotion under article 17 of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (the *Financial Promotion Order*).

Q27. Will any of the other exemptions in the Financial Promotion Order apply to promotions of a personal pension scheme?

Yes. All the usual exemptions that apply to the promotion of *securities* generally will apply. This includes the exemption for promotions made by an employer to their employees about a *group personal pension scheme* to which they are to contribute (article 72 of the *Financial Promotion Order*).

Q28. Can I find out more about the financial promotion restriction?

Yes. Chapter 8 of PERG has detailed guidance about the scope of the financial promotion restriction and the exemptions that are available.

12.6 Practical transitional considerations

Q29. I am currently operating a SIPP but am not an authorised person. Do I have to become authorised by 6 April 2007 or will there be any transitional arrangements to allow for the possibility that I do not obtain authorisation by that date?

Transitional arrangements have been put in place. The broad effect of these arrangements is that you will be able to benefit from interim authorisation as respects any of the new regulated activities that relate to personal pension schemes pending the final determination of your application. This is provided:

- you were carrying on the regulated activities, for which you are seeking permission, on or before 1 October 2006; and
- your application for authorisation was submitted on or before 23 March 2007.

Q30. I am already authorised. Do I need to seek a variation of permission to carry on any of the new regulated activities?

This depends on what activities are covered by your existing *permission*. If, immediately prior to 6 April 2007, your permission covers any regulated activity that relates to stakeholder pension schemes, you will automatically be granted permission to carry on each such regulated activity in relation to personal pension schemes. This is provided you have not exercised your right to notify the FSA by 23 March 2007 that you do not wish your permission to be extended in this way.

If your existing permission does not cover a regulated activity relating to stakeholder pension schemes, you will need to apply for a variation of permission if you wish to carry on any of the new regulated activities. As with applications for authorisation (see Q29), you will benefit from interim permission provided:

- you were carrying on the regulated activities, for which you are seeking to vary your permission, on or before 1 October 2006; and
- your application to vary your permission was submitted on or before 23 March 2007.

Q31. Can I avoid the need to be authorised by becoming an appointed representative of an authorised person?

You cannot be an *appointed representative* for *establishing, operating or winding up a personal pension scheme*. But you can be an appointed representative for activities such as advising on or arranging deals in rights under a *personal pension scheme*.

If you are an appointed representative prior to 6 April 2007 and you intend to carry on any of the new regulated activities, you will need to consider whether your existing agreement with your principal will cover those activities or whether it will need to be amended to do so. You may be an appointed representative of a life office for the purpose of advising on or arranging deals in its investment products and also undertake unregulated activities in relation to personal pension schemes offered by third parties. If those unregulated activities include activities that will become regulated from 6 April 2007, you will need either to become the appointed representative of another appropriately authorised firm or to seek authorisation yourself. This is because an appointed representative of a life office can only undertake regulated activities that arise directly from the life office's insurance business.

Remember also that a person cannot generally be authorised and exempt as an appointed representative at the same time. However, this rule is waived if you obtain interim authorisation to carry on the new regulated activities and wish, pending determination of your application for authorisation, to continue to conduct existing regulated activities as an appointed representative.

ANNEX B

Amendments to the Perimeter Guidance manual

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

Rights under a ~~stakeholder~~ pension scheme

2.6.19 G ~~A stakeholder pension scheme is defined in section 1 of the Welfare Reform and Pensions Act 1999. Regulations made under that section set out detailed rules under which such schemes will operate (see the Stakeholder Pension Scheme Regulations 2000). Schemes must be registered with The Pensions Regulator and approved by the Board of HM Revenue and Customs. Rights under such schemes are specified investments for the purposes of the Regulated Activities Order. There are no exclusions in the Order.~~

Two types of investment are specified here:

- (1) rights under a stakeholder pension scheme; and
- (2) rights under a personal pension scheme.

2.6.19A G A stakeholder pension scheme is defined in section 1 of the Welfare Reform and Pensions Act 1999. Regulations made under that section set out detailed rules under which such schemes will operate (see the Stakeholder Pension Scheme Regulations 2000). Schemes must be registered with The Pensions Regulator.

2.6.19B G A personal pension scheme is, broadly speaking, a pension scheme which is not an occupational pension scheme or a stakeholder pension scheme. That is, a scheme or arrangement that is comprised in one or more instruments or agreements, having or capable of having effect so as to provide benefits to or in respect of people:

- (1) on retirement; or
- (2) on having reached a particular age; or
- (3) on termination of service in an employment.

2.6.19C G Rights under stakeholder pension schemes and personal pension schemes are specified investments for the purposes of the Regulated Activities Order.

There are no exclusions in the Order.

...

Establishing etc ~~stakeholder~~ pension schemes

- 2.7.14 G The *regulated activities* carried on in relation to ~~stakeholder pension schemes~~ pension schemes are the ~~establishment~~ establishing, operating or winding up of a stakeholder pension scheme and establishing, operating or winding up a personal pension scheme. ~~Managers of such schemes will require authorisation as they will be operating the schemes.~~ The identity of the operator of such a pension scheme depends on the facts. However, the scheme administrator will usually be the operator of the scheme either on its own or jointly with the scheme trustees. More detailed guidance on the scope of this activity is in PERG 12 (Q4).

...

- 2.7.21 Gcarrying on any of the activities that are regulated in relation to *collective investment schemes*, ~~and stakeholder pension schemes~~ or personal pension schemes. A person will need to make sure that...

...

Establishing etc ~~stakeholder~~ pension schemes

- 2.8.11 G The only exclusion from the range of activities specified as being regulated in relation to *stakeholder pension schemes* and personal pension schemes relates to *incoming ECA providers* (see PERG 2.9.18G).

...

- 2.10.14 G The *regulated activities* that may be carried on in this way are restricted by an Order made by the Treasury under section 327(6) of the *Act* (Exemption from the general prohibition) (the *Non-Exempt Activities Order*). Accordingly, under that section, a person may not by way of business carry on any of the following activities without *authorisation*:

(1) ...

(5) establishing, operating or winding up a stakeholder pension scheme or a personal pension scheme;

...

PERG 2 Annex 2G

2 Table

Table 1: Regulated Activities [See note 1 to Table 1]

Regulated activity

**Specified investment in relation to which
the regulated activity (in the corresponding
section of column one) may be carried on**

...

(p) *establishing, operating or winding up a stakeholder pension scheme (article 52(a))*

(p-a) *establishing, operating or winding up a personal pension scheme (article 52(b))*

(pa) *providing basic advice ...*

Note 1

In addition to the ...

- *establishing, operating or winding up a stakeholder pension scheme or establishing operating or winding up a personal pension scheme (article 52)*

...

Note 4

For the purpose of the

- *stakeholder pension scheme (article 82(1));*
- *personal pension scheme (article 82(2));*
- *life policy (explained in note 5); and*
- *rights to or interests in investments in so far as they relate to a unit, a stakeholder pension scheme, a personal pension scheme or a life policy.*

...

5 Table

Table 3: Securities, contractually based investments and relevant investments [see notes 1 and 2 to Table 3]

Security

.....

...

stakeholder pension scheme (article 82(1));

personal pension scheme (article 82(2));

...

8.25.1 G For the purposes of article 53 of the *Regulated Activities Order*, a *security or relevant investment* is any one of the following:

...

(7) *stakeholder pension schemes* or *personal pension schemes*;

...

8.36.4 G ...

(9) Rights under a stakeholder pension scheme or a personal pension scheme.

...

10.1 Q1. ...

The Q&As are primarily concerned with identifying the regulated activities (such as dealing or arranging deals in investments, managing investments or advising on investments) that may be carried on by persons (including trustees) who are involved with *occupational pension schemes* and ~~personal pension schemes~~ *personal pension schemes*. They are also concerned, but only in relation to *personal pension schemes* and *stakeholder pension schemes*, with identifying when the regulated activity of operating such a scheme will be carried on (see Q26).

The Q&As complement the general *guidance* on regulated activities in Chapter 2 of our Perimeter Guidance Manual ('PERG'), the general guidance on insurance mediation activities in Chapter 5 of PERG (PERG 5) and the relevant legislation. In addition, Chapter 12 of PERG (PERG 12) has further guidance about the regulated activities relating to the operation and sale of personal pension schemes that ~~came~~ came into force on 6 April 2007.

The Q&As that follow are set out in sections:

...

Q3. ...

- *establishing, operating or winding up a stakeholder pension scheme;*
- *establishing, operating or winding up a personal pension scheme.*

...

Q4. ...

Securities, such as shares, debt securities, warrants, or unit trusts, or rights under a personal pension scheme or a stakeholder pension scheme and contractually based investments such as ...

...

Q23. ...

No, provided it is not establishing, operating or winding up the scheme and is able to satisfy various exclusions that apply to other regulated activities. But note that, under government proposals for reforming the way in which personal pension schemes are permitted to be established and registered, it may need to be authorised by 6 April 2007 for operating a personal pension scheme—see HM Treasury’s Consultation Document entitled “Proposed changes to the eligibility rules for establishing a pension scheme—A consultation document, September 2005”. This is available on HM Treasury’s website at: www.hm-treasury.gov.uk/consultations_and_legislation/pension_scheme/consult_pensionscheme_index.cfm. The document sets out several options and indicates that the Treasury’s preferred option is to introduce a new regulated activity of establishing, operating or winding up a personal pension scheme other than a stakeholder pension scheme (where those activities are already regulated). The new regulated activity would come into force on 6 April 2007. At the same time, rights under a personal pension scheme would become an investment for the purposes of existing *regulated activities* such as *dealing, arranging, managing investments and advising on investments*. The FSA proposes to consult on further perimeter *guidance* about the changes to regulatory scope in this area during the course of 2006. Guidance on the regulated activities of establishing, operating and winding up a personal pension scheme is in Q24 to Q28 and in PERG 12 (Q3 to Q5).

So, your company’s position until April 2007 will depend on a combination of the activities that it carries on and the availability of certain exclusions. These exclusions may also apply to trustees of pension schemes other than SIPPs, including trustees of stakeholder pension schemes, with the exception of that for *managing investments* (which will not apply to a trustee of an OPS).

...

(6) There are no exclusions from the regulated activities of *establishing*.

operating or winding up a stakeholder pension scheme or establishing, operating or winding up a personal pension scheme. Guidance to help you determine whether or not your company will be carrying on any of these activities is in Q24 to Q28 and in PERG 12 (Q3 to Q5).

Q24. My company acts as corporate trustee of a for both trust-based stakeholder and personal pension schemes. Does it need to be authorised?

This depends on the responsibilities that your company assumes as trustee. Establishing, operating or winding up a stakeholder pension scheme or a personal pension scheme are regulated activities in their own right. These are functions that ~~are~~ may often be carried out by the trustees of a trust-based ~~stakeholder pension~~ scheme other than where the trustees are mere bare trustees. This is apart from establishing a scheme which is a function that may often be carried out by a third party such as a product provider. See Q25 to Q28 and PERG 12 (Q3 to Q5) for further guidance on these activities.

Q25. What does establishing a stakeholder or personal pension scheme involve?

The establisher of a stakeholder or personal pension scheme is the *person* responsible for putting in place the arrangements founding the scheme ~~and registering it with HM Revenue & Customs~~. With a trust-based scheme, this will usually be the person who executes the trust as principal provider. In a scheme ...

Q26. What does operating a stakeholder or personal pension scheme involve?

The 'operator' is the *person* responsible, ~~under the scheme's constitution, for ensuring continuing compliance with the management and administration requirements in respect of the assets and income of, and the benefits payable under, the scheme as imposed under relevant pensions and tax legislation. For example, with~~ to the members for managing and administering the assets and income of, and the benefits payable under, the scheme in accordance with relevant pensions and tax legislation, the scheme's constitution and the regulatory system. In this respect, the responsibilities that are placed under Part 4 of the Finance Act 2004 on a pension scheme administrator (as defined in section 270(1) of that Act) will mean that he is likely to be the operator of the scheme. In a trust-based schemes, the trustees ~~will often be the operator by virtue of the responsibilities they assume under the trust deed. In~~ may act as scheme administrator or there may be a separate person who acts in that capacity. Where there are separate trustees, it may be the case that they are operating the scheme jointly with the scheme administrator by virtue of the responsibilities they assume under the trust deed for the management and administration of the scheme assets. However, in situations where the trustees' role is merely to act as a bare trustee holding the scheme assets, it

~~may be the case that there is a third party who has responsibility for the management and administration of the scheme and its assets and who will be the scheme's~~ it is the scheme administrator who is likely to be the sole operator of the scheme. The scheme may be established by an *authorised person* who acts as a provider of investment products or services to the scheme. This does not make that person the operator of the scheme if, as a matter of fact, he has appointed another person ~~(such as a trustee)~~ to be responsible to the members for carrying out all of the operator's functions as scheme administrator or as trustee, or both as the case may be in his place.

Q27. What is my position as the operator of a stakeholder or personal pension scheme if I delegate day-to-day functions such as administration of the scheme or management of the scheme assets to another person?

...

Q28. What does winding-up a stakeholder or personal pension scheme involve?

The *person* who winds-up such a stakeholder pension scheme ~~pension scheme~~ will be the person ...

...

10.4

Q31. ...

(4) Arranging the appointment of a custodian on behalf ... will then safeguard and administer in accordance with pre-existing arrangements.

(5) Arranging for persons to join or to leave a stakeholder pension scheme or a personal pension scheme or to exercise certain rights under such a scheme. This is because the rights themselves will be a form of investment and so you will be arranging. This is explained in more detail in PERG 12 (Q15 to Q20).

(6) Acting as the scheme administrator (as defined in section 270(1) of the Finance Act 2004) for a stakeholder pension scheme or a personal pension scheme. This is because you are likely to be operating the scheme (see Q26).

(7) Advising the trustees on the merits of buying or selling particular securities or relevant investments or advising a member on the merits of joining or leaving, or of exercising certain rights under, a stakeholder pension scheme or a personal pension scheme. This is because you will be advising on investments (see Q38 and Q39).

Services that typically will not involve any regulated activities ...

...

Q39. ...

It ~~may~~ is likely to be if the advice concerns a ~~personal pension scheme~~ personal pension scheme but probably not if it concerns an OPS that is not a stakeholder pension scheme. The same factors apply to advice given to a member as apply to advice given to trustees (see Q38). But a particular factor ~~is likely to~~ will be whether the member is himself *buying* or *selling* a *security* or *relevant investment* (a “regulated investment”).

~~With a trust-based pension scheme, the trustees will usually hold the legal title to the scheme’s investments with the members having a beneficial interest in those investments. These beneficial interests may themselves be regulated investments (under article 89 of the *Regulated Activities Order*) that can be bought or sold by the member.~~

~~So, for example, the interests which a member may acquire in *units* or *life policies* held under a SIPP will amount to a regulated investment held by the investor, even though the legal title to the investments is held by the trustees on the member’s behalf. Advice to the member on the merits of acquiring or disposing of those interests will then be regulated advice. But advice on the merits of acquiring or disposing of interests in other assets such as real property or cash will not be regulated advice.~~

It is usually the case that, where regulated investments are held under trust, the person for whose benefit the investments are held will acquire a beneficial interest in the investments. Such interests are regulated investments in their own right under article 89 of the *Regulated Activities Order*. Where an OPS that is not a *stakeholder pension scheme* is concerned, however, the interests obtained by members are specifically excluded from being regulated investments (see article 89(2) of the *Regulated Activities Order*). This means that a member of an a money purchase OPS does not acquire a regulated investment simply through having a beneficial interest in investments held under the trust for the purpose of providing his benefits. Similarly, an interest in investments that result from a member having made additional voluntary contributions and which are held under the trust for his benefit will not be a regulated investment. So, advice to the member on the merits of his making additional voluntary contributions under his OPS will not be regulated advice.

The position with *stakeholder pension schemes* and *personal pension schemes* (including free-standing additional voluntary contributions schemes) is different. The rights under such a scheme (whether it is trust-based or contractual) are a specific type of regulated investment. So, advice on the merits of joining or leaving, or of exercising certain rights under, such a ~~stakeholder pension~~ stakeholder pension scheme will be regulated advice. This is the case with a stakeholder pension scheme even if the scheme is also an OPS. More detailed guidance on the meaning of rights under a personal pension scheme

and the circumstances in which advice about such rights is regulated is in PERG 12 (Q15 to Q20). That guidance will apply equally to rights under a stakeholder pension scheme.

~~The rights or interests that a person acquires under free-standing additional voluntary contribution arrangements will be regulated investments if and to the extent that the underlying investments are *securities* or *contractually based investments*. Where this is the case, advice on the merits of making free-standing additional voluntary contributions will be regulated advice.~~

~~If operating a personal pension scheme becomes a regulated activity in line with the government's proposals (see Q23), the rights that a member obtains under any such scheme (including a SIPP) will become regulated investments in their own right and so advice on the merits of *buying* or *selling* such rights would be regulated.~~

Q40. I provide administration services to the providers of pension products such as insurers, unit trust managers or banks. Is my position any different to that of a person who provides administration services to pension scheme trustees?

Potentially, yes. This is because:

...

- although you are likely to be carrying on *dealing* or *arranging* activities if you handle such things as arranging new policies or units, additional payments, surrenders, switches or assignments, some of the exclusions may not apply to you, for example:

...

Q41A. ...

Activity	Potential ISD investment service?	Potential application of ISD or of an ISD article 2.2 exemption?
Dealing in scheme assets as trustee	...	
Issuing rights under a stakeholder <u>or personal</u> pension scheme to members	None – the rights are not ISD investments	ISD does not apply

...		
Establishing, operating or winding up a stakeholder <u>or</u> <u>personal</u> pension scheme	None	ISD does not apply
...		

Q43. ...

You are unlikely to be carrying on a *regulated activity* in the case of an OPS ... staff with the opportunity to participate in a ~~group~~ *personal pension scheme* or a *stakeholder pension scheme*, you are likely to be *arranging*. You may also be *advising on investments* if you provide your employees with advice on the merits of their joining the scheme (see Q39).

Q44. As an employer, I ~~am~~ may offering my staff a stakeholder pension scheme or a personal pension scheme. If I do so, wWill I satisfy the by-way-of-business test?

...

Annex 3

Table summarising regulatory position of pension scheme trustees and service providers

Potential regulated activity	When will such regulated activities be carried on?
...	...
<i>Establishing, operating or winding-up a stakeholder pension scheme</i> <u>or</u> <i>establishing, operating or winding-up a personal pension scheme</i> (article 52 of the Regulated Activities Order)	The trustee of a trust-based stakeholder <u>or</u> <u>personal</u> pension scheme will often <u>may</u> be its operator. This is where the trustee is <u>not merely</u> a bare trustee and <u>is</u> responsible under the instruments establishing the scheme for complying with the management and administration requirements in respect of the assets and income of, and the benefits payable under, the scheme as imposed under relevant pensions and tax legislation. <u>Persons who are not scheme trustees are only</u>

	<u>likely to be carrying on these activities if they are the scheme administrator</u> (see Q26).
...	...

Annex 4

Table summarising regulatory position of employers and affinity groups

Activity carried on by employer or affinity group	Potential implications in terms of regulated activities and the need for authorisation
...	...
Acting as trustee of a trust-based stakeholder pension scheme	This is <u>likely to</u> will be a regulated activity <u>as</u> if the trustee is <u>likely to be</u> operating the stakeholder pension scheme. But the employer or affinity group will only need to be authorised or exempt if, as trustee, they are acting by way of business which, in most instances, should not be the case (see Q6, Q44 and Q45).
Arranging for employees to participate in an occupational pension scheme or a group personal pension scheme or a stakeholder pension scheme	Arranging for employees to participate in an occupational pension scheme (other than one that is also a stakeholder pension scheme) is not a regulated activity as the employees are not acquiring investments. Arranging for employees to participate in <u>any form of a group personal pension scheme or in a stakeholder pension scheme</u> is likely to involve <i>arranging</i> as is arranging for employees to participate in a stakeholder pension scheme . But the employer or affinity group will only need to be authorised or exempt if they are acting by way of business which, in most instances, should not be the case (see Q6, Q44 and Q45).
Advising employees on the merits of participating in an occupational pension scheme or a group personal pension scheme or a stakeholder pension scheme, including advising employees against joining a personal pension scheme or advising them to transfer from a personal	Advice on the merits of participating in an occupational pension scheme (other than one that is also a stakeholder pension scheme) is not a regulated activity as the employees are not acquiring investments. Advice on the merits of participating in a <u>particular</u> group personal pension scheme or a stakeholder pension scheme will be a regulated activity <u>because the rights that a person would acquire by becoming a member of the scheme are a form of investment</u> (see Q39). Advice against joining or to transfer from a <u>particular</u> personal pension scheme will be a

pension scheme	<p>regulated activity <u>for the same reasons</u> if the advice relates to a particular security or relevant investment that is or is to be held under the scheme or if the scheme is a stakeholder pension scheme. If the advice relates to personal pension schemes generally but not one in particular it will not be a regulated activity (see Q39 and Q40).</p> <p>But the employer or affinity group will only need to be authorised or exempt if they are acting by way of business which, in most instances, should not be the case (see Q6, Q44 and Q45).</p>
...	...

Annex 5

Table summarising regulatory position concerning financial promotions by trustees, employers and affinity groups

Person communicating	Subject or purpose of communication	Need for approval or exemption available
...
Employer, affinity group or trustee	To persuade employees or members to join a stakeholder pension scheme or a <i>group personal pension scheme</i> .	<p>Approval or exemption needed as rights under a stakeholder pension scheme will be, and rights under a group personal pension scheme are likely to be or to include, <u>themselves</u> investments.</p> <p>Promotions about stakeholder pension schemes ...</p>
Employer or affinity group	To persuade employees or members to make free-standing additional voluntary contributions (FSAVCs) or to take out any other type of personal pension scheme <i>personal pension scheme</i> (other than a stakeholder pension scheme or a	Approval or exemption is likely to <u>will</u> be needed as rights under FSAVCs and other personal pension schemes are likely to be or to include <u>themselves</u> investments.

	group personal pension scheme).	
...

12 Guidance for persons running or advising on personal pension schemes

12.1 Background

Q1. What is the purpose of these questions and answers ('Q&As') and who should be reading them?

These Q&As are aimed at, and should be read by, *persons* involved in the running of a *personal pension scheme* and those who give advice about or provide services to such schemes. They are intended to help such persons understand whether they will be carrying on a *regulated activity* and need *authorisation* or exemption under section 19 of the Financial Services and Markets Act 2000 following the changes to pension legislation that ~~took~~ are proposed to take effect on 6 April 2007. ~~Under the proposed changes, establishing, operating or winding up a personal pension scheme will become a regulated activity and rights under a personal pension scheme will become a specified investment.~~ The Q&As complement the general *guidance* on regulated activities which is in Chapter 2 of our Perimeter Guidance manual ('PERG') and the general guidance about pensions-related activities which is in Chapter 10 of PERG.

The Q&As are set out under ~~four~~ five sections:

- ~~the scope of the proposed new regulated activity of~~ *establishing, operating or winding up a personal pension scheme* (PERG 12.2);
- ~~the implications of the proposed new specified investment of rights under a personal pension scheme~~ (PERG 12.3);
- the application of EU Directives (PERG 12.4); and
- *financial promotion* issues (PERG 12.5); ~~and~~
- ~~practical transitional considerations~~ (PERG 12.6).

...

Q11. I am a trustee operating a self-invested personal pension scheme ('SIPP'). Can I ~~continue to~~ rely on the various exclusions available to trustees for other regulated activities such as dealing in investments, managing investments and safeguarding and administering investments?

Yes, provided you are able to satisfy the conditions applicable to the ~~you may continue to rely on existing exclusions for those activities.~~ No changes ~~are being~~ were made to those any of the

exclusions as a result of the changes in regulatory scope that took effect on 6 April 2007. Guidance on the exclusions is given in Chapter 10 (Q23) of PERG.

...

Q24. Do the changes in the scope of regulated activities concerning pension schemes that ~~take~~ took effect on 6 April 2007 have any implications for pension scheme trustees or service providers under the Investment Services Directive (or, in future, the Markets in Financial Instruments Directive) or the Insurance Mediation Directive?

In general terms, if a pension scheme trustee or service provider ~~does~~ did not need to be authorised under the *Investment Services Directive* prior to 6 April 2007 he should not need to be authorised ...

Similarly, a pension scheme trustee or service provider who was is not subject to regulation under the *Insurance Mediation Directive* prior to 6 April 2007 will not become subject to regulation purely as result of the changes in regulatory scope that ~~take~~ took effect on 6 April 2007. Detailed guidance ...

12.6 Practical transitional considerations

~~Q29. I am currently operating a SIPP but am not an authorised person. Do I have to become authorised by 6 April 2007 or will there be any transitional arrangements to allow for the possibility that I do not obtain authorisation by that date?~~

~~Transitional arrangements have been put in place. The broad effect of these arrangements is that you will be able to benefit from interim authorisation as respects any of the new regulated activities that relate to personal pension schemes pending the final determination of your application. This is provided:~~

- ~~• you were carrying on the regulated activities for which you are seeking permission on or before 1 October 2006; and~~
- ~~• your application for authorisation was submitted on or before 23 March 2007.~~

~~Q30. I am already authorised. Do I need to seek a variation of permission to carry on any of the new regulated activities?~~

~~This depends on what activities are covered by your existing *permission*. If, immediately prior to 6 April 2007, your permission covers any regulated activity that relates to stakeholder pension schemes, you will automatically be granted permission to carry on each such regulated activity in relation to personal pension schemes. This is provided you have not exercised your right to notify the FSA by 23 March 2007 that you do not wish your permission to be extended in this way.~~

~~If your existing permission does not cover a regulated activity relating to stakeholder pension schemes, you will need to apply for a variation of permission if you wish to carry on any of the new regulated activities. As with applications for authorisation (see Q29) you will benefit from interim permission provided:~~

- you were carrying on the regulated activities, for which you are seeking to vary your permission, on or before 1 October 2006; and
- your application to vary your permission was submitted on or before 23 March 2007.

Q31. Can I avoid the need to be authorised by becoming an appointed representative of an authorised person?

You cannot be an *appointed representative* for *establishing, operating or winding up a personal pension scheme*. But you can be an appointed representative for activities such as advising on or arranging deals in rights under a *personal pension scheme*.

If you are an appointed representative prior to 6 April 2007 and you intend to carry on any of the new regulated activities, you will need to consider whether your existing agreement with your principal will cover those activities or whether it will need to be amended to do so. You may be an appointed representative of a life office for the purpose of advising on or arranging deals in its investment products and also undertake unregulated activities in relation to personal pension schemes offered by third parties. If those unregulated activities include activities that will become regulated from 6 April 2007, you will need either to become the appointed representative of another appropriately authorised firm or to seek authorisation yourself. This is because an appointed representative of a life office can only undertake regulated activities that arise directly from the life office's insurance business.

Remember also that a person cannot generally be authorised and exempt as an appointed representative at the same time. However, this rule is waived if you obtain interim authorisation to carry on the new regulated activities and wish, pending determination of your application for authorisation, to continue to conduct existing regulated activities as an appointed representative.

**INTERIM PERMITTED PERSONS
(PERSONAL PENSIONS) INSTRUMENT 2006**

Powers exercised

- A. The Financial Services Authority makes this instrument in the exercise of the powers and related provisions in:
- (1) the following sections of the Financial Services and Markets Act 2000 (“the Act”):
 - (a) section 138 (General rule-making power);
 - (b) section 156 (General supplementary powers);
 - (c) section 213 (The compensation scheme); and
 - (d) section 214 (General); and
 - (2) article 6 of the Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) Order 2006 (SI No 2006/1969).
- B. The powers listed above are specified for the purposes of section 153(2) (Rule-making instruments) of the Act.

Commencement

- C. This instrument comes into force on 6 April 2007.

Citation

- D. This instrument may be cited as the Interim Permitted Persons (Personal Pensions) Instrument 2006.

By order of the Board
28 September 2006

Annex

Directions and rules for Interim Permitted Persons in respect of Personal Pension Business

In this Annex, new provisions are being introduced and they are not underlined.

1. Application
 - 1.1 R These *rules* and directions apply to:
 - (1) an *authorised person* with an *interim permission*; and
 - (2) an *authorised person* with an *interim variation of permission*.
 2. The application of the Handbook and the disapplication of COMP
 - 2.1 D The *FSA* directs that the *Handbook* applies to an *authorised person* with an *interim permission* or an *interim variation of permission* as if that *person's application* had been granted in the terms applied for.
 - 2.2 D The *FSA* directs that the *Glossary* definition of '*relevant person*' does not include an *authorised person* with an *interim permission*.
 3. Disclosure of status
 - 3.1 R Whenever an *authorised person* with an *interim permission* or an *interim variation of permission* is required, and whenever that *person* is permitted and chooses, to disclose that:
 - (1) it is an *authorised person* or it is regulated by the *FSA*, and that disclosure is made in respect of; or
 - (2) it has a *permission* which includes, one or more of the *regulated activities* or the *specified investment* described in article 4 (Interim permission) of the *Order*, that *person* must instead disclose that:
 - (3) (if the *authorised person* has an *interim permission*):
 - (a) it is an authorised person with an interim permission, pending the determination of its application for a permission; and
 - (b) compensation will not be available from the Financial Services Compensation Scheme if the authorised person cannot meet its obligations.
 - (4) (if the *authorised person* has an *interim variation of permission*) it is an authorised person with an interim permission that allows it to carry on personal pension business pending the determination of its application for a variation of permission.
 - 3.3 R Whenever:
 - (1) an *authorised person* with an *interim permission* or an *interim variation of permission* is required, and whenever that *person* is permitted and chooses, to disclose that the *FSA* has approved one

or more of its *approved persons* for the purposes of section 59 of the *Act* (Approval for particular arrangements); and

- (2) the disclosure in (1) is related to one or more of the *regulated activities* or the *specified investment* described in article 4 (Interim permission) of the *Order*,

the *authorised person* must instead disclose (if it is the case) that one or more of the its approved persons has been approved on a interim basis pending the determination of an application for approved person status.

4. Defined terms

- 4.1 R In these *rules* and directions, the terms in (1) have the meanings ascribed to them by (2). Further, terms in italics that do not appear below have the meaning given to them in the *Glossary* in the *FSA's Handbook*.

	(1)	(2)
<i>application</i>		an application for: (1) a <i>Part IV permission</i> which includes; or (2) a variation of a <i>Part IV permission</i> so that it will include, the <i>regulated activity</i> of <i>establishing, operating or winding up a personal pension scheme</i> , or one or more of the <i>regulated activities</i> described in article 4(1)(b)(ii) of the <i>Order</i> in respect of rights under a <i>personal pension scheme</i> .
<i>interim permission</i>		a <i>Part IV permission</i> deemed to have been granted by article 4 (Interim permission) of the <i>Order</i> to a <i>person</i> because he has submitted an application for a <i>Part IV permission</i> .
<i>interim variation of permission</i>		a variation of a <i>Part IV permission</i> deemed to have been granted by article 4 (Interim permission) of the <i>Order</i> .
<i>Order</i>		the Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) Order 2006 (SI No 2006/1969).

HOME REVERSION AND HOME PURCHASE ACTIVITIES (CONSEQUENTIAL AMENDMENTS TO THE HANDBOOK) INSTRUMENT 2006

Powers exercised

- A. The Financial Services Authority makes this instrument in the exercise of the powers and related provisions in:
- (1) the following sections of the Financial Services and Markets Act 2000 (“the Act”):
 - (a) section 138 (General rule-making powers);
 - (b) section 139(4) (Miscellaneous ancillary matters);
 - (c) section 145 (Financial promotion rules);
 - (d) section 146 (Money laundering rules);
 - (e) section 149 (Evidential provisions);
 - (f) section 150(2) (Actions for damages);
 - (g) section 156 (General supplementary powers);
 - (h) section 157(1) (Guidance);
 - (i) section 213 (The compensation scheme);
 - (j) section 214 (General);
 - (k) section 234 (Industry funding);
 - (l) section 332(1) (Rules in relation to persons to whom the general prohibition does not apply);
 - (m) section 340(1) (Appointment of auditors and actuaries); and
 - (n) paragraph 17(1) of Schedule 1 (Fees); and
 - (2) regulation 3 of The Electronic Commerce Directive (Financial Services and Markets) Regulations 2002 (S.I. 2002/1775); and
 - (3) the other powers referred to in Schedule 4 of the General Provisions.
- B. The rule-making powers listed above are specified for the purpose of section 153(2) (Rule-making instruments) of the Financial Services and Markets Act 2000.

Commencement

- C. Subject to The Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) (No.2) Order 2006 (SI No 2006/2383) being in force on 6 November 2006, this instrument comes into force as follows:
- (1) the amendments in Part 1 of Annex A and Part 1 of Annex D come into force on 6 November 2006;
 - (2) the remainder of this instrument comes into force on 6 April 2007.

Amendments to the Handbook

- D. The Prudential sourcebook for Mortgage Firms and Insurance Intermediaries (or MIPRU) shall be cited as Prudential sourcebook for Mortgage and Home Finance Firms, and Insurance Intermediaries (or MIPRU) and all references in the Handbook are changed accordingly.
- E. The modules of the FSA's Handbook of rules and guidance listed in column (1) below are amended in accordance with Annexes to this instrument listed in column (2) below:

(1)	(2)
Glossary of definitions	Annex A
Principles for Businesses (PRIN)	Annex B
General Provisions sourcebook (GEN)	Annex C
Fees Manual (FEES)	Annex D
Senior Management Arrangements, Systems and Controls sourcebook (SYSC)	Annex E
Prudential sourcebook for Mortgage and Home Finance Firms, and Insurance Intermediaries (or MIPRU)	Annex F
Conduct of Business sourcebook (COB)	Annex G
Insurance: Conduct of Business sourcebook (ICOB)	Annex H
Training and Competence sourcebook (TC)	Annex I
Supervision manual (SUP)	Annex J
Compensation sourcebook (COMP)	Annex K
Electronic Commerce Directive sourcebook (ECO)	Annex L

- F. All references to '*regulated lifetime mortgage contract*' in the Handbook are amended to '*lifetime mortgage*'.

Citation

- G. This instrument may be cited as the Home Reversion and Home Purchase Activities (Consequential Amendments to the Handbook) Instrument 2006.

By order of the Board
25 October 2006

Annex A

Amendments to the Glossary of definitions

Part 1

Insert the following new definitions in the appropriate alphabetical position:

advising on a home finance transaction any of the *regulated activities* of *advising on regulated mortgage contracts*, *advising on a home purchase plan* or *advising on a home reversion plan*.

advising on a home purchase plan the *regulated activity*, specified in article 53C of the *Regulated Activities Order*, which is in summary: advising a *person* if the advice:

- (a) is given to him in his capacity as a *home purchaser* or potential *home purchaser*; and
- (b) is advice on the merits of his:
 - (i) entering into a particular *home purchase plan*; or
 - (ii) varying the terms of a *home purchase plan* entered into by him on or after 6 April 2007 in such a way as to vary his obligations under that plan.

advising on a home reversion plan the *regulated activity*, specified in article 53B of the *Regulated Activities Order*, which is in summary: advising a *person* if the advice:

- (a) is given to him in his capacity as *reversion occupier* or plan provider or potential *reversion occupier* or potential plan provider; and
- (b) is advice on the merits of his:
 - (i) entering into a particular *home reversion plan*; or
 - (ii) varying the terms of a *home reversion plan* entered into by him on or after 6 April 2007 in such a way as to vary his obligations under that plan.

arranging (bringing about) a home finance transaction any of the *regulated activities* of *arranging (bringing about) a regulated mortgage contract*, *arranging (bringing about) a home purchase plan* or *arranging (bringing about) a home reversion plan*.

arranging (bringing the *regulated activity*, specified in article 25C(1) of the *Regulated Activities*

<i>about) a home purchase plan</i>	<p><i>Order</i>, which is in summary: making arrangements for another <i>person</i> to:</p> <ul style="list-style-type: none"> (a) enter into a <i>home purchase plan</i> as <i>home purchaser</i>; or (b) vary the terms of a <i>home purchase plan</i> entered into by him as <i>home purchaser</i> on or after 6 April 2007.
<i>arranging (bringing about) a home reversion plan</i>	<p>the <i>regulated activity</i>, specified in article 25B(1) of the <i>Regulated Activities Order</i>, which is in summary: making arrangements for another <i>person</i> to:</p> <ul style="list-style-type: none"> (a) enter into a <i>home reversion plan</i> as <i>reversion occupier</i> or as plan provider; or (b) vary the terms of a <i>home reversion plan</i> entered into by him as <i>reversion occupier</i> or as plan provider on or after 6 April 2007.
<i>entering into a home finance transaction</i>	any of the <i>regulated activities</i> of <i>entering into a regulated mortgage contract</i> , <i>entering into a home purchase plan</i> or <i>entering into a home reversion plan</i> .
<i>entering into a home purchase plan</i>	the <i>regulated activity</i> , specified in article 63F(1) of the <i>Regulated Activities Order</i> , which is in summary: entering into a <i>home purchase plan</i> as provider.
<i>entering into a home reversion plan</i>	the <i>regulated activity</i> , specified in article 63B(1) of the <i>Regulated Activities Order</i> , which is in summary: entering into a <i>home reversion plan</i> as provider, or acquiring any obligations or rights (including his interest in land) of the plan provider under a <i>home purchase plan</i> entered into by him on or after 6 April 2007.
<i>home finance adviser</i>	a <i>firm</i> with <i>permission</i> (or which ought to have <i>permission</i>) for <i>advising on a home finance transaction</i> .
<i>home finance arranger</i>	a <i>firm</i> with <i>permission</i> (or which ought to have <i>permission</i>) for <i>arranging a home finance transaction</i> .
<i>home finance provider</i>	a <i>firm</i> with <i>permission</i> (or which ought to have <i>permission</i>) for <i>entering into a home finance transaction</i> .
<i>home purchase plan</i>	(in accordance with article 63F(3) of the <i>Regulated Activities Order</i>) an arrangement comprised in one or more instruments or agreements which meets the following conditions at the time it is entered into:

- (a) the arrangement is one under which a *person* (the 'home purchase provider') buys a *qualifying interest in land* or an undivided share of a *qualifying interest in land*;
- (b) where an undivided share of a *qualifying interest in land* is bought, the interest is held on trust for the home purchase provider and the individual or trustees in (c) as beneficial tenants in common;
- (c) the arrangement provides for the obligation of an individual or trustees (the *home purchaser*) to buy the interest bought by the home purchase provider during the course of or at the end of a specified period; and
- (d) the *home purchaser* (if he is an individual) or an individual who is a beneficiary of the trust (if the *home purchaser* is a trustee), or a related person, is entitled under the arrangement to occupy at least 40% of the land in question as or in connection with a dwelling during that period and intends to do so;

in this definition "related person" means:

- (A) that *person's* spouse or civil partner;
- (B) a *person* (whether or not of the opposite sex) whose relationship with that *person* has the characteristics of the relationship between husband and wife; or
- (C) that *person's* parent, brother, sister, child, grandparent or grandchild.

home purchase provider a *firm* with *permission* (or which ought to have *permission*) for *entering into a home purchase plan*.

home purchaser the individual (or trustees), specified in article 63F(3) of the *Regulated Activities Order*, who in summary:

- (a) is (or are) obliged under a *home purchase plan* to buy the interest in land bought by the home purchase provider (as defined in article 63F(3) of the *Regulated Activities Order*) over the course of or at the end of a specified period; and
- (b)
 - (i) in the case of an individual, is entitled under the arrangement to occupy at least 40% of the land in question as or in connection with a dwelling and intends to do so; or
 - (ii) in the case of trustees, are trustees of a trust a beneficiary of which is an individual described in (i).

*home
reversion plan*

(in accordance with article 63B(3) of the *Regulated Activities Order*) an arrangement comprised in one or more instruments or agreements which meets the following conditions at the time it is entered into:

- (a) the arrangement is one under which a *person* (the *reversion provider*) buys all or part of a *qualifying interest in land* from an individual or trustees (the *reversion occupier*);
- (b) the *reversion occupier* (if he is an individual) or an individual who is a beneficiary of the trust (if the *reversion occupier* is a trustee), or a related person, is entitled under the arrangement to occupy at least 40% of the land in question as or in connection with a dwelling and intends to do so; and
- (c) the arrangement specifies that the entitlement to occupy will end on the occurrence of one or more of:
 - (i) a *person* in (b) becoming a resident of a care home;
 - (ii) a *person* in (b) dying; or
 - (iii) the end of a specified period of at least twenty years from the date the *reversion occupier* entered into the arrangement;

in this definition "related person" means:

- (A) that *person's* spouse or civil partner;
- (B) a *person* (whether or not of the opposite sex) whose relationship with that *person* has the characteristics of the relationship between husband and wife; or
- (C) that *person's* parent, brother, sister, child, grandparent or grandchild.

*qualifying
interest in land*

(in accordance with article 63B(4)(a) of the *Regulated Activities Order*) land (other than timeshare accommodation) in the *UK* which is:

- (a) in relation to land in England and Wales, an estate in fee simple absolute or a term of years absolute whether subsisting at law or in equity; or
- (b) in relation to land in Scotland, the interest of an owner in land or the tenant's right over or interest in a property subject to a lease; or
- (c) in relation to land in Northern Ireland, any freehold estate or any leasehold estate whether subsisting at law or in equity.

reversion occupier the individual (or trustees), specified in article 63B(3) of the *Regulated Activities Order*, who in summary:

- (a) is (or are) the *person* (or *persons*) from whom all or part of an interest in land is bought as part of an arrangement comprising a *home reversion plan*; and
- (b)
 - (i) in the case of an individual, is entitled under the arrangement to occupy at least 40% of the land in question as or in connection with a dwelling and intends to do so; or
 - (ii) in the case of trustees, are trustees of a trust a beneficiary of which is an individual described in (i).

reversion provider a *firm* with *permission* (or which ought to have *permission*) for *entering into a home reversion plan*.

Part 2

Insert in the following new definitions in the appropriate alphabetical position:

administering a home finance transaction any of the *regulated activities* of *administering a regulated mortgage contract*, *administering a home purchase plan* or *administering a home reversion plan*.

administering a home purchase plan the *regulated activity*, specified in article 63F(2) of the *Regulated Activities Order*, which is in summary: *administering a home purchase plan* where the plan was entered into by way of business on or after 6 April 2007.

administering a home reversion plan the *regulated activity*, specified in article 63B(2) of the *Regulated Activities Order*, which is in summary: *administering a home reversion plan* where the plan was entered into on or after 6 April 2007.

annual statement provisions (in *MCOB*) in relation to a:

- (a) *regulated mortgage contract*, *MCOB 7.5*;
- (b) *home purchase plan*, *MCOB 7.8.3R* to *MCOB 7.8.6R*; and
- (c) *instalment reversion plan*, *MCOB 9.9.1R* to *MCOB 9.9.4R*.

APR rules *MCOB 10*.

distance marketing information

(in MCOB) MCOB 6 Annex 1.

distance home purchase mediation contract

a *distance contract*, the making or performance of which constitutes, or is part of:

- (a) *advising on a home purchase plan*;
- (b) *arranging (bringing about) a home purchase plan*;
- (c) *making arrangements with a view to a home purchase plan*;
or
- (d) *agreeing to carry on a regulated activity in (a) to (c)*.

equity release activity

any *regulated mortgage activity* carried on in relation to a *lifetime mortgage*, or a *reversion activity*.

equity release adviser

a *firm* with *permission* (or which ought to have *permission*) for:

- (a) *advising on regulated mortgage contracts* (when carried on in relation to a *lifetime mortgage*); or
- (b) *advising on a home reversion plan*.

equity release arranger

a *firm* with *permission* (or which ought to have *permission*) for *arranging a*:

- (a) *regulated mortgage contract* (when carried on in relation to a *lifetime mortgage*); or
- (b) *home reversion plan*.

equity release intermediary

a *firm* with *permission* (or which ought to have *permission*) to carry on *equity release mediation activity*.

equity release mediation activity

any of the *regulated activities* of:

- (a) *arranging a regulated mortgage contract* (when carried on in relation to a *lifetime mortgage*) or a *home reversion plan*;
- (b) *advising on a regulated mortgage contract* (when carried on in relation to a *lifetime mortgage*) or a *home reversion plan*;
or
- (c) *agreeing to carry on a regulated activity in (a) or (b)*.

<i>equity release provider</i>	a <i>firm</i> with <i>permission</i> (or which ought to have <i>permission</i>) for: <ul style="list-style-type: none"> (a) <i>entering into a regulated mortgage contract</i> (when carried on in relation to a <i>lifetime mortgage</i>); or (b) <i>entering into a home reversion plan</i>.
<i>equity release transaction</i>	a <i>lifetime mortgage</i> or a <i>home reversion plan</i> .
<i>home finance activity</i>	any <i>home finance mediation activity</i> , <i>home finance providing activity</i> or <i>administering a home finance transaction</i> .
<i>home finance administrator</i>	a <i>firm</i> with <i>permission</i> (or which ought to have <i>permission</i>) for <i>administering a home finance transaction</i> .
<i>home finance intermediary</i>	a <i>firm</i> with <i>permission</i> (or which ought to have <i>permission</i>) to carry on a <i>home finance mediation activity</i> .
<i>home finance mediation activity</i>	any <i>mortgage mediation activity</i> , <i>home purchase mediation activity</i> or <i>reversion mediation activity</i> .
<i>home finance providing activity</i>	any of the <i>regulated activities</i> of: <ul style="list-style-type: none"> (a) <i>entering into a regulated mortgage contract</i>; (b) <i>entering into a home purchase plan</i>; (c) <i>entering into a home reversion plan</i>; or (d) <i>agreeing to carry on a regulated activity</i> in (a) to (c).
<i>home finance transaction</i>	a <i>regulated mortgage contract</i> , <i>home purchase plan</i> or <i>home reversion plan</i> .
<i>home purchase activity</i>	any of the <i>regulated activities</i> of: <ul style="list-style-type: none"> (a) <i>arranging (bringing about) a home purchase plan</i> (article 25C(1)); (b) <i>making arrangements with a view to a home purchase plan</i> (article 25C(2)); (c) <i>advising on a home purchase plan</i> (article 53C);

- (d) *entering into a home purchase plan* (article 63F(1));
- (e) *administering a home purchase plan* (article 63F(2)); or
- (f) *agreeing to carry on a regulated activity in (a) to (e)* (article 64).

home purchase administrator a firm with *permission* (or which ought to have *permission*) for *administering a home purchase plan*.

home purchase adviser a firm with *permission* (or which ought to have *permission*) for *advising on a home purchase plan*.

home purchase arranger a firm with *permission* (or which ought to have *permission*) for *arranging a home purchase plan*.

home purchase intermediary a firm with *permission* (or which ought to have *permission*) to carry on a *home purchase mediation activity*.

home purchase mediation activity any of the following *regulated activities*:

- (a) *arranging (bringing about) a home purchase plan* (article 25C(1));
- (b) *making arrangements with a view to a home purchase plan* (article 25C(2));
- (c) *advising on a home purchase plan* (article 53C); or
- (d) *agreeing to carry on a regulated activity in (a) to (c)* (article 64).

instalment reversion plan a *home reversion plan* under which more than one payment is made to the *customer* during the life of the plan.

keyfacts logo provisions GEN 5.1 and GEN 5 Annex 1G.

making arrangements with a view to a home finance transaction any of the *regulated activities* of *making arrangements with a view to a regulated mortgage contract, making arrangements with a view to a home reversion plan or making arrangements with a view to a home purchase plan*.

making arrangements with a view to a home purchase plan the *regulated activity*, specified in article 25C(2) of the *Regulated Activities Order*, which is in summary: making arrangements with a view to a *person* who participates in the arrangements entering into a *home purchase plan* as *home purchaser*.

making arrangements with a view to a home reversion plan the *regulated activity*, specified in article 25B(2) of the *Regulated Activities Order*, which is in summary: making arrangements with a view to a *person* who participates in the arrangements entering into a *home reversion plan* as *reversion occupier* or as plan provider.

reversion activity any of the *regulated activities* of:

- (a) *arranging (bringing about) a home reversion plan* (article 25B(1));
- (b) *making arrangements with a view to a home reversion plan* (article 25B(2));
- (c) *advising on a home reversion plan* (article 53B);
- (d) *entering into a home reversion plan* (article 63B(1));
- (e) *administering a home reversion plan* (article 63B(2)); or
- (f) *agreeing to carry on a regulated activity* in (a) to (e) (article 64).

reversion administrator a *firm* with *permission* (or which ought to have *permission*) for *administering a home reversion plan*.

reversion adviser a *firm* with *permission* (or which ought to have *permission*) for *advising on a home reversion plan*.

reversion arranger a *firm* with *permission* (or which ought to have *permission*) for *arranging a home reversion plan*.

reversion intermediary a *firm* with *permission* (or which ought to have *permission*) to carry on a *reversion mediation activity*.

reversion mediation activity any of the following *regulated activities*:

- (a) *arranging (bringing about) a home reversion plan* (article 25B(1));

- (b) *making arrangements with a view to a home reversion plan* (article 25B(2));
- (c) *advising on a home reversion plan* (article 53B); or
- (d) *agreeing to carry on a regulated activity* in (a) to (c) (article 64).

unauthorised reversion provider a person who carries on, or proposes to carry on, the activity specified in article 63B(1) of the *Regulated Activities Order* which is entering into a *home reversion plan* as plan provider, and who does not have *permission* for, and is not an *exempt person* in relation to, *entering into a home reversion plan*.

Amend the following definitions as shown and reorder in the appropriate alphabetical position. Underlining indicates new text and striking through indicates deleted text. Where an entire definition is deleted the place where the change will be made is indicated and the text is not shown struck through.

arranging (a) (except in relation to a ~~*regulated mortgage contract*~~ *home finance transaction*)...

(b) ...

(c) (in relation to a *home purchase plan*) *arranging (bringing about) a home purchase plan, making arrangements with a view to a home purchase plan or agreeing to carry on either of those regulated activities.*

(d) (in relation to a *home reversion plan*) *arranging (bringing about) a home reversion plan, making arrangements with a view to a home reversion plan or agreeing to carry on either of those regulated activities.*

arrears (in relation to a *regulated mortgage contract* or a *home purchase plan*) either:

- (a) a shortfall (equivalent to two or more regular payments) in the accumulated total payments actually made by the *customer* measured against the accumulated total amount of payments due to be received from the *customer*; or
- (b) remaining in breach, for more than one month, of an agreed borrowing limit or of an obligation to pay or repay where the loan or *home purchase plan* does not have a regular payment or repayment plan.

client (1) (except in *PROF*; and in relation to a ~~*regulated mortgage contract*~~

home finance transaction) ...

...

(5) (in relation to a home purchase plan, except in PROF) the home purchaser or potential home purchaser.

(6) (in relation to a home reversion plan, except in PROF):

(a) the reversion occupier or potential reversion occupier; or

(b) an individual who is an unauthorised reversion provider and who is not, or would not, be required to have permission to enter into a home reversion plan.

client money ...

(3) (in MIPRU):

(a) ...

(b) in relation to a ~~mortgage~~ home finance intermediary when acting as such, money of any currency which in the course of carrying on ~~mortgage~~ home finance mediation activity, the firm holds on behalf of a client, either in a bank account or in the form of cash.

combined
initial
disclosure
document
(CIDD)

information set out in COB 4 Annex 5R about the scope and nature of the services offered by a firm in relation to:

(a) a combination of two or more of the following:

(i) packaged products;

(ii) non-investment insurance contracts;

(iii) regulated mortgage contracts other than lifetime mortgages;

(iv) home purchase plans;

~~(iv) regulated lifetime mortgage contract~~ equity release transactions; or

(b) a combination of two or more of the following:

(i) stakeholder products;

(ii) ~~regulated lifetime mortgage contract~~ equity release transactions;

(iii) *regulated mortgage contracts other than lifetime mortgages*;

(iv) *home purchase plans*;

(v) *non-investment insurance contracts*.

controlled activity

(in accordance with section 21(9) of the *Act* (The classes of activity and investment)) any of the following activities specified in Part 1 of Schedule 1 to the Financial Promotions Order (Controlled Activities):

...

(m) *arranging qualifying credit etc. (paragraph 10A—~~coming into force 31st October 2004~~)*;

(n) *advising on qualifying credit etc. (paragraph 10B—~~coming into force 31st October 2004~~)*;

(o) *entering into a home purchase plan* (paragraph 10C);

(p) *making arrangements with a view to a home purchase plan* (paragraph 10D);

(q) *advising on a home purchase plan* (paragraph 10E);

(r) *entering into a home reversion plan* (paragraph 10F);

(s) *making arrangements with a view to a home reversion plan* (paragraph 10G);

(t) *advising on a home reversion plan* (paragraph 10H);

(eu) *agreeing to carry on specified kinds of activity (paragraph 11) which are specified in paragraphs 3 to 10H—~~(10B from 31 October 2004)~~ of Part 1 of Schedule 1 to the *Financial Promotion Order*.*

energy market participant a firm:

(a) ...

(b) which is not an ... , ~~mortgage~~ *home finance administrator, mortgage lender* ~~home finance provider~~, ...

failure

~~(in CASS)~~ the appointment of a liquidator, receiver or administrator, or trustee in bankruptcy, or any equivalent procedure in any relevant jurisdiction.

*financial
promotion
rules*

~~COB 3 and~~, ICOB 3, MCOB 2.2.6R to MCOB 2.2.8BG and MCOB 3.

illustration

(in *MCOB*) the illustration of the costs and features of a *regulated mortgage contract* or *home reversion plan* which is required to be provided by *MCOB* 5 (Pre-application disclosure), *MCOB* 6 (Disclosure at the offer stage), *MCOB* 7 (Disclosure at start of contract and after sale) and *MCOB* 9 (~~Lifetime mortgages~~Equity release: product disclosure) and the template for which is set out:

- (a) for a *regulated mortgage contract* other than a *lifetime mortgage*, at *MCOB* 5 Annex 1;
- (b) for a *lifetime mortgage*, at *MCOB* 9 Annex 1; and
- (c) for a *home reversion plan*, at *MCOB* 9 Annex 2.

*initial
disclosure
document
(IDD)*

information about the scope and nature of the services offered by a *firm* in relation to:

- (a) *packaged products* as required by *COB* 4.3.7R; ~~or~~
- (b) *stakeholder products* as required by *COB* 5A.2.1R(1);
- (c) a *regulated mortgage contract* other than a *lifetime mortgage* as required by *MCOB* 4.4.1R(1) and set out in *MCOB* 4 Annex 1;
- (d) an *equity release transaction* as required by *MCOB* 4.4.1R(1) and set out in *MCOB* 8 Annex 1;
- (e) a *home purchase plan* as required by *MCOB* 4.10.2R and set out in *MCOB* 4 Annex 1; or
- (f) a *non-investment insurance contract* in accordance with *ICOB* 4.2.4G to *ICOB* 4.2.6R and set out in *ICOB* 4 Annex 1.

*mortgage-sale
shortfall-debt*

the outstanding ~~debt~~ amount due to the *home finance provider* under a ~~*regulated mortgage contract*~~ *home finance transaction*, following the sale of the ~~mortgaged~~ property that is its subject.

*non-real time
financial
promotion*

(in accordance with article 7(2) of the *Financial Promotion Order*) (~~as more fully described in *COB* 3.5.5R ("Real time" and "non-real time" financial promotions) and *AUTH App* 1.10 (Types of financial promotion))~~) a *financial promotion* that is not a *real time financial promotion*.

*non-real time
qualifying
credit
promotion* [deleted]

offer document (in *MCOB*) a document in which the ~~*mortgage lender*~~*home finance provider* offers to enter into a ~~*regulated mortgage contract*~~*home finance transaction* with a *customer*.

*oil market
participant* a *firm*:

- (a) ...
- (b) which is not an ... , ~~*mortgage*~~*home finance administrator*, ~~*mortgage lender*~~*home finance provider*, ...

*overseas
person* (in accordance with article 3(1) of the *Regulated Activities Order* (Interpretation)) a *person* who:

- (a) carries on any of the following *regulated activities*:
 - ...
 - (xix) *arranging (bringing about) a home reversion plan*;
 - (xx) *making arrangements with a view to a home reversion plan*;
 - (xxi) *advising on a home reversion plan*;
 - (xxii) *entering into a home reversion plan*;
 - (xxiii) *administering a home reversion plan*;
 - (xxiv) *arranging (bringing about) a home purchase plan*;
 - (xxv) *making arrangements with a view to a home purchase plan*;
 - (xxvi) *advising on a home purchase plan*;
 - (xxvii) *entering into a home purchase plan*;
 - (xxviii) *administering a home purchase plan*;
 - ~~(ixxxxix)~~ ... ; but
- (b) does not carry on any such activities, or offer to do so, from a permanent place of business maintained by him in the *United Kingdom*.

<i>price information</i>	(in <i>MCOB</i>) information, in a <i>qualifying credit</i> <i>financial promotion</i> , that relates to...
<i>procurement fee</i>	the total amount paid by a <i>mortgage lender</i> <i>home finance provider</i> to a <i>mortgage</i> <i>home finance intermediary</i> , whether directly or indirectly, in connection with providing applications from <i>customers</i> to enter into <i>regulated mortgage contracts</i> <i>home finance transactions</i> with that <i>mortgage lender</i> <i>home finance provider</i> .
<i>protected home finance mediation mortgage business</i>	activities in relation to <i>regulated mortgage contracts</i> <i>home finance transactions</i> which are covered by the <i>compensation scheme</i> , as defined in <i>COMP 5.6.1R</i> .
<i>qualifying credit promotion</i>	[deleted]
<i>qualifying credit promotion rules</i>	[deleted]
<i>real time financial promotion</i>	(in accordance with article 7(1) of the <i>Financial Promotion Order</i>) (as more fully described in <i>COB 3.5.5R</i> ("Real time" and "non-real time" financial promotions) and <i>AUTH 1.10</i> (Types of financial promotion))) a <i>financial promotion</i> made in the course of a personal visit, telephone conversation or other interactive dialogue.
<i>real time qualifying credit promotion</i>	[deleted]
<i>regulated activity</i>	(in accordance with section 22 of the <i>Act</i> (The classes of activity and categories of investment)) any of the following activities specified in Part II of the <i>Regulated Activities Order</i> (Specified Activities): ... (gc) <u>arranging (bringing about) a home reversion plan</u> (article

25B(1));

(gd) making arrangements with a view to a home reversion plan (article 25B(2));

(ge) arranging (bringing about) a home purchase plan (article 25C(1));

(gf) making arrangements with a view to a home purchase plan (article 25C(2));

...

(pb) advising on a home reversion plan (article 53B);

(pc) advising on a home purchase plan (article 53C);

...

(sc) entering into a home reversion plan (article 63B(1));

(sd) administering a home reversion plan (article 63B(2));

(se) entering into a home purchase plan (article 63F(1));

(sf) administering a home purchase plan (article 63F(2));

...

which is carried on by way of business ...

*regulated
mortgage
contract*

(a) (in relation to a contract) a contract which:

(i) (in accordance with article 61(3) of the *Regulated Activities Order*) ~~a contract which~~, at the time it is entered into, meets the following conditions:

(iA) ...

(iiB) ... :

(A) ...

(B) ...

(C) ... ; and

(ii) is not a home purchase plan.

(b) (in relation to a *specified investment*) ...

<i>repossess</i>	(in <i>MCOB</i>) take possession of the mortgaged property <u>that is the subject of a regulated mortgage contract or home purchase plan.</u>
<i>solicited real time financial promotion</i>	(in accordance with article 8 of the <i>Financial Promotion Order</i>) (as more fully described in COB 3.10.1R (Meaning of "solicited" and "unsolicited" real time financial promotion) and AUTH App 1.10 (Types of financial promotion)) a <i>real time financial promotion</i> which ...
<i>solicited real time qualifying credit promotion</i>	<u>[deleted]</u>
<i>specified investment</i>	any of the following <i>investments</i> specified in Part III of the <i>Regulated Activities Order</i> (Specified Investments): ... <u>(ob) home reversion plan (article 63B(3));</u> <u>(oc) home purchase plan (article 63F(3));</u> ...
<i>tariff of charges</i>	a list of all charges (including amounts) that are payable on a regulated mortgage contract <u>home finance transaction</u> , including the reason for, and amount of, each charge.
<i>third party processor</i>	(1) A <i>firm</i> ("Firm A") which carries on regulated mortgage <u>home finance activities</u> ... for another <i>firm</i> (or an <i>appointed representative</i>) ("Firm B") under a properly documented <i>outsourcing</i> agreement, ... (2) A <i>firm</i> ("Firm C") which carries on regulated mortgage <u>home finance activities</u> ... for a <i>third party processor</i> within (1) ("Firm A"), ...
<i>tied product</i>	a product, other than <i>linked borrowing</i> or a <i>linked deposit</i> , that a <i>customer</i> is obliged to purchase through a <i>mortgage lender</i> <u>or reversion provider</u> as a condition of taking out a <i>regulated mortgage contract</i> <u>or home reversion plan</u> with that mortgage lender <u>firm</u> .
<i>unsolicited real time financial promotion</i>	(in accordance with article 8 of the <i>Financial Promotion Order</i>) (as more fully described in COB 3.10.1R (Meaning of "solicited" and "unsolicited" real time financial promotion) and AUTH App 1.10 (Types of financial promotion)) a <i>real time financial promotion</i> which is not a <i>solicited real time financial promotion</i> .

*unsolicited
real time
qualifying
credit
promotion*

[deleted]

Annex B

Amendments to the Principles for Businesses sourcebook (PRIN)

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

...

3.2.1 R *PRIN* applies with respect to the carrying on of:

...

(3) *ancillary activities* in relation to ... ~~*regulated mortgage home*~~
finance activity ...

...

Annex C

Amendments to the General Provisions sourcebook (GEN)

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

...

- 4.2.2 G There are other pre-contract information requirements outside this chapter, including:
- ...
- (5) for *regulated mortgage contracts* and home purchase plans, initial disclosure requirements in MCOB 4.4 (~~Initial disclosure requirements~~), pre-application disclosure requirements in MCOB 5.6 (~~Content of illustrations~~), and disclosure at the offer stage in MCOB 6.4 (~~Content of the offer document~~); and
- (6) for ~~regulated lifetime mortgage contracts~~ equity release transactions, initial disclosure requirements in MCOB 8.4 (~~Initial disclosure requirements~~), pre-application disclosure requirements in MCOB 9.4 (~~Content of illustrations~~) and disclosure at the offer stage in MCOB 9.5 (~~Disclosure at the offer stage for lifetime mortgages~~).

...

...

Exception: use of third party processors in ~~mortgage~~ home finance and non-investment insurance business

- 4.3.6 R ...
- (2) Where an *appointed representative* has outsourced ... ~~mortgage~~ home finance *mediation activities* to a *third party processor*, GEN 4.3.1R does not apply to that *third party processor* when acting as such, so long as ...
- (3) Where an *appointed representative* of a *firm* is carrying on:
- ...
- (b) ~~mortgage~~ home finance *mediation activities*;
- which have been outsourced to it by the *firm*, GEN 4.3.1R does not apply to the *firm* when the *appointed representative* is carrying on the outsourced activities, so long as ...

...

- 4.4.1 R (1) If, in any communication:
- (a) made to a ~~private customer~~ or, in the case of a communication relating to ~~non-investment insurance contracts, a retail customer~~;
 - (i) (in relation to a non-investment insurance contract) a retail customer;
 - (ii) (in relation to a home finance transaction) a customer; or
 - (iii) (in all other cases) a private customer; and
 - ...
 - ...
 - (3) A firm need not provide the information required by (1) if it has already provided it in writing to the ~~private customer~~ to whom the communication is made.

...

GEN 5 Annex 1G

Licence for use of the FSA and keyfacts logos by authorised firms and appointed representatives

...

- 3A.2 The following are examples of places where the *rules* require or permit the keyfacts logo to be used:

...

- (3) In *MCOB*:
 - (a) in an ~~initial disclosure document or combined initial disclosure document (MCOB 4.4.1R, MCOB 4.4.7R, MCOB 8.3.1R and MCOB 8.4.1R)~~initial disclosure document or combined initial disclosure document;
and
 - (b) in an *illustration* (MCOB 5.6.2R and MCOB 9.4.2R);
and
 - (c) in a risks and features statement (MCOB 4.10.11R) and financial information statement (MCOB 5.8.7R).

...

GEN TP 1

(3) Transitional Provisions applying to GEN only

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
...
6	<i>GEN 4.3.1R</i>	R	[delete existing text] <u>Expired</u>	[delete existing text]	[delete existing text]
7	<i>GEN 4.3.1R</i>	G	[delete existing text] <u>Expired</u>	[delete existing text]	[delete existing text]
...
10	<u><i>GEN 4.3.1R</i></u>	<u>R</u>	<p><u>(1) For the purpose of this rule, a regulated activity does not include a home purchase activity or home reversion activity.</u></p> <p><u>(2) If a firm in a letter (or electronic equivalent) which it or its employees send to a customer, with a view to or in connection with the firm carrying out a home purchase activity or a reversion activity, makes a statement about its statutory or regulated status under the Act for carrying on that regulated activity, the firm must include the disclosure in GEN 4 Annex 1 in that letter.</u></p>	<u>From 6 April 2007 for six months</u>	<u>6 April 2007</u>

...

Annex D

Amendments to the Fees manual (FEES)

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

Part 1

FEES 3 Annex 1R

3 Annex 1R Authorisation fees payable

R Part 2...

Straightforward cases	
Activity grouping	Description
...	
A.18	Mortgage lenders <u>Home finance providers, advisers and arrangers</u> (excluding mortgage lenders <u>home finance providers</u>)
...	
Moderately complex cases	
Activity grouping	Description
...	
A.2	Mortgage lenders <u>Home finance providers</u> and <u>administrators</u>
...	

Part 2

FEES 4 Annex 1R

4 Annex 1R Activity groups, tariff bases and valuation dates applicable

R Part 1 ...

Activity group	Fee payer falls in the activity group if
...	
A.2 Mortgage lenders <u>Home finance providers</u>	its <i>permission</i> includes <u>a regulated activity within one or more of the following:</u>

and administrators	<ul style="list-style-type: none"> • entering into a regulated mortgage contract home finance transaction; or • administering a regulated mortgage contract home finance transaction; or • agreeing to carry on a regulated activity which is within either of the above.
...	
A.18 Mortgage lenders <u>Home finance providers, advisers and arrangers</u>	<p>its <i>permission</i> includes <u>a regulated activity</u> within one or more of the following:</p> <ul style="list-style-type: none"> • entering into a regulated mortgage contract home finance transaction; or • arranging (bringing about) regulated mortgage contracts a home finance transaction; or • making arrangements with a view to regulated mortgage contracts a home finance transaction; or • advising on regulated mortgage contracts a home finance transaction; or • agreeing to carry on a regulated activity which is within any of the above.
...	

Part 2 ...

Activity group	Tariff-base
...	
A.2	<p><u>NUMBER OF MORTGAGES OR OTHER HOME FINANCE TRANSACTIONS ENTERED INTO AND ADMINISTERED</u> The number of new mortgage contracts, <i>home purchase plans</i> or <i>home reversion plans</i> entered into; AND The number of mortgage contracts, <i>home purchase plans</i> or <i>home reversion plans</i> being administered, multiplied by 0.05 for mortgage outsourcing <i>firms</i> or other <u>home finance outsourcing firms</u> and by 0.5 for all other firms.</p> <p>Notes: (1) Mortgage outsourcing <i>firms</i> are <i>firms</i> with <i>permission for administering regulated mortgage contracts</i>, but not to enter the contract as lender. <u>Home finance outsourcing firms are firms with permission for administering a home finance transaction, but not entering into a home finance transaction.</u></p> <p>(2) In this context a 'mortgage' means a loan secured by a first charge over residential property in the <i>United Kingdom</i>. For the measure of the number of contracts being administered, each first charge counts as one contract, irrespective of the number of loans involved.</p> <p>(3) Mortgages, <i>home purchase plans</i> or <i>home reversion plans</i> administered include those that the <i>firm</i> administers on behalf of other <i>firms</i>.</p>
...	
A.18	<p>ANNUAL INCOME (a) ... due to the <i>firm</i> in respect of or in relation to <i>mortgage mediation activity</i> <u><i>home finance mediation activity</i></u> (or activities which would have been <i>mortgage mediation activity</i> if they had been carried out after 30 October 2004 or <u><i>home purchase mediation activity</i></u> or <u><i>reversion mediation activity</i></u> if they had been carried out on or after 6 April 2007); Plus (b) for any <i>mortgage mediation activity</i> <u><i>home finance mediation activity</i></u> carried out by the <i>firm</i> for which it receives payment from the lender or provider on a basis other than that in (a), the value of all new mortgage</p>

	<p>advances and amounts provided under other <i>home finance transactions</i> resulting from that activity multiplied by 0.004;</p> <p>Plus</p> <p>(c) if the <i>firm</i> is a <i>mortgage lender home finance provider</i>, the value of all new mortgage advances and amounts provided under other <i>home finance transactions</i> which are or would be <i>regulated mortgage contracts</i> if they had been made after 30 October 2004 or <i>home purchase plans</i> or <i>home reversion plans</i> if they had been made on or after 6 April 2007 (other than those made as a result of <i>mortgage mediation activity</i> <i>home finance mediation activity</i> by another <i>firm</i>), multiplied by 0.004.</p> <p>For mortgage outsourcing <i>firms</i> or <i>home finance outsourcing firms</i> whose <i>permission</i> does not include <i>advising on regulated mortgage contracts</i> a <i>home finance transaction</i> the relevant amounts are multiplied by 0.15.</p> <p>Notes on annual income:</p> <p>...</p> <p>(2) For the purposes of calculating annual income, "net amount retained" means all the commission, fees, etc. in respect of <i>mortgage home finance mediation activity</i> that the <i>firm</i> has not rebated to customers or passed on to other <i>firms</i> ...</p> <p>...</p> <p>(4) ...which would be <i>mortgage mediation activity</i> if they had been carried out after 30 October 2004 or <i>home purchase mediation activity</i> or <i>reversion mediation activity</i> if they had been carried out on or after 6 April 2007.</p> <p>(5) ...</p> <p><u>Home finance outsourcing firms are firms whose permission includes administering a home finance transaction, but not entering into a home finance transaction.</u></p>
...	

Part 3 ...

Activity group	Valuation date
...	
A.2	Number of mortgages, <i>home purchase plans</i> or <i>home reversion plans</i> entered into in the twelve months

	ending 31 December. AND Number of mortgages, <u>home purchase plans</u> or <u>home reversion plans</u> being administered on 31 December.
...	

FEES 5 Annex 1R

5 Annex 1R Annual Fees Payable in Relation to 2006/07

R ...

Part 1: ...

Part 2: Fee tariffs for general levy and supplementary levy

Industry block	Tariff base	General levy payable by firm
1-Deposit acceptors, <u>mortgage lenders</u> <u>home finance providers</u> and <u>administrators</u> (excluding <i>firms</i> in block 14)
...		
16 - Mortgage lenders <u>Home finance providers</u> , <u>advisers</u> <u>advisers</u> and <u>arrangers</u> (excluding <i>firms</i> in blocks 13, 14 & 15)

FEES 6

6.3 The FSCS's power to impose levies

...

6.3.8 R The *FSCS* must not require a *participant firm* in the ~~mortgage~~ home finance advice and arranging *sub-scheme* ...

...

6.5 Compensation costs

...

6.5.7 R ...

- (4) the ~~mortgage~~ home finance advice and arranging *sub-scheme*, the FSCS must use the *contribution group* and tariff base set out in the table in ~~FEES~~ FEES 6.5.10R;

...

6.5.10 R Table: the contribution groups and tariff bases for the ~~mortgage~~ home finance advisers and arrangers (see ~~FEES~~ FEES 6.5.7R(4))

SUB-SCHEME	CONTRIBUTION GROUP (REFERENCES TO A1, A2 ETC ARE TO THE FSA FEE BLOCKS)	LEGAL BASIS FOR ACTIVITY (references to articles are to articles of the <i>Regulated Activities Order</i>)	TARIFF BASE
<u>Mortgage Home finance</u> advice and arranging	A18 Mortgage lenders <u>Home finance providers</u> , advisers and arrangers	Any of the following: (a) arranging (bringing about) regulated mortgage contracts <u>arranging (bringing about) a home finance transaction</u> ; (b) making arrangements with a view to regulated mortgage contracts <u>a home finance transaction</u> ; (c) advising on regulated mortgage contracts <u>a home finance transaction</u> ; (d) agreeing to carry on a regulated activity which is within any of the above; and (e) the activities of a mortgage lender <u>home finance provider</u> which	<i>annual eligible income</i>

		would be <i>arranging</i> but for article 28A of the <i>Regulated Activities Order</i> (Arranging contracts <u>or plans</u> to which the arranger is a party).	
--	--	----------------------------------------------------------------------------------------------------------------------------------------------------------------	--

FEES TP Transitional Provisions

FEES TP 1.1

(1)	(2)	(3)	(4)	(5)	(6)
	Material to which the transitional provision applies		Transitional Provision	Transitional provision: dates in force	Handbook provision: coming into force
...					
<u>3</u>	<u>FEES 4 Annex 1R Part 3, Activity group A2</u>		<u>Any reference to the number of <i>home purchase plans</i> and/or <i>home reversion plans</i> must be read as including any home purchase plan or home reversion plan entered into or administered before 6 April 2007, as relevant, which would be a <i>home purchase plan</i> or a <i>home reversion plan</i> if entered into or administered on or after 6 April 2007.</u>	<u>From 6 April 2007 – 30 April 2008</u>	<u>6 April 2007</u>

Annex E

Amendments to the Senior Management Arrangements, Systems and Controls sourcebook (SYSC)

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

...

What?

1.1.3 R SYSC 2 and SYSC 3 apply with respect to the carrying on of:

...

(3) *ancillary activities in relation to designated investment business, ~~regulated mortgage~~home finance activity and insurance mediation activity;*

...

1.1.3A R SYSC 3.2.6AR to SYSC 3.2.6JG do not apply:

...

(2) in relation to the following *regulated activities*:

...

(e) ... ;~~and~~

(f) *mortgage mediation activity and administering a regulated mortgage contract;*

(g) *home purchase mediation activity and administering a home purchase plan; and*

(h) *reversion activity.*

...

Annex F

Amendments to the Prudential sourcebook for Mortgage and Home Finance Firms, and Insurance Intermediaries (MIPRU)

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

...

1.1 Application

1.1.1 G This sourcebook applies to a *firm* with *Part IV permission* to carry on:

- (1) *insurance mediation activity*;
- (2) ~~*mortgage*~~ *home finance* *mediation activity*;
- (3) ~~*mortgage lending*~~ *home financing*;
- (4) ~~*mortgage*~~ *home finance* *administration*; and
- (5) *insurance business*;

as specified in the beginning of each of the remaining chapters.

...

3 Professional indemnity insurance

...

Application

3.1.1 R This chapter applies to a *firm* with *Part IV permission* to carry on any of the following activities:

- (1) *insurance mediation activity*;
- (2) ~~*mortgage*~~ *home finance* *mediation activity*;

...

(4) in relation to ~~*mortgage*~~ *home finance* *mediation activity*, this chapter does not apply to a *firm* if:

(a) ...

...

(5) ...

(6) in relation to ~~*mortgage*~~ *home finance* *mediation activity*, this chapter does not apply to an *authorised professional firm* if:

- (a) ...
- (b) whose ~~mortgage~~ home finance mediation activity is incidental to its main business.

...

- 3.2.2 G The minimum *limits of indemnity* for a firm whose *Part IV permission* covers both *insurance mediation activity* and ~~mortgage~~ home finance mediation activity is the higher of the *limits of indemnity* for these activities. If the firm opts for a single comparable guarantee to finance the claims which might arise as a result of both activities, the requirements for *insurance mediation activity* apply.

...

- 3.2.4 R The contract of professional indemnity insurance must incorporate terms which make provision for:

(1) ...

...

(5) continuous cover in respect of claims arising from work carried out from the date on which the firm was given *Part IV permission* for the *insurance mediation activity* or ~~mortgage~~ home finance mediation activity concerned; and

(6) ...

...

Minimum limits of indemnity: ~~mortgage~~ home finance intermediary

- 3.2.9 R If the firm is a ~~mortgage~~ home finance intermediary, then the minimum *limit of indemnity* is the higher of 10% of *annual income* up to £1 million, and:

...

...

4 Capital resources

...

- 4.1.1 R This chapter applies to a firm with *Part IV permission* to carry on any of the following activities unless an exemption in this section applies:

(1) *insurance mediation activity*;

(2) ~~mortgage~~ home finance mediation activity;

- (3) *entering into a ~~regulated mortgage contract~~ home finance transaction (that is, ~~mortgage lending~~ home financing);*
- (4) *administering a ~~regulated mortgage contract~~ home finance transaction (that is, ~~mortgage~~ home finance administration).*

...

- 4.1.9 G (1) ...
- (2) ...
- (3) A credit union cannot carry on home purchase activities or reversion activities because the Credit Unions Act 1979 restricts the circumstances whereby credit unions can hold land.

...

Application: social housing firms

- 4.1.13 G There are special provisions for a *social housing firm* when it is carrying on ~~mortgage lending~~ home financing or ~~mortgage~~ home finance administration (see MIPRU 4.2.7R).

...

Purpose: social housing firms

- 4.1.18 R *Social housing firms* undertake small amounts of ~~mortgage~~ home finance business even though their main business consists of activities other than *regulated activities*. Their ~~mortgage lending~~ home financing is only done as an adjunct to their primary purpose (usually the provision of housing) and is substantially different in character to that done by commercial lenders. Furthermore, they are *subsidiaries* of local authorities or registered social landlords which are already subject to separate regulation. The FSA does not consider that it would be proportionate to the risks involved with such business to impose significant capital requirements for these *firms*. The capital resources requirement for *social housing firms* therefore simply provides that, where their *Part IV permission* is limited to ~~mortgage lending~~ home financing and ~~mortgage~~ home finance administration, their net tangible assets must be greater than zero.

...

Capital resources requirement: social housing firms

- 4.2.7 R The capital resources requirement for a *social housing firm* whose *Part IV permission* is limited to carrying on the *regulated activities* of:
- (1) ~~mortgage lender~~ home financing; or
 - (2) ~~mortgage~~ home finance administration (or both);

is that the *firm's* net tangible assets must be greater than zero.

- 4.2.8 G If a *social housing firm* is carrying on ~~*mortgage-lending home financing*~~ or ~~*mortgage home finance administration*~~ (and no other *regulated activity*), its net tangible assets must be greater than zero. However, if it carries on *insurance mediation activity* or ~~*mortgage home finance mediation activity*~~, there is no special provision and the capital resources requirement for *firms* carrying on mediation activities only applies to it as appropriate.

...

- 4.2.10 R Table: Application of capital resources requirements

	Regulated activities	Provisions
1.	(a) <i>insurance mediation activity</i> ; or	MIPRU 4.2.11R
	(b) <i>mortgage home finance mediation activity</i> (or both);	
	and no other <i>regulated activity</i> .	
2.	(a) <i>mortgage-lending home financing</i> ; or	MIPRU 4.2.12R to MIPRU 4.2.17E
	(b) <i>mortgage-lending-home financing</i> and <i>mortgage home finance administration</i> ;	
	and no other <i>regulated activity</i> .	
3.	<i>mortgage home finance administration</i> ;	MIPRU 4.2.18R to MIPRU 4.2.19R
	and no other <i>regulated activity</i> .	
4.	<i>insurance mediation activity</i> ; and	MIPRU 4.2.20R
	(a) <i>mortgage-lending-home financing</i> ; or	
	(b) <i>mortgage home finance administration</i> (or both).	
5.	<i>mortgage home finance mediation activity</i> ; and	MIPRU 4.2.21R
	(a) <i>mortgage-lending-home financing</i> , or	
	(b) <i>mortgage home finance administration</i> (or both).	
6.	Any combination of <i>regulated activities</i> not within rows 1 to 5.	MIPRU 4.2.22R

Capital resources requirement: mediation activity only

- 4.2.11 R (1) If a *firm* carrying on *insurance mediation activity* or ~~*mortgage home finance mediation activity*~~ (and no other *regulated activity*) does not hold *client money* or other *client assets* in relation to these activities, its capital resources requirement is the higher of:
- (a) £5,000; and
 - (b) 2.5% of the *annual income* from its *insurance mediation activity* or ~~*mortgage home finance mediation activity*~~ (or both).
- (2) If a *firm* carrying *insurance mediation activity* or ~~*mortgage home finance mediation activity*~~ (and no other *regulated activity*) holds *client money* or other *client assets* in relation to these activities, its capital resources requirement is the higher of:
- (a) £10,000; and
 - (b) 5% of the *annual income* from its *insurance mediation activity* or ~~*mortgage home finance mediation activity*~~ (or both).

Capital resources requirement: ~~*mortgage lending home financing*~~ and *home finance administration* (but not ~~*mortgage home finance administration*~~ only)

- 4.2.12 R (1) The capital resources requirement for a *firm* carrying on ~~*mortgage lending home financing*~~, or ~~*mortgage lending home financing*~~ and ~~*mortgage home finance administration*~~ (and no other *regulated activity*) is the higher of:
- (a) £100,000; and
 - (b) 1% of:
 - (i) its total assets plus total undrawn commitments and unreleased amounts under the *home reversion plan*; less:
 - (ii) excluded loans or amounts plus intangible assets (see Note 1 in the table in *MIPRU 4.4.4R*).
- (2) Undrawn commitments and unreleased amounts means the total of those amounts which a ~~borrower~~ *customer* has the right to draw down or to receive from the *firm* but which have not yet been drawn down or received, excluding those under an agreement:
- (a) which has an original maturity of up to one year; or
 - (b) which can be unconditionally cancelled at any time by the lender or provider.

- 4.2.13 G When considering what is an undrawn commitment or unreleased amount, the *FSA* takes into account an amount which a ~~borrower~~ *customer* has the right to draw down or to receive under a *home finance transaction*, but which has not yet been drawn down or received, whether the commitment or obligation is

revocable or irrevocable, conditional or unconditional.

- 4.2.14 R When calculating total assets, the *firm* may exclude a loan or plan which has been transferred to a third party only if it meets the following conditions:
- (1) the first condition is that the loan or the plan must have been transferred in a legally effective manner by:
 - (a) novation; or
 - (b) legal or equitable assignment; or
 - (c) sub-participation; or
 - (d) declaration of trust; and
 - (2) the second condition is that the ~~lender~~ home finance provider:
 - (a) retains no material economic interest in the loan or the plan; and
 - (b) has no material exposure to losses arising from it.
- 4.2.15 E (1) When seeking to rely on the second condition, a *firm* should ensure that the loan or plan qualifies for the 'linked presentation' accounting treatment under Financial Reporting Standard 5 (Reporting the substance of transactions) issued in April 1994, and amended in December 1994 and September 1998 (if applicable to the *firm*).
- (2) ...
- ...
- 4.2.17 E (1) When seeking to rely on the second condition, a *firm* should not provide material credit enhancement in respect of the loan or plan unless it deducts the amount of the credit enhancement from its capital resources before meeting its capital resources requirement.
- (2) Credit enhancement includes:
 - (a) any holding of subordinated loans or notes in a transferee that is a special purpose vehicle; or
 - (b) over collateralisation by transferring loans or plans to a larger aggregate value than the *securities* to be issued; or
 - (c) any other arrangement with the transferee to cover a part of any subsequent losses arising from the transferred loan or plan.
- (3) Contravention of (1) may be relied upon as tending to establish contravention of the second condition.

Capital resources requirement: ~~mortgage~~ home finance administration only

4.2.18 R The capital resources requirement for a *firm* carrying on mortgage home finance administration only, which has all or part of the ~~regulated mortgage contracts~~ home finance transactions that it administers on its balance sheet, is the amount which is applied to a *firm* carrying on ~~mortgage lending~~ home financing or ~~mortgage lending~~ home financing and mortgage home finance administration, and no other *regulated activity* (see MIPRU 4.2.12R).

4.2.19 R The capital resources requirement for a *firm* carrying on mortgage home finance administration only, which has all the ~~regulated mortgage contracts~~ home finance transactions that it administers off its balance sheet is the higher of:

- (1) £100,000; and
- (2) 10% of its *annual income*.

Capital resources requirement: insurance mediation activity and ~~mortgage lending~~ home financing or mortgage home finance administration

4.2.20 R The capital resources requirement for a *firm* carrying on *insurance mediation activity* and ~~mortgage lending~~ home financing or mortgage home finance administration is the sum of the requirements which are applied to the *firm* by:

- (1) the capital resources requirement *rule* for a *firm* carrying on *insurance mediation activity* or mortgage home finance mediation activity and no other *regulated activity* (see MIPRU 4.2.11R); and
- (2) (a) the capital resources requirement *rule* of a *firm* carrying on ~~mortgage lending~~ home financing, or ~~mortgage lending~~ home financing and mortgage home finance administration (and no other *regulated activity*) (see MIPRU 4.2.12R); or
(b) if, in addition to its *insurance mediation activity*, the *firm* carries on mortgage home finance administration and has all the assets that it administers off balance sheet, the capital resources requirement *rule* for such *firm* (see MIPRU 4.2.19R).

Capital resources requirement: mortgage home finance mediation activity and ~~mortgage lending~~ home financing or mortgage home finance administration

4.2.21 R (1) If a *firm* carrying on ~~mortgage home finance mediation activity~~ and ~~mortgage lending~~ home financing or ~~mortgage home finance administration~~ does not hold *client money* or other *client assets* in relation to its ~~mortgage home finance mediation activity~~, the capital requirement is the amount applied to a *firm*, according to the activities carried on by the *firm*, by:

- (a) the capital resources requirement *rule* for a *firm* carrying on ~~mortgage lending~~ home financing, or ~~mortgage lending~~ home financing and mortgage home finance administration, and no other *regulated activity* (see MIPRU 4.2.12R); or

(b) if, in addition to its *mortgage home finance mediation activity*, the *firm* carries on *mortgage home finance administration* and has all the assets that it administers off balance sheet, the capital resources requirement *rule* for such *firm* (see MIPRU 4.2.19R).

(2) If the *firm* holds *client money* or other *client* assets in relation to its *mortgage home finance mediation activity*, the capital resources requirement is:

(a) the amount calculated under (1); plus

(b) the amount which is applied to a *firm* carrying on *insurance mediation activity* or *mortgage home finance mediation activity*, (and no other *regulated activity*) that holds *client money* or other *client* assets in relation to these activities (see MIPRU 4.2.11R(2)).

...

4.2.22 R The capital resources requirement for a *firm* carrying any other combination of *regulated activities* is the amount which is applied to a *firm* carrying on *insurance mediation activity* and *mortgage lending home financing* or *mortgage home finance administration* (see MIPRU 4.2.20R).

...

4.3.3 R For a *firm* which carries on *insurance mediation activity* or *mortgage home finance mediation activity*, *annual income* is the amount of all brokerage, fees, *commissions* and other related income (for example, administration charges, overrides, profit shares) due to the *firm* in respect of or in relation to those activities.

...

Annual income for *mortgage home finance administration*

4.3.7 R For the purposes of the calculation of capital resources requirement of a *firm* carrying on *mortgage home finance administration* only with all the assets it administers off balance sheet, *annual income* is the sum of:

...

...

4.4.2 R Table: Items which are eligible to contribute to the capital resources of a *firm*

1. Share capital ...

...

6. General/ collective provisions (Note 1)

These are provisions that a *firm* carrying on *mortgage lending home financing* or *mortgage home finance administration* holds against potential losses that have

	not yet been identified but which experience indicates are present in the <i>firm's</i> portfolio of assets. Such provisions must be freely available to meet these unidentified losses wherever they arise. Subject to Note 1, general/collective provisions must be verified by external auditors and disclosed in the <i>firm's</i> annual report and accounts.
--	--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------

...

...

Subordinated loans

4.4.7 R A subordinated debt must not form part of the capital resources of the *firm* unless it meets the following conditions:

(1) (for a *firm* which carries on *insurance mediation activity*, ~~or mortgage home finance mediation activity~~ (or both) but not ~~mortgage-lending home financing~~ or ~~mortgage home finance administration~~) it has an original maturity of:

- (a) at least two years; or
- (b) it is subject to two years' notice of repayment;

(2) ...

...

4.4.8 R (1) This *rule* applies to a *firm* which:

- (a) carries on:
 - (i) *insurance mediation activity*; or
 - (ii) ~~mortgage home finance mediation activity~~ (or both); and
- (b) in relation to those activities, holds *client money* or other *client assets*;

but is not carrying on ~~mortgage-lending home financing~~ or ~~mortgage home finance administration~~.

...

Reversion providers: additional requirement for instalment reversions

4.4.10 R (1) If the *reversion provider* agrees under the terms of an *instalment reversion plan* to pay the *reversion occupier* for the *qualifying interest in land* over a period of time, then the *provider* must:

- (a) take out and maintain adequate insurance from an *insurance*

undertaking authorised in the EEA or a person of equivalent status in:

(i) a Zone A country; or

(ii) the Channel Islands, Gibraltar, Bermuda or the Isle of Man; or

(b) enter into a written agreement with a credit institution;

to meet these obligations in the event that the reversion provider is unable to do so.

(2) This rule does not apply if:

(a) the instalment reversion plan is linked to an investment and it is reasonably anticipated that the amounts due to the reversion occupier under the plan will be paid out of the proceeds of the investment to the occupier by a product provider other than the reversion provider; or

(b) the reversion provider acquires its interest in the property in steps proportionate to the instalments paid.

4.4.11 G The additional requirement for reversion providers aims to protect the reversion occupier against the insolvency of the reversion provider where the reversion occupier has agreed to receive the price for the part of the qualifying interest in land sold in instalments rather than in a lump sum. The requirement does not arise, for example, in relation to reversions linked to annuities as the reversion occupier has no credit risk on the reversion provider. Also, the requirement does not arise in relation to 'mini-reversions' (or 'staged reversions') as under these plans the reversion occupier continues to own the qualifying interest in land.

5 Insurance undertakings and ~~mortgage lenders~~ home finance providers using insurance or ~~mortgage~~ home finance mediation services

...

Application

5.1.1 R This chapter applies to a firm with a Part IV permission to carry on:

(1) *insurance business*; or

(2) ~~mortgage-lending~~ home financing;

(3) and which uses, or proposes to use, the services of another person consisting of:

(a) *insurance mediation*; or

(b) *insurance mediation activity*; or

(c) ~~mortgage~~ home finance mediation activity.

Purpose

5.1.2 G The purpose of this chapter is to implement article 3.6 of the *Insurance Mediation Directive* in relation to *insurance undertakings*. The provisions of this section have been extended to ~~mortgage lenders~~ home finance providers in relation to *insurance mediation activity*, and to *insurance undertakings* and ~~mortgage lenders~~ home finance providers in relation to ~~mortgage~~ home finance mediation activity, to ensure that *firms* using these services are treated in the same way and to ensure that *clients* have the same protection. To avoid the loss of protection where an intermediary itself uses the services of an *unauthorised person*, this chapter also ensures that each person in the chain of those providing services is authorised.

...

5.2.1 R A *firm* must not use, or propose to use, the services of another person consisting of:

- (1) *insurance mediation*; or
- (2) *insurance mediation activity*; or
- (3) ~~mortgage~~ home finance mediation activity;

unless two conditions are satisfied.

...

5.2.2 R The first condition is that the person, in relation to the activity:

- (1) ...

...

- (6) in relation to ~~mortgage~~ home finance mediation activity, is not carrying this activity on in the *United Kingdom*.

...

Annex G

Amendments to the Conduct of Business sourcebook (COB)

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

...

General application: what?

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

(1) all *regulated activities* except:

(a) ~~*regulated mortgage*~~ *home finance* activities; or

...

...

1.3.2 G ...

(7) *MCOB* applies to a *firm* that carries on ~~*regulated mortgage*~~ *home finance* activity.

...

...

3.1.2 G This chapter applies generally to *firms* in relation to all *financial promotions*. This wide application is however cut back by *COB* 3.2 (Application: what?) and *COB* 3.3 (Application: where?) which limit the application of this chapter for:

(1) *financial promotions* for *deposits*, *general insurance contracts*, *pure protection contracts*, *reinsurance contracts* and ~~*regulated mortgage contracts*~~, *qualifying credit*, *home purchase plans* and *home reversion plans*;

...

...

Financial promotions for ~~*regulated mortgage contracts*~~ *home finance transactions*

3.2.3A R This chapter does not apply to a *firm* to the extent that in relation to a *financial promotion* is a *qualifying credit promotion* of a *qualifying credit*, *home purchase plan* or *home reversion plan* (but see ~~*MCOB*~~ 3 (Financial promotions) the *financial promotion rules* in the Mortgage and Home Finance: Conduct of Business sourcebook).

...

4.3.3 R ...

(6) A firm which is required in accordance with this rule to provide an *initial disclosure document* to a *private customer* may instead provide the *customer* with a *combined initial disclosure document* if it has reasonable grounds to be satisfied that the *services* which it is likely to provide to the *customer* will, in addition to *packaged products*, relate to one or more of the following:

(a) *regulated mortgage contracts other than lifetime mortgages*;

(aa) *home purchase plans*;

(b) ~~*regulated lifetime mortgage contracts*~~ *equity release transactions*;

(c) ...

...

...

5.1.11B G (1) ...

(2) A firm that carries on business ~~both~~ in relation to *packaged products*, ~~and~~ *regulated mortgage contracts* ~~and~~ *home reversion plans* can do so in relation to the whole market and therefore be "independent" for one but offer only a limited service for the others. ...

...

...

5.3.29 G Guidance on matters which should be taken into account when assessing the suitability of various personal recommendations. This table belongs to COB 5.3.13G(4).

Suitability guidance		
...
H	Borrowing to invest	
	When considering the suitability of a particular <i>investment product</i> which is linked directly or indirectly to any form of loan, or mortgage <u>or home reversion plan</u> , a firm:	

	(a)	should take account of the source of the funds being invested and the suitability of the overall transaction; and
	(b)	must follow any relevant suitability and other rules in <i>COB</i> and <i>MCOB</i> .
For example, the circumstances in which a recommendation to enter into an regulated lifetime mortgage contract <u>equity release transaction</u> and invest the funds into a <i>long-term care insurance contract</i> might be appropriate are limited, and both <i>COB</i> 5.3 and <i>MCOB</i> 8.5 apply.		

...

Disclosure on making first contact: information about services

5A.2.1 R ...

(4) A *firm* which is required by this *rule* to provide an *initial disclosure document* to a *private customer* may instead provide the *customer* with a *combined initial disclosure document*, that complies with *COB* 4.3.9R(2), if it has reasonable grounds to be satisfied that the *services* which it is likely to provide to the *customer* will, in addition to *stakeholder products*, relate to one or more of the following:

(a) *regulated mortgage contracts* other than lifetime mortgages;

(aa) home purchase plans;

(b) ~~regulated lifetime mortgage contracts~~equity release transactions;

(c) ...

...

...

COB 4 Annex 5R: Combined initial disclosure document ~~required by COB 4.3.9R(2)~~ (“CIDD”)

This Annex belongs to COB 4.3.9R(2), ICOB 4.2.7R(1), MCOB 4.4.1R(1) and MCOB 4.10.2R(1).

1. ~~Firms should omit the notes, asterisks and square brackets which appear in the following specimen.~~

This specimen covers services in relation to *packaged products, non-investment insurance contracts* and ~~*regulated mortgage contracts*~~ *home finance transactions* (including ~~*lifetime mortgages*~~ and ~~home reversion schemes~~ *equity release transactions*).

If the *firm* is ~~only~~ not providing services in relation to ~~two types of these~~ all products, the parts of the CIDD that are not relevant must be omitted.

Information about *regulated mortgage contracts* and *home purchase plans* can be combined in the same CIDD. A *firm* must not give information about *equity release transactions* in a CIDD that contains information about either *regulated mortgage contracts* (other than *lifetime mortgages*) or *home purchase plans*. Where a *firm* offers these types of services as well as *equity release transactions* it will need to have different versions of the CIDD and issue the CIDD that is appropriate for the services that it expects to provide to the *customer* concerned. Where relevant, this will mean the *firm* issuing the *customer* with both documents.

Firms must omit the notes and square brackets that appear in the following CIDD. The CIDD must contain the keyfacts logo, headings and text in the order shown and in accordance with the notes. [Note 1]

...

2 Whose products do we offer? [Note 6] [Note 7]

...

[Home Finance Products] [Note 14]

[Compliance with Islamic law [Note 7A]

Our services are regularly checked by [name(s) of scholar(s)] to ensure compliance with Islamic law. Ask us if you want further information about the role of our scholar(s).]

[1] [~~Lifetime~~][~~Mortgages~~] [Equity Release Products] [~~and home reversion schemes~~] [Note 14]

We offer [lifetime] [mortgages] [home reversion plans] [equity release products] from the whole market.

We [can] [Note 8] only offer [lifetime] [mortgages] [home reversion plans] [equity release products] from a limited number of [lenders / companies]. Ask us for a list of the [lenders / companies] we offer [lifetime] [mortgages] [home reversion plans] [equity release products] from. [Note 11]

We [can] [Note 8] only offer [a limited range of the] [a] [lifetime] [mortgage] [s] [home reversion plan] [s] [equity release products] from [a single lender / company] [name of single lender / company]. [Note 10(1) and (3)][Note 13]

[or]

We only offer our own [lifetime] [mortgages] [home reversions plan] [equity release products]. [Note 10(2)]

We do not offer [lifetime mortgages] [home reversion plans]. [Note 7B]

[2] [Islamic Home Purchase Plans] [Note 13A] [Note 14]

We offer Islamic home purchase plans from the whole market.

We [can] [Note 8] only offer Islamic home purchase plans from a limited number of providers.
Ask us for a list of the providers we offer Islamic home purchase plans from.
[Note 11]

We [can] [Note 8] only offer [a limited range of the] [a] Islamic home purchase plan [s] from [a single provider] [name of single provider]. [Note 10(1) and (3)][Note 13]

[or]

We only offer our own Islamic home purchase plans. [Note 10(2)]

3 Which service will we provide you with? [Note 6]

...

[Home Finance Products] [Note 14]

[1] [~~Lifetime~~]-[Mortgages] [Equity Release Products] [~~and home reversion schemes~~] [Note 14]

We will advise and make a recommendation for you on [lifetime mortgages] [home reversions] [equity release products] after we have assessed your needs.

You will not receive advice or a recommendation from us. We may ask some questions to narrow down the selection of ~~products~~[lifetime mortgages] [home reversions] [equity release products] that we will provide details on. You will then need to make your own choice about how to proceed.

[2] [Islamic Home Purchase Plans] [Note 14]

We will advise and make a recommendation for you after we have assessed your needs.

You will not receive advice or a recommendation from us. We may ask some questions to narrow down the selection of products that we will provide details on. You will then need to make your own choice about how to proceed.

4 What will you have to pay us for our services?

...

[Home Finance Products] [Note 14]

[1] ~~[Lifetime]~~ [Mortgages] [Equity Release Products] ~~[and home reversion schemes]~~ [Note 14]

- No fee. [We will be paid by commission from the [lender/company that buys your home].] [Note 17]
- A fee of £[] payable at the outset and £[] payable when you apply for a [lifetime] [mortgage] ~~[or home reversion scheme]~~ [home reversion plan] [equity release product]. [We will also be paid commission from the [lender/company that buys your home]]. [Note 17] [Note 18]

You will receive a key facts illustration when considering a particular [lifetime] [mortgage] [home reversion plan] [equity release product], ~~[or further information about a particular home reversion scheme]~~ which will tell you about any fees relating to it. [Note 14]

Refund of fees [Note 19] [Note 14]

If we charge you a fee, and your [lifetime] [mortgage] ~~[or home reversion scheme plan]~~ does not go ahead, you will receive: [Note 20]

- A full refund [if the [lender/company] rejects your application]. [Note 21]
- A refund of £ [] [if your application falls through]. [Note 21] [Note 22]
- No refund [if you decide not to proceed]. [Note 21]

[2] [Islamic Home Purchase Plans] [Note 14]

- No fee. [We will be paid by commission from the provider. [Note 17]
- A fee of £[] payable at the outset and £[] payable when you apply for an Islamic home purchase plan. [We will also be paid commission from the provider]. [Note 17] [Note 18]

Refund of fees [Note 19]

If we charge you a fee, and your Islamic home purchase plan does not go ahead, you will receive: [Note 20]

- A full refund [if the provider] rejects your application]. [Note 21]
- A refund of £ [] [if your application falls through]. [Note 21] [Note 22]
- No refund [if you decide not to proceed]. [Note 21]

5 Who regulates us? [Note 23]

[XYZ Financial Services] [123 Any Street, Some Town, ST21 7QB] [Note 24] [Note 25] is authorised and regulated by the Financial Services Authority. Our FSA Register number is []. [Note 26]

Our permitted business is []. [Note 27]

[or] [Note 28]

[Name of *appointed representative*] [Note 3] [Note 4] is an appointed representative of [name of *firm*] [address of *firm*] [Note 24] [Note 25] which is authorised and regulated by the Financial Services Authority. [Name of *firm's*] FSA Register number is [].

[Name of *firm's*] permitted business is [] [Note 27]

You can check this on the FSA's Register by visiting the FSA's website www.fsa.gov.uk/register or by contacting the FSA on 0845 606 1234.

~~[Home reversion schemes are not regulated by the FSA.] [Note 14]~~

6 Loans and ownership [Note 29]

[B&C Investments plc owns 20% of our share capital.]

[London Union plc provides us with loan finance of £250,000 per year.]

[XYZ Financial Services (or we) have 20% of the voting rights in Royal Edinburgh.]

[Note 29][Note 30]Note 31][Note 32][Note 33][Note 34]

7 What to do if you have a complaint [Note 23]

If you wish to register a complaint, please contact us:

...**in writing** Write to [XYZ Financial Services], [Complaints Department, 123 Any Street, Some Town, ST21 7QB].

... **by phone** Telephone [0121 100 1234]. [Note 35]

If you cannot settle your complaint with us, you may be entitled to refer it to the Financial Ombudsman Service. [Note 36] [Note 36A] [Note 37] ~~[The Financial Ombudsman Service does not consider complaints about home reversion schemes.] [Note 14]~~

8 Are we covered by the Financial Services Compensation Scheme (FSCS)? [Note 23] [Note 38] [Note 38A]

We are covered by the FSCS. You may be entitled to compensation from the scheme if we cannot meet our obligations. This depends on the type of business and the circumstances of the claim.

...

[Lifetime] [Mortgages] [and] [Home Purchase Plans] [Equity Release Products] [Note 14]

[Mortgage], [and] [Home purchase] [and] [Equity release] advising and arranging is covered for 100% of the first £30,000 and 90% of the next £20,000 so the maximum compensation is £48,000. ~~[Home reversion schemes are not covered by the Financial Services Compensation Scheme.] [Note 14]~~

Further information about compensation scheme arrangements is available from the FSCS.

[Note 40] Message from the Financial Services Authority

Think carefully about this information before deciding whether you want to go ahead. If you are at all unsure about which ~~lifetime mortgage or home reversion~~ scheme equity release product is right for you, you should ask your adviser to make a recommendation.

Please remember that home reversion schemes are not regulated by the FSA.

[Note 41] Think carefully about the product and services you need. [We can only offer services in relation to Islamic home purchase plans and cannot provide advice on standard mortgages.] [If you want [information] or [advice] on standard mortgages, please ask.]

The following notes do not form part of the CIDD.

...

Note 6 – for services in relation to *packaged products* and ~~*regulated mortgage contracts, regulated lifetime mortgage contracts*~~ and ~~home reversion schemes~~ the *firm* must select, for example by ticking, one box which is appropriate for the service which it expects to provide to the *customer*. ... For services in relation to *equity release transactions*, firms must select by ticking the box (es) which is (are) appropriate for the service that they expect to provide to the *customer*. This means a *firm* selecting a maximum of two boxes within this section. *Firms* must not omit the boxes not selected (but see Note 7A).

...

Note 7A – The ‘Compliance with Islamic law’ subsection is optional unless the *firm* holds itself, its *regulated mortgage contract* or *home purchase plan* products or services out as compliant with Islamic law in the CIDD. If a *firm* includes Section 1A then it must describe the section on the CIDD as section 2 and renumber subsequent sections accordingly.

A *firm* that wishes to hold itself, its *regulated mortgage contract* or *home purchase plan* products or services out as compliant with religious or philosophical beliefs other than Islamic law in the CIDD may also use the sub-section in accordance with this note and modify the wording in the section to the extent appropriate.

Note 7B – if the *firm* does not advise or give personalised information on both types of *equity release transactions*, then it must indicate to the *customer* the sector that the *firm* does not cover. However, if the *firm's* scope of service does not include *equity release transactions*, the last box ('We do not offer [*lifetime mortgages*] [*home reversion plans*]'), must be omitted.

Note 8 – insert “can” if the *firm's* range of products is determined by any contractual obligation. This does not apply where a *product provider, insurer, lender, lender, or company home purchase provider* or *home reversion provider* is selling its own products.

...

Note 10 – if the *firm* selects this box, it will be offering the products of one provider to the *customer* for a particular product type. It should therefore follow the format specified in (1) below except when offering its own products, in which case it should follow (2) instead. ...

(1) Insert the name of the provider, namely ... the ~~*lender*~~ *lender* for *regulated mortgage contracts* and ~~*regulated lifetime mortgage contracts*~~, and the ~~*company*~~ *home purchase provider* for *home purchase plans* and the *home reversion provider* for *home reversion plans*. ... If the *firm* does not offer all of the ~~*mortgages or home reversion schemes*~~ *home finance transactions* generally available from that provider, it must insert the words "a limited range of" as shown in the specimen.

(2) ...

(3) If the *firm* offers *home reversion plans* from only one *reversion provider*, and *lifetime mortgages* from only one *lender*, which is different from the *reversion provider*, then the *firm* should identify the *lender* and the *reversion provider* and specify the type of *equity release transaction* to which they relate. For example,

"We can only offer lifetime mortgages from ABC Mortgages Ltd and home reversion plans from XYZ Reversions Ltd."

Note 11 – for services provided in relation to ~~regulated mortgage contracts, regulated lifetime mortgage contracts and home reversion schemes~~ home finance transactions, this sentence is required only where a *firm* selects this service option. It may also be omitted if a *firm* chooses to list all of the ~~lenders~~ lenders, home purchase providers and home reversion providers it offers ~~mortgages~~ home finance transactions from ~~instead of the text "a limited number of lenders"~~, in the previous line, so long as the *firm* offers all of the products generally available from each ~~lender~~.

...

Note 13 – if the *firm* does not select this box, it must alter the wording to say "a single group of companies" for *packaged products*, "a single insurer" for *non-investment insurance contracts*, "a single lender" for *regulated mortgage contracts* or ~~regulated lifetime mortgages~~ ~~contracts~~ and "a single company" (or "a single provider") for ~~home reversion schemes~~ home purchase plans and home reversion plans. For example: "We only offer the products from a single group of companies" should replace the text in the specimen CIDD.

Note 13A – A *firm* that carries on home purchase activities may omit the word "Islamic" from "Islamic home purchase plan(s)" if one or more home purchase plans within its scope of service is not held out as compliant with Islamic law. If "Islamic" is omitted, it should be omitted consistently throughout the document. However, a *firm* may omit the word "Islamic" in sections 5 and 8 without having to omit it throughout the document. A *firm* that wishes to hold itself, its products or services out as compliant with religious or philosophical belief other than Islamic law in the IDD may make appropriate amendments to references to "Islamic" and "Islamic law".

Note 14 – in describing the services and products provided, *firms* must omit the text in brackets that do not apply and ensure that they describe accurately their activities with respect of the services and products that they offer, as follows:

(1) Headings and sub-headings:

- a. If the *firm* offers both regulated mortgage contracts and home purchase plans, it must include the heading "Home Finance Products" in the CIDD and describe the regulated mortgage contracts and home purchase plans that it offers under two separate sub-headings. The sub-headings ("Mortgages" and "Home Purchase Plans") must be numbered accordingly. If the *firm* only offers one of these two products, then the heading "Home Finance Products" should be omitted and the heading will read "Mortgages" or "Home Purchase Plans", as appropriate.
- b. If the *firm* offers equity release transactions, then the heading "Home Finance Products" should be omitted and the heading will read "Equity Release Products" (even if the *firm* offers equity release transactions from only one sector).

(2) Describing the products:

- a. If a firm advises or gives personalised information on lifetime mortgages, it must change “mortgage” to “lifetime mortgage”, where the firm sells only regulated lifetime mortgage contracts.
- b. If a firm advises or gives personalised information on home reversion plans, it must use the text in brackets relating to home reversion plans.
- c. If the firm advises or gives personalised information on products from both equity release market sectors, then it must use the term 'equity release products' when referring to them collectively.

(3) Describing the provider: If a firm advises or gives personalised information on home purchase plans or home reversion plans, it must change Firms must insert the text relating to home reversion schemes and change “mortgage” to “product” and “lender” to “company” or “provider”, as appropriate. if they advise or give personalised information on schemes in addition to advising on investments or giving personalised information on regulated lifetime mortgage contracts.

...

Note 17 – if the firm receives commission instead of, or in addition to, fees from the customer for services relating to ~~regulated home finance transactions mortgage contracts, regulated lifetime mortgage contracts~~ or home reversion schemes, it must insert a plain language explanation of this (see specimen for a plain language example). If the firm will pay over to the customer any commission the firm receives, it may refer to that fact here.

Note 18 – insert a plain language description of when any fees are payable for services relating to ~~regulated home finance transactions mortgage contracts, regulated lifetime mortgage contracts~~ or home reversion schemes. ... If a firm offers more than one pricing option in relation to equity release transactions, it should specify the pricing policy for each of them. For example, "A fee of £100 payable at the outset and £120 when you apply for a lifetime mortgage and £80 when you apply for a home reversion plan". ~~it may illustrate each with a separate box.~~ If a firm does not charge a fee, the text for the second box should be abbreviated to 'A fee'.

Note 19 – omit this part of the CIDDD on ‘Refund of fees’ if the firm has indicated that there will be “No fee” for services in relation to ~~regulated home finance transactions mortgage contracts, regulated lifetime mortgage contracts~~ or home reversion schemes or that any fee will be payable only if the product completes.

...

Note 21 – insert a short, plain language description of the circumstances in which the fee for services in relation to ~~regulated home finance transactions mortgage contracts, regulated lifetime mortgage contracts~~ or home reversion schemes is refundable or not refundable as described. If the refund policy is different depending on the equity release transaction in question, the firm should specify the refund policy for each of them. For example, "A refund of £100 if your lifetime mortgage application falls through and a refund of £120 if your home reversion plan application falls through."

Note 22 – a *firm* may delete this line if it does not offer a partial refund for services in relation to ~~*regulated home finance transactions*~~ ~~*mortgage contracts*~~, ~~*regulated lifetime mortgage contracts*~~ or ~~home reversion schemes~~ in any circumstances.

Section 5: Who regulates us?

Note 23 – ... This section may be omitted for services relating to ~~*regulated mortgage contracts*~~ (including ~~*regulated lifetime mortgage contracts*~~) and ~~home reversion schemes~~ ~~*home finance transactions*~~ in accordance with MCOB 4.4.1R(3). If this section is omitted, the other sections of the CIDD must be renumbered accordingly.

...

Lifetime mortgage Home finance products warning

Note 40 - This warning box should be added when the *firm* sells ~~*regulated lifetime mortgages*~~ ~~*contracts*~~ or ~~home reversion schemes~~ ~~*home reversion plans*~~ or both.

Note 41 - A *firm* must only include this paragraph if the services to which the CIDD relates include *home purchase activities*. If the *firm* does not carry on *regulated mortgage activities*, it must include the second sentence and delete the third. If the *firm* carries on *regulated mortgage activities* as well as *home purchase activities* it must omit the second sentence and include the third.

Annex H

Amendments to the Insurance: Conduct of Business sourcebook (ICOB)

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

...

- 3.1.3 G A communication may contain both a *non-investment financial promotion* and one or more of ~~a financial promotions of other products and a qualifying credit promotion~~, for example, a leaflet from a firm which describes the range of insurance, savings and mortgage products it provides. In such cases, ~~ICOB 3, COB 3 and MCOB 3~~ the financial promotion rules in this, the Conduct of Business and the Mortgages and Home Finance: Conduct of Business sourcebooks will all be relevant.

...

Retail and commercial customers: disclosure before or immediately after conclusion of the contract

- 4.2.1 G ...
- (2) ... For example, an *insurance intermediary* who is also providing services in connection with *packaged products* or ~~regulated mortgage contracts~~ home finance transactions may wish to combine the information required by ~~ICOB 4.2~~ this section with the status disclosure requirements in ~~COB or MCOB~~ the Conduct of Business and Mortgages and Home Finance: Conduct Business sourcebooks, and provide the information to the *customer* on initial contact, using the ~~combined initial disclosure document in ICOB 4 Annex 2~~ combined initial disclosure document.

...

- (4) ... An *insurance intermediary* may use the ~~initial disclosure document in ICOB 4 Annex 1~~ initial disclosure document, the ~~combined initial disclosure document in ICOB 4 Annex 2~~ combined initial disclosure document, a terms of business letter, or another document to provide information to the *customer*.

...

- 4.2.4 G (1) ... Alternatively, in circumstances where the *insurance intermediary* has reasonable grounds to be satisfied that the services which it is likely to provide will, in addition to relating to *non-investment insurance contracts*, also relate to ~~regulated mortgage contracts, regulated lifetime mortgage contracts~~ home

finance transactions or *packaged products*, the *insurance intermediary* may use the ~~combined initial disclosure document set out in *ICOB 4 Annex 2*~~*combined initial disclosure document*.

...

...

4.2.7 R If an *insurance intermediary* chooses to use the ~~combined initial disclosure document at *ICOB 4 Annex 2*~~*combined initial disclosure document*...

Delete ICOB 4 Annex 2R. The deleted text is not shown.

ICOB 4 Annex 2R: Combined initial disclosure document (“CIDD”)
[deleted – see *COB 4 Annex 5*]

Annex I

Amendments to the Training and Competence sourcebook (TC)

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

...

2.1.1A G Although not subject to TC 2, a firm should have regard to TC 2 in relation to its home purchase activities when deciding how it wishes to align its systems and controls with the high level commitments in TC 1.

Where?

2.1.2 R ...

(2) In relation to *regulated mortgage activities* or home reversion activities carried on with or for a *customer*, this chapter applies if the *customer* is resident in:

(a) the *United Kingdom*; or

(b) another *EEA State*, but in this case only if the activity is carried on from an establishment maintained by the firm or its *appointed representative* in the *United Kingdom* only;

at the time that the ~~*regulated mortgage activity*~~activity is carried on.

...

...

2.1.4 R Activities to which TC 2 applies

	Activity	Extent of Application
1. Employees engaging in:	<p>...</p> <p>Advising (without dealing)</p> <p>...</p> <p><u>(pa) advising a customer on a home reversion plan;</u></p> <p>...</p> <p><u>(ra) designing scripted questions for use in sales to customers of home reversion plans which do not involve personal recommendations;</u></p> <p>...</p>	<p>1. ...</p> <p>2. In relation to <i>regulated mortgage activities</i> <u>and home reversion activities</u>, whole of TC 2 applies.</p> <p>3. ...</p>
2. ...	<p>...</p> <p>(b) <i>safeguarding and administering investments</i> or holding of <i>client money</i> (unless held in the course of carrying on a <i>mortgage mediation activity</i>, <u>a reversion mediation activity</u>, or an <i>insurance mediation activity</i> only in relation to a <i>non-investment insurance contract</i>);</p> <p>...</p> <p>(g) the sales to customers of <i>regulated lifetime mortgage contracts</i> <u><i>equity release transactions</i></u> which do not involve <i>personal recommendations</i>.</p>	<p>...</p>

...

- 2.4.3 G In TC 2.4.2R(1)(b) an adequate level of application of knowledge and skills includes:
- (1) specific knowledge of the *firm's* relevant systems and procedures, and of the kinds of *designated investment business* and, regulated mortgage activities and home reversion activities carried on by the *firm*; and

...

...

2.5.1A R The time limits to which TC 2.5.1R applies

Activity in TC 2.1.4R		Examination must be passed:
1.	...	...
	(p)- <u>and</u> (q)	within two years of starting the activity
	<u>(pa)</u>	<u>no time limit</u>
...
	<u>(ra)</u>	<u>no time limit</u>
...

...

Insert the following new transitional provisions. The place where the text is added is shown, but the text is not underlined.

TC TP 2

Transitional provisions relating to home reversion plans

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
1	TC 2	R	<p>Competent employees who carry on lifetime mortgage and home reversion activities</p> <p>(1) This transitional provision applies:</p> <p>(a) in relation to <i>home reversion plans</i>; and</p> <p>(b) in respect of an individual employed by a <i>firm</i> at 6 April 2007, if that individual had before that date been assessed as competent by the <i>firm</i> in relation to:</p>	From 6 April 2007 for two years	Apply in relation to <i>home reversion plans</i> from 6 April 2007

		<p>(i) advising on <i>lifetime mortgages</i>;</p> <p>(ii) designing scripted questions for use in non-advised sales to customers of <i>lifetime mortgages</i>; or</p> <p>(iii) overseeing non-advised sales of <i>lifetime mortgages</i>.</p> <p>(2) The <i>firm</i> in 1(b) will (subject to (4)) be deemed to have complied with <i>TC 2.4.5R</i> in respect of activities carried on in relation to <i>home reversion plans</i> that correspond to those in (1)(b) provided that:</p> <p>(a) the individual has been assessed as competent to apply the knowledge and skills necessary to engage in or oversee the relevant home reversion activity before 6 April 2007;</p> <p>(b) the home reversion activity which the individual engages in or oversees continues to be the same, or substantially the same as that immediately before 6 April 2007; and</p> <p>(c) the individual has not experienced any significant break of employment since the previous assessment.</p> <p>(3) Any other <i>firm</i> which subsequently employs the individual in 1(b) will (subject to (4)) be deemed to have complied with <i>TC 2.4.5R(1)(b)</i> provided that:</p> <p>(a) the conditions in 2(b) and (c) are met; and</p> <p>(b) the <i>firm</i> assesses the individual to be competent in accordance with <i>TC 2.4.5R(1)(a)</i>.</p> <p>(4) If the individual has not passed</p>		
--	--	------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------	--	--

			an appropriate home reversions top-up examination before 6 April 2009, a <i>firm</i> in (2) or (3) will cease to be deemed to comply with TC 2.4.5R in relation to that individual.		
2		G	<p>Until 5 April 2009, a <i>firm</i> may rely on paragraph 1 to assess an individual as competent to:</p> <p>(1) advise on <i>home reversion plans</i>;</p> <p>(2) design scripted questions for use in non-advised sales to customers of <i>home reversion plans</i>; or</p> <p>(3) oversee non-advised sales of <i>home reversion plans</i>,</p> <p>if that individual had been assessed by the <i>firm</i> as competent before 6 April 2007 in relation to corresponding <i>lifetime mortgage</i> activities and the activity or role of that individual in relation to his home reversion activities after that date remains the same or substantially the same as it was prior to it.</p> <p>After 5 April 2009 a <i>firm</i> may not rely on paragraph 1 to assess an individual as competent: the individual must be assessed as competent and must have passed an appropriate home reversions top-up examination if they are to continue to carry on a home reversion activity in (1), (2) or (3) after that date. If the individual has not passed an appropriate home reversions top-up examination before 6 April 2009, the individual must be assessed as competent and must have passed an appropriate examination on equity release if they are to carry on a home reversion activity in</p>	From 6 April 2007 for two years	Apply in relation to <i>home reversion plans</i> from 6 April 2007

			(1), (2) or (3).		
3		G	A <i>firm</i> which relies on paragraph 1 of this table in establishing the competence of an individual should have regard to TC 2.6. In particular, a <i>firm</i> should keep under review the status of an individual deemed competent under paragraph 1 and consider whether an individual may no longer be competent (for example in the light of repeated failures to pass an appropriate home reversion top-up examination).	From 6 April 2007 for two years	Apply in relation to <i>home reversion plans</i> from 6 April 2007
4	TC 2	R	<p>Competent employees who carry on home reversion activities only</p> <p>(1) This transitional provision applies:</p> <p>(a) in relation to <i>home reversion plans</i>; and</p> <p>(b) in respect of an individual employed by a <i>firm</i> at 6 April 2007 other than an individual described in paragraph (1)(b) of transitional provision 1.</p> <p>(2) The <i>firm</i> in 1(b) will (subject to (4)) be deemed to have complied with TC 2.4.5R in respect of:</p> <p>(a) advising on <i>home reversion plans</i>;</p> <p>(b) designing scripted questions for use in non-advised sales to customers of <i>home reversion plans</i>; or</p> <p>(c) overseeing non-advised sales of <i>home reversion plans</i>,</p> <p>provided that:</p> <p>(A) the individual has been assessed as competent to apply the knowledge and skills necessary to</p>	From 6 April 2007 for two years	Apply in relation to <i>home reversion plans</i> from 6 April 2007

			<p>engage in or oversee the relevant home reversion activity before 6 April 2007;</p> <p>(B) the home reversion activity which the individual engages in or oversees continues to be the same, or substantially the same as that immediately before 6 April 2007; and</p> <p>(C) the individual has not experienced any significant break of employment since the previous assessment.</p> <p>(3) Any other <i>firm</i> which subsequently employs the individual in 1(b) will (subject to (4)) be deemed to have complied with TC 2.4.5R(1)(b) provided that:</p> <p>(a) the conditions in 2(B) and (C) are met; and</p> <p>(b) the <i>firm</i> assesses the individual to be competent in accordance with TC 2.4.5R(1)(a).</p> <p>(4) If the individual has not passed an appropriate examination before 6 April 2009, a <i>firm</i> in (2) or (3) will cease to be deemed to comply with TC 2.4.5R in relation to that individual.</p>		
5		G	<p>Until 5 April 2009, a <i>firm</i> may rely on paragraph 4 of this table to assess an individual as competent to:</p> <p>(i) advise on <i>home reversion plans</i>;</p> <p>(ii) design scripted questions for use in non-advised sales to customers of <i>home reversion plans</i>; or</p> <p>(iii) oversee non-advised sales of</p>	From 6 April 2007 for two years	Apply in relation to <i>home reversion plans</i> from 6 April 2007

			<p><i>home reversion plans,</i></p> <p>if that individual did not carry out (and therefore had not been assessed as competent in relation to) <i>lifetime mortgage</i> activities prior to 6 April 2007 and the activity or role of that individual in relation to his home reversion activities after that date remains the same or substantially the same as it was prior to it.</p> <p>After 5 April 2009 a <i>firm</i> may not rely on paragraph 4 to assess an individual as competent: the individual must be assessed as competent and must have passed an appropriate examination on equity release if they are to carry on a home reversion activity in (i), (ii) or (iii).</p>		
6		G	<p>A <i>firm</i> which relies on paragraph 4 of this table in establishing the competence of an individual should have regard to TC 2.6. In particular, a <i>firm</i> should keep under review the status of an individual deemed competent under paragraph 4 and consider whether an individual may no longer be competent (for example in the light of repeated failures to pass an appropriate exam).</p>	<p>From 6 April 2007 for two years</p>	<p>Apply in relation to <i>home reversion plans</i> from 6 April 2007</p>

Annex J

Amendments to the Supervision manual (SUP)

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

...

3.1.1A G For the avoidance of doubt, this chapter does not apply to the following *firms* if they do not hold *client money* or client assets and do not appoint an auditor under or as a result of a statutory provision other than in the *Act*:

...

(6) ~~mortgage~~home finance administrators;

(7) ~~mortgage~~home finance intermediaries;

(8) ~~mortgage lenders~~home finance providers;

Applicable sections (see SUP 3.1.1R)

3.1.2 R

	(1) Category of firm	(2) Sections applicable to the firm	(3) Sections applicable to its auditor
...
(9)	Mortgage lender <u>Home finance provider</u> which has an auditor appointed under or as a result of a statutory provision other than in the <i>Act</i>	SUP 3.1 - SUP 3.7	SUP 3.1, SUP 3.2, SUP 3.8
...
(12)	Mortgage <u>Home finance intermediary</u> or mortgage <u>home finance administrator</u> which has an auditor appointed under or as a result of a statutory provision other than in the <i>Act</i> .	SUP 3.1, SUP 3.2, SUP 3.7	SUP 3.1, SUP 3.2, SUP 3.8

...

10.1.17 G ...

- (2) *SUP 10.1.16R* has a limited application to an *appointed representative* appointed by a *firm* to carry on *insurance mediation activity* or ~~*mortgage*~~*home finance* *mediation activity*.

...

...

...

What is a "network"?

- 12.2.6 G A *firm* is referred to as a '*network*' if ... However, a *network* does not include:

...

- (d) A ~~*mortgage lender*~~*home finance provider*.

Business for which an appointed representative is exempt

- 12.2.7 G (1) The *Appointed Representatives Regulations* ... describe, among other things, the business for which an *appointed representative* may be exempt, which is business which comprises any of:

...

- (d) ~~*arranging (bringing about) regulated mortgage contracts*~~*arranging (bringing about) a home finance transaction* (articles 25A(1), 25B(1) and 25C(1) of the *Regulated Activities Order*);

- (e) ~~*making arrangements with a view to regulated mortgage contracts*~~*making arrangements with a view to a home finance transaction* (articles 25A(2), 25B(2) and 25C(2) of the *Regulated Activities Order*);

...

- (j) ~~*advising on regulated mortgage contracts*~~*advising on a home finance transaction* (articles 53A, 53B and 53C of the *Regulated Activities Order*); and

...

...

What is an introducer appointed representative?

- 12.2.8 G ...

- (2) The permitted scope of appointment of an *introducer appointed representative* does not include in particular:

...

- (d) *advising on investments, providing basic advice on stakeholder products, advising on ~~regulated mortgage contracts~~ a home finance transaction or other activity that might reasonably lead a customer to believe that he had received basic advice or advice on investments or on ~~regulated mortgage contracts~~ home finance transactions or that the introducer appointed representative is permitted to provide basic advice or give advice on investments or on ~~regulated mortgage contracts~~ home finance transactions.*

...

...

- 12.4.5E G (1) Under the relevant Advising and Selling chapters of *COB*, *ICOB* and *MCOB*, the customer will receive ... details of the complaints procedure for the *product provider*, *insurer* or ~~*mortgage lender*~~ *home finance provider*.

...

- (3) The complaints procedure should also explain that the customer has a choice of whether to contact the ... ~~*mortgage lender*~~ *home finance provider* and that ...

...

...

- 12.5.2 G (1) Regulations 3(1) to (3B) of the *Appointed Representatives Regulations* makes it a requirement that ...

...

- (2) Under the *Appointed Representative Regulations*, an appointed representative is treated as representing other counterparties if, broadly, it:

...

- (e) *arranges:*

- (i) for persons to enter (or with a view to persons entering) as ~~borrowers~~ customers into ~~regulated mortgage contracts~~ home finance transactions (or as plan providers in the case of a home reversion plan) with other counterparties; ~~or~~
- (ii) for a person to vary a ~~regulated mortgage contract~~ home finance transaction entered into by a person as ~~borrower~~ customer (or as plan provider in the case of a home reversion plan) on or after

31 October 2004 (in the case of a regulated mortgage contract) or 6 April 2007 (in all other cases) with other counterparties; or

- (f) gives advice (within articles 53A, 53B or 53C of the *Regulated Activities Order* (~~Advising on investments~~)) on the merits of:
- (i) persons entering as ~~borrowers~~ customers into ~~regulated mortgage contracts~~ home finance transactions (or as plan provider in the case of a home reversion plan) with other counterparties; or
 - (ii) persons varying ~~regulated mortgage contracts~~ home finance transactions entered into by them as ~~borrower~~ customer (or as plan provider in the case of a home reversion plan) on or after 31 October 2004 (in the case of a regulated mortgage contract) or 6 April 2007 (in all other cases) with other counterparties;

...

...

...

Prohibition of multiple principals for certain activities

- 12.5.6A R (1) A firm must ensure that, if appointing an *appointed representative* (other than an *introducer appointed representative*), to carry on any of the following *regulated activities*, its written contract prohibits the *appointed representative* from carrying on any of the specified activities as an *appointed representative* for another firm:

...

- (c) any *regulated mortgage activities* in relation to *lifetime mortgages*: the prohibition must cover all *lifetime mortgages*;
- (d) any reversion activities: the prohibition must cover all reversion activities;
- (e) any home purchase activities: the prohibition must cover all home purchase activities.

...

12.5.6B G ...

- (2) The effect of ~~SUP 12.5.6AR(1)(b)~~ and ~~SUP 12.5.6AR(1)(c)~~ the rule prohibiting multiple principals for certain activities is that, in relation to ~~regulated mortgage~~ home finance activities with ~~customer~~, appointed representatives are restricted to having ~~two~~ four principals: one for regulated mortgage contracts other than lifetime mortgages, and one for lifetime mortgages, one for home reversion plans and one for home purchase plans.

...

Obligations of firms under the approved persons regime

- 12.6.8 G (1) ...
- (a) ...
- (b) although the *customer functions* (other than the investment manager function) apply to an *appointed representative*, the descriptions of the functions themselves do not extend to ... ~~mortgage~~ home finance *mediation activity* ...

...

...

...

SUP 12 Annex 3R

Appointed Representative Appointment Form

...

		Yes	No
12	Will the appointed representative undertake regulated mortgage <u>home finance</u> activities? *	<input type="checkbox"/>	<input type="checkbox"/>

...

SUP 12 Annex 4R

Appointed Representative Notification Form

...

Yes No

12

Does the appointed representative undertake regulated
~~mortgage~~home finance activities? *

...

Annex K

Amendments to the Compensation sourcebook (COMP)

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

...

Areas of particular interest to claimants (see *COMP* 1.1.3G).

1.3.3 G This Table belongs to ~~COMP 4.3.3~~1.1.3G.

...
Q2	How much compensation will I be offered?		
A2	This depends on whether your <i>protected claim</i> is:		

	(4)	a <i>claim</i> in connection with protected mortgage <u>businesshome finance mediation</u> .	<i>COMP</i> 5.6

Q3	How will the FSCS calculate the compensation that is offered to me?		
A3	Again, this will depend on whether your <i>protected claim</i> is-a:		

	(4)	a <i>claim</i> in connection with protected mortgage <u>businesshome finance mediation</u> .	<i>COMP</i> 12.4.17R
...

...

Protected investment business and protected ~~mortgage business~~home finance mediation

4.3.7 G There are no exceptions to *COMP* 4.2.2R for *claims* made in connection with *protected investment business* or ~~protected mortgage business~~home finance mediation.

...

What is a protected claim?

5.2.1 R A *protected claim* is:

...

- (4) a claim in connection with *protected mortgage business home finance mediation* (see *COMP 5.6*); or

...

...

Protected mortgage business home finance mediation

5.6.1 R *Protected mortgage business home finance mediation* is:

- (1) *advising on regulated mortgage contracts a home finance transaction*; or
- (2) *arranging (bringing about) regulated mortgage contracts a home finance transaction*; or
- (3) *making arrangements with a view to regulated mortgage contracts a home finance transaction*; or
- (4) *agreeing to carry on a regulated activity in (1) to (3)*; or
- (5) the activities of a *mortgage lender home finance provider* which would be *arranging* but for article 28A of the *Regulated Activities Order* (*Arranging contracts or plans* to which the arranger is a party);

provided that the condition in *COMP 5.6.2R* is satisfied.

5.6.2 R *COMP 5.6.1R* applies only if the *protected mortgage business home finance mediation* was carried on by a *relevant person*:

- (1) with a *customer* who was a resident in the *United Kingdom*; or
- (2) from an establishment maintained by the *relevant person* (or its *appointed representative*) in the *United Kingdom* with a *customer* who was resident elsewhere in the *EEA*;

at the time the *protected mortgage business home finance mediation* was carried on.

...

6.3.4 R For *claims* arising in connection with *protected investment business* or *protected mortgage business*, *protected home finance mediation* or *protected non-investment insurance mediation*, the *FSCS* has the additional power to determine that a *relevant person* is in *default* if it is satisfied that a *protected claim* exists, and ...

...

8.2.4 R For claims made in connection with *protected investment business* or ~~*protected mortgage business*~~, *protected home finance mediation* or *protected non-investment insurance mediation*, the *FSCS* may disregard a defence of limitation where the *FSCS* considers that it would be reasonable to do so.

...

9.2.2 R The *FSCS* may postpone paying compensation if:

...

- (2) in the case of a *claim* relating to *protected investment business* which is not an *ICD claim* or a claim relating to ~~*protected mortgage business*~~ *home finance mediation*, the *FSCS* considers that the claimant should first exhaust his rights against the *relevant person* or any third party, or make and pursue an application for compensation to any other *person*; or

...

...

Table limits

10.2.3 R This table belongs to *COMP* 10.2.1R

Type of claim	Level of cover	Maximum payout
...
<i>Protected mortgage business</i> <i>home finance mediation</i>	100% × first £30,000 90% × next £20,000	£48,000
...

...

~~*Protected mortgage business*~~ *home finance mediation*

12.3.7 R For a *claim* made in connection with ~~*protected mortgage business*~~ *home finance mediation*, the *FSCS* must determine a specific date as the *quantification date*, and this date may be either on, before or after the date of determination of default.

...

~~*Protected mortgage business*~~ *home finance mediation*

12.4.17 R The *FSCS* may pay compensation for any *claim* made in connection with ~~*protected mortgage business*~~ *home finance mediation* only to the extent that the *FSCS* considers that the payment of compensation is essential in order to

provide the claimant with fair compensation.

- 12.4.18 R The *FSCS* must not pay compensation for any *claim* in connection with *protected ~~mortgage~~ businesshome finance mediation* to the extent that it relates to or depends on:

...

- 12.4.19 R The *FSCS* may decide to reduce the compensation that would otherwise be payable for a *claim* made in connection with *protected ~~mortgage~~ businesshome finance mediation* if it is satisfied that there is evidence of contributory negligence by the claimant and it would be inequitable for *FSCS* not to take account of that fact.

...

Annex L

Amendments to the Electronic Commerce Directive sourcebook (ECO)

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

...

Exceptions: ~~regulated mortgage contracts~~ home finance transactions

1.2.5A R *ECO 1.2.1 R does not apply to an incoming ECA provider with respect to an electronic commerce activity which relates to a ~~regulated mortgage contract~~ home finance transaction.*

...

LISTING RULES (AMENDMENT) INSTRUMENT 2006

Powers exercised

- A. The Financial Services Authority makes this instrument in the exercise of the powers and related provisions in the following sections of the Financial Services and Markets Act 2000:
- (1) section 73A (Part 6 rules);
 - (2) section 96 (Obligations of issuers of listed securities);
 - (3) section 101 (Listing rules: general provisions); and
 - (4) Schedule 7 (The Authority as Competent Authority for Part VI).

Commencement

- B. This instrument comes into force on 1 November 2006.

Amendments to the Handbook

- C. The Glossary of definitions is amended in accordance with Annex A to this instrument.
- D. The Listing Rules (LR) are amended in accordance with Annex B to this instrument.

Citation

- E. This instrument may be cited as the Listing Rules Amendment Instrument 2006.

By order of the Board
25 October 2006

Annex A

Amendments to the Glossary of definitions

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

Delete the definition of “Combined Code” and substitute the following definition:

Combined Code (in *LR*) in relation to an *issuer*:

- (1) in respect of a reporting period commencing on or after 1 November 2006, the Combined Code on Corporate Governance published in June 2006 by the Financial Reporting Council; or
- (2) in respect of a reporting period commencing before 1 November 2006, the Combined Code on Corporate Governance published in July 2003 by the Financial Reporting Council.

Annex B

Amendments to the Listing Rules (LR)

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

In LR Appendix 1, delete the definition of “Combined Code” and substitute the following definition:

Combined Code

in relation to an *issuer*:

- (1) in respect of a reporting period commencing on or after 1 November 2006, the Combined Code on Corporate Governance published in June 2006 by the Financial Reporting Council; or
- (2) in respect of a reporting period commencing before 1 November 2006, the Combined Code on Corporate Governance published in July 2003 by the Financial Reporting Council.

**REINSURANCE DIRECTIVE (CONSEQUENTIAL AMENDMENTS)
INSTRUMENT 2006**

Powers exercised

- A. The Financial Services Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 ("the Act"):
- (1) section 138 (General rule-making power);
 - (2) section 150(2) (Actions for damages);
 - (3) section 156 (General supplementary powers);
 - (4) section 157(1) (Guidance);
 - (5) section 340 (Appointment); and
 - (6) paragraph 17(1) of Schedule 1 (Fees).
- B. The rule-making powers listed above are specified for the purpose of section 153(2) (Rule-making instruments) of the Act.

Commencement

- C. This instrument comes into force as follows:
- (1) Part 1 of Annex A and Annex C come into force on 6 November 2006; and
 - (2) the remainder of this instrument comes into force on 31 December 2006.

Amendments to the Handbook

- D. The modules of the FSA's Handbook of rules and guidance listed in column (1) below are amended in accordance with the Annexes to this instrument listed in column (2).

(1)	(2)
Glossary of definitions	Annex A
Senior Management Arrangements, Systems and Controls (SYSC)	Annex B
Fees manual (FEES)	Annex C
Interim Prudential sourcebook for Insurers (IPRU(INS))	Annex D
Supervision manual (SUP)	Annex E

Citation

- E. This instrument may be cited as the Reinsurance Directive (Consequential Amendments) Instrument 2006.

By order of the Board
25 October 2006

Annex A

Amendments to the Glossary of definitions

In this Annex, underlining indicates new text and striking through indicates deleted text. Where new definitions are being inserted, the text is not underlined.

Part 1: New definitions

Insert the following new definitions in the appropriate alphabetical position:

<i>captive reinsurer</i>	<p>a <i>pure reinsurer</i> owned by:</p> <ul style="list-style-type: none">(a) a financial <i>undertaking</i> other than an <i>insurance undertaking</i> or a <i>reinsurance undertaking</i>; or(b) a <i>group</i> of <i>insurance undertakings</i> or <i>reinsurance undertakings</i> to which the <i>Insurance Groups Directive</i> applies; or(c) a non-financial <i>undertaking</i>, <p>the purpose of which is to provide <i>reinsurance</i> cover exclusively for the risks of the <i>undertaking</i> or <i>undertakings</i> to which it belongs or of an <i>undertaking</i> or <i>undertakings</i> of the <i>group</i> of which that <i>pure reinsurer</i> is a member.</p>
<i>EEA ISPV</i>	<p>an <i>ISPV</i> (including a <i>UK ISPV</i>) whose head office is in any <i>EEA State</i> and which has received authorisation pursuant to article 46 of the <i>Reinsurance Directive</i> from its <i>Home State Regulator</i>.</p>
<i>EEA pure reinsurer</i>	<p>a <i>reinsurance undertaking</i> (other than an <i>ISPV</i>) whose head office is in any <i>EEA State</i> except the <i>United Kingdom</i> and which has received authorisation under article 3 of the <i>Reinsurance Directive</i> from its <i>Home State Regulator</i>.</p>
<i>insurance special purpose vehicle</i>	<p>an <i>undertaking</i>, other than an <i>insurance undertaking</i> or <i>reinsurance undertaking</i> which has received an official authorisation in accordance with article 6 of the <i>First Non-Life Directive</i>, article 4 of the <i>Consolidated Life Directive</i> or article 3 of the <i>Reinsurance Directive</i>:</p> <ul style="list-style-type: none">(a) which assumes risks from such <i>insurance undertakings</i> or <i>reinsurance undertakings</i>; and(b) which fully funds its exposures to such risks through the proceeds of a debt issuance or some other financing mechanism where the repayment rights of the providers of

such debt or other financing mechanism are subordinated to the *undertaking's reinsurance obligations*.

ISPV an *insurance special purpose vehicle*.

life protection reinsurance business *reinsurance acceptances which are contracts of insurance:*

- (a) falling within *long-term insurance business class I*; or
- (b) falling within *long-term insurance business class III* and providing *index-linked benefits*;

that are not:

- (c) *with-profits insurance contracts*; or
- (d) *whole life assurances*; or
- (e) contracts to pay annuities on human life; or
- (f) contracts which pay a sum of money on the survival of the life assured to a specific date or on his earlier death.

mixed insurer an *insurer* (other than a *pure reinsurer*) which carries on *reinsurance business* and where one or more of the following conditions is met in respect of its *reinsurance acceptances*:

- (a) the *premiums* collected in respect of those acceptances during the previous *financial year* exceeded 10% of its total *premiums* collected during that year;
- (b) the *premiums* collected in respect of those acceptances during the previous *financial year* exceeded €50 million; and
- (c) the *technical provisions* in respect of those acceptances at the end of the previous *financial year* exceeded 10% of its total *technical provisions* at the end of that year.

permanent health reinsurance business *reinsurance acceptances which are contracts of insurance falling within long-term insurance business class IV*.

Reinsurance Directive the Directive of 16 November 2005 of the European Parliament and of the Council (No 2005/68/EC) on reinsurance and amending the *First Non-Life Directive* and the *Third Non-Life Directive* as well as the *Insurance Groups Directive* and the *Consolidated Life Directive*.

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

UK ISPV an *ISPV* with a *Part IV permission* to effect or carry out contracts of *insurance*.

Part 2: Amended definitions

Amend the following definitions as shown:

admissible asset (1)...
(2) ~~(in PRU)~~ otherwise:
(a) (in relation to an *insurer* which is not a *pure reinsurer*) an asset that falls into one or more categories in *PRU 2 Annex 1R*; or
(b) (in relation to a *pure reinsurer*) an asset the holding of which is consistent with compliance by the *firm* with *INSPRU 3.1.61AR*.

EEA firm ...
(f) ...
(g) an *undertaking* pursuing the activity of *reinsurance* (within the meaning of article 1 of the *Reinsurance Directive*) which has received authorisation under article 3 of the *Reinsurance Directive* from its *Home State Regulator*.

insurance health risk and life protection reinsurance capital component one of the components of the *long-term insurance capital requirement* as set out in *PRU 7.2.85R* to *PRU 7.2.86R*.

insurance holding company (1) a *parent undertaking*, other than an *insurance undertaking*, the main business of which is to acquire and hold participations in *subsidiary undertakings* and which fulfils the following conditions:
(a) its *subsidiary undertakings* are either exclusively or mainly *insurance undertakings*; and
(b) at least one of those *subsidiary undertakings* is an *UK insurer* or an *EEA firm* that is a *regulated insurance entity* or a *reinsurance undertaking*; ~~and~~

(e) ~~it is not a mixed financial holding company.~~

a parent undertaking, other than an insurance undertaking, that fulfils the conditions in paragraphs (1) (a) and (b) of this definition is not an insurance holding company if:

(c) it is a mixed financial holding company; and

(d) notice has been given in accordance with Article 4(2) of the Financial Groups Directive that the financial conglomerate of which it is a mixed financial holding company is a financial conglomerate.

(2) ...

insurer

a firm with permission to ~~effect~~effect or carry out contracts of insurance (other than ~~a bank~~a UK ISPV).

regulated related undertaking

a related undertaking that is any of the following:

....

(f) an insurance holding company; or

(g) an EEA ISPV.

Annex B

Amendments to Senior Management Arrangements, Systems and Controls (SYSC)

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

...

3A.1.1 G ...

3A.1.1A G SYSC 3A applies to a UK ISPV.

...

Annex C

Amendments to the Fees manual (FEES)

In this Annex, underlining indicates new text.

...

FEES 3 Annex 1R Authorisation fees payable

...

Part 2 ...

Moderately Complex Cases R

Moderately complex cases	
Activity grouping	Description
...	
A.2	<i>Mortgage lenders and administrators</i>
<u>A.3</u>	<u>UK ISPVs</u>
<u>A.4</u>	<u>UK ISPVs</u>
...	

...

Complex Cases R

Complex cases	
Activity grouping	Description
...	
A.3	Insurers - general (excluding <i>friendly societies</i> and <u>UK ISPVs</u>)
A.4	Insurers - life (excluding <i>friendly societies</i> and <u>UK ISPVs</u>)
...	

...

FEES 4 Annex 1R Activity groups, tariff bases and valuation dates applicable

...

Part 2

...

Activity group	Tariff-base
...	
A.3	GROSS PREMIUM INCOME AND GROSS TECHNICAL LIABILITIES

	For <i>insurers</i> : ...
	Note: (1) In both (a) and (b) above only <i>premium</i> receivable in respect of <i>United Kingdom</i> business are relevant. (2) For <i>UK ISPVs</i> the tariff base is not relevant and a flat fee set out in <u>FEES 4 Annex 2R is payable.</u>
A.4	ADJUSTED GROSS PREMIUM INCOME AND MATHEMATICAL RESERVES <u>Except for <i>UK ISPVs</i>:</u> Amount of new regular <i>premium</i> business...
	Notes: (1) [deleted] (2) Only <i>premiums</i> receivable... (3) For <i>UK ISPVs</i> the tariff base is not relevant and a flat fee set out in <u>FEES 4 Annex 2R is payable.</u>
...	

...

FEES 4 Annex 2 ...

...

Activity group	Fee-payable	
...		
A.3	... > 1,000	......
	<u>For <i>UK ISPVs</i> the tariff rates are not relevant and a flat fee of £400 is payable in respect of the period 1 January 2007 to 31 March 2007 to be invoiced with the fee for the financial period 2007/8.</u>	
A.4	... > 15,000	......
	<u>For <i>UK ISPVs</i> the tariff rates are not relevant and a flat fee of £400 is payable in respect of the period 1 January 2007 to 31 March 2007 to be invoiced with the fee for the financial period 2007/8.</u>	

Annex D

Amendments to the Interim Prudential sourcebook for Insurers (IPRU(INS))

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

...

Chapter 9

FINANCIAL REPORTING

...

- 9.42A (1) An *insurer* that reports under rule 9.40(1) must, subject to rule 9.42B, provide to any person...
- (2) (1) does not apply to a *pure reinsurer* which became a *firm in run-off* before 10 December 2007 and whose *Part IV permission* has not subsequently been varied to add back the *regulated activity of effecting contracts of insurance*.

...

Chapter 12

TRANSITIONAL ARRANGEMENTS

...

Insert after the Instructions to 2005 Return Transitional Table D and before the heading Guidance above paragraph 12.6 the following heading and transitional rule 12.5A:

Pure reinsurance groups

- 12.5A A *pure reinsurer* whose *ultimate EEA insurance parent undertaking* is the *parent undertaking* of a *group* comprised solely of *reinsurance undertakings* need not comply with rule 9.40 (Group capital adequacy) before 10 December 2007.

...

APPENDIX 9.1 (rules 9.12 and 9.13)

BALANCE SHEET AND PROFIT AND LOSS ACCOUNT (FORMS 1 TO 3 AND 10 TO 19)

...

Instructions for completion of Form 1

...

9. The *base capital resources requirement* at line 33 must be taken from *PRU 2.1.26R*. For a *pure reinsurer* writing both non-life and life business, the *base capital resources requirement* must be allocated between F1.33 and F2.33 in the ratio of the *general insurance capital requirement* to the sum of the *long-term insurance capital requirement* and the *resilience capital requirement*.

...

16. The *base capital resources requirement* at line 33 must be taken from *PRU 2.1.26R*. For a *pure reinsurer* writing both non-life and life business, the *base capital resources requirement* must be allocated between F1.33 and F2.33 in the ratio of the *general insurance capital requirement* to the sum of the *long-term insurance capital requirement* and the *resilience capital requirement*.

...

Instructions for completion of Form 2

...

9. The *base capital resources requirement* at line 33 must be taken from *PRU 2.1.26R*. For a *pure reinsurer* writing both non-life and life business, the *base capital resources requirement* must be allocated between F1.33 and F2.33 in the ratio of the *general insurance capital requirement* to the sum of the *long-term insurance capital requirement* and the *resilience capital requirement*.

...

- 17B. The *base capital resources requirement* at line 33 must be taken from *PRU 2.1.26R*. For a *pure reinsurer* writing both non-life and life business, the *base capital resources requirement* must be allocated between F1.33 and F2.33 in the ratio of the *general insurance capital requirement* to the sum of the *long-term insurance capital requirement* and the *resilience capital requirement*.

...

Calculation of general insurance capital requirement– premiums amount and brought forward amount

Form 11

Name of insurer
 Global business / UK branch business / EEA branch business
 Financial year ended
 General/long-term insurance business

		Company registration number	GL/UK/CM	day	month	year	units
R11							£000
				This financial year 1		Previous year 2	
Gross premiums written		11					
Premiums taxes and levies (included in line 11)		12					
Premiums receivable written net of taxes and levies (11-12)		13					
Premiums for classes 11, 12 or 13 (included in line 13)		14					
Premiums for "actuarial health insurance" (included in line 13)		15					
Sub-total A (13 + ½ 14 - ²/₃ 15)		16					
Gross premiums earned		21					
Premium taxes and levies (included in line 21)		22					
Premiums earned net of taxes and levies (21-22)		23					
Premiums for classes 11, 12 or 13 (included in line 23)		24					
Premiums for "actuarial health insurance" (included in line 23)		25					
Sub-total H (23 + ½ 24 - ²/₃ 25)		26					
Sub-total I (higher of sub-total A and sub-total H)		30					
Adjusted sub-total I if financial year is not a 12 month period to produce an annual figure		31					
Division of gross adjusted premiums amount: sub-total I (or adjusted sub-total I if appropriate)	x 0.18	32					
	Excess (if any) over 5053.1M EURO x 0.02	33					
Sub-total J (32-33)		34					
Claims paid in period of 3 financial years		41					
Claims outstanding carried forward at the end of the 3 year period	For insurance business accounted for on an underwriting year basis	42					
	For insurance business accounted for on an accident year basis	43					
Claims outstanding brought forward at the beginning of the 3 year period	For insurance business accounted for on an underwriting year basis	44					
	For insurance business accounted for on an accident year basis	45					
Sub-total C (41+42+43-44-45)		46					
Amounts recoverable from reinsurers in respect of claims included in Sub-total C		47					
Sub-total D (46-47)		48					
Reinsurance ratio (Sub-total D / sub-total C or, if more, 50% 0.50 or, if less, 100% 1.00)		49					
Premiums amount (Sub-total J x reinsurance ratio)		50					
Provision for claims outstanding (before discounting and net of reinsurance)		51					
Brought forward amount (12.43.2 x 51.1 / 51.2 or, if less, 12.43.2)		52					
Greater of lines 50 and 52		53					

...

Calculation of general insurance capital requirement– claims amount and result

Form 12

Name of insurer
 Global business / UK branch business / EEA branch business
 Financial year ended
 General/long-term insurance business

		Company registration number	GL/UK/CM	day	month	year	units
		R12					£000
				This financial year	Previous year		
				1	2		
Reference period (No. of months) See PRU 7.2.63R		11					
Claims paid in reference period		21					
Claims outstanding carried forward at the end of the reference period	For insurance business accounted for on an underwriting year basis	22					
	For insurance business accounted for on an accident year basis	23					
Claims outstanding brought forward at the beginning of the reference period	For insurance business accounted for on an underwriting year basis	24					
	For insurance business accounted for on an accident year basis	25					
Claims incurred in reference period (21+22+23-24-25)		26					
Claims incurred for classes 11, 12 or 13 (included in 26)		27					
Claims incurred for "actuarial health insurance" (included in 26)		28					
Sub-total E (26 + $\frac{1}{2}$ 27 - $\frac{2}{3}$ 28)		29					
Sub-total F – Conversion of sub-total E to annual figure (multiply by 12 and divide by number of months in the reference period)		31					
Division of sub-total F (gross adjusted claims amount)	x 0.26	32					
	Excess (if any) over <u>3537.2M</u> EURO x 0.03	33					
Sub-total G (32 - 33)		39					
Claims amount Sub-total G x reinsurance ratio (11.49)		41					
Higher of premiums amount and brought forward amount (11.53)		42					
General insurance capital requirement (higher of lines 41 and 42)		43					

Instructions for completion of Forms 11 and 12

...

1. For a *composite firm*, Forms 11 and 12 must be completed separately for the total *general insurance business* and for the total *long-term insurance business* which is *class IV*, ~~or~~ supplementary accident and sickness insurance business or *life protection reinsurance business*. For other *firms*, the forms must be completed for the total *general insurance business* or for the total *long-term insurance business* which is *class IV*, ~~or~~ supplementary accident and sickness insurance business or *life protection reinsurance business*, as appropriate.
2. Notwithstanding instruction 1, if the gross annual office premiums for *class IV* business, *life protection reinsurance business* and supplementary accident and sickness insurance in force on the 'valuation date' do not exceed 1% of the gross annual office premiums in force on that date for all *long-term insurance business*, Forms 11 and 12 need not be completed for *long-term insurance business* as long as it can be stated that the entry in line 21 of Form 60 exceeds the amount that would be obtained if Forms 11 and 12 were to be completed for *long-term insurance business*. In this circumstance, the method of estimating the entry in line 21 of Form 60, together with a statement of the gross annual office premiums in force at the 'valuation date' in respect of *Class IV* business, *life protection reinsurance business* and supplementary accident and sickness insurance, must be given in a supplementary note (code 6001).
3. When completing Forms 11 and 12 for *long-term insurance business* the accounting conventions for *general insurance business* should be followed, but reasonable approximations may be used if they are unlikely to result in an underestimate of the *insurance health risk and life protection reinsurance capital component*.

...

7. ~~If the financial year began before 1 January 2004: then~~
 - ~~11.14.2, 11.24.2, 11.52.2 and 12.27.2 should be left blank;~~
 - ~~lines 21 to 41, column 2, of Form 12 relating to *long term insurance business*, should be left blank; and~~
 - ~~no amounts should be included in column 2 of Form 11 that relate to *class IV* business.~~

If the financial year ends after 30 December 2006, the amounts to be shown in column 2 must be the amounts shown in column 1 for the previous financial year, unless Forms 11 and 12 were not completed for the previous financial year. In that event column 2 must be left blank, apart from the amounts in 11.51.2 and 12.43.2. The amounts in 11.51.2 and 12.43.2 must be calculated in accordance with the rules in force at the date to which they relate, so for a previous financial year ending prior to 31 December 2006 they must exclude *life protection reinsurance business*.

...

10. *Premiums* and *claims* are defined by references to *contracts of insurance* and these themselves are defined by the *Regulated Activities Order* so that *premiums* or *claims* may be included for contracts that would not be treated as insurance under normal accounting conventions. All direct and indirect costs related to the *claims* must be included. For *life protection reinsurance business* and *permanent health reinsurance business* the discount to the premium, during any initial period, to allow for acquisition expenses of the cedant must be ignored, i.e. an adjustment must be made to *premiums* written and *premiums* earned as if the *premium* is the amount excluding the discount and the discount had been accounted for as an expense.

...

Instructions for completion of Form 11

...

2. In accordance with *PRU 7.2.54R*, the reinsurance ratio calculated at line 49 must be:

- ~~100%~~ 1.00 if sub-total C is zero
- ~~100%~~ 1.00 if sub-total D / sub-total C exceeds ~~100%~~ 1.00;
- ~~50%~~ 0.50 if sub-total D / sub-total C is less than ~~50%~~ 0.50; and
- sub-total D / sub-total C, otherwise.

The ratio at line 49 must be shown to two decimal places, but the unrounded ratio must be used for calculating **Form 11** line 50 and **Form 12** line 41.

...

Instructions for completion of Form 13

...

11. Lines 60 to 63 and 85 relate only to *general insurance business*. The amount in lines 60-62 recoverable from *Insurance Special Purpose Vehicles* must be disclosed in a supplementary note (code 1320).

...

APPENDIX 9.3 (rules 9.14 and 9.23)

**LONG-TERM INSURANCE BUSINESS
REVENUE ACCOUNT AND ADDITIONAL INFORMATION
(FORMS 40 TO 60)**

...

Long term insurance capital requirement

Form 60

Name of insurer

Global business / UK branch business / EEA branch business

Financial year ended

Units

		LTICR factor	Gross reserves / capital at risk	Net reserves / capital at risk	Reinsurance factor	LTICR Financial year	LTICR Previous year
		1	2	3	4	5	6
Insurance death risk capital component							
Life protection reinsurance	11	0.0%					
Classes I (other), II and IX	142	0.1%					
Classes I (other), II and IX	123	0.15%					
Classes I (other), II and IX	134	0.3%					
Classes III, VII and VIII	145	0.3%					
Total	156						
Insurance health risk and life protection reinsurance capital component							
Class IV, and supplementary classes 1 and 2 and life protection reinsurance	21						
Insurance expense risk capital component							
Life protection and permanent health reinsurance	31	0%					
Classes I (other), II and IX	342	1%					
Classes III, VII and VIII (investment risk)	323	1%					
Classes III, VII and VIII (expenses fixed 5 yrs +)	334	1%					
Classes III, VII and VIII (other)	345	25%					
Class IV (other)	356	1%					
Class V	367	1%					
Class VI	378	1%					
Total	389						
Insurance market risk capital component							
Life protection and permanent health reinsurance	41	0%					
Classes I (other), II and IX	442	3%					
Classes III, VII and VIII (investment risk)	423	3%					
Classes III, VII and VIII (expenses fixed 5 yrs +)	434	0%					
Classes III, VII and VIII (other)	445	0%					
Class IV (other)	456	3%					
Class V	467	0%					
Class VI	478	3%					
Total	489						
Long term insurance capital requirement	51						

...

Instructions for completion of Form 60

1. The *insurance death risk capital component* in lines 11-1-4-5 column 5 is based on capital at risk for those contracts where it is not negative. Capital at risk is the benefit payable as a result of death less the *mathematical reserves* after distribution of surplus. Life protection reinsurance business written by a pure reinsurer or a mixed insurer is reported in line 11. Other ~~b~~Business in classes I, II and IX must be split between lines 142, 123 and 134 in accordance with PRU 7.2.82R. Line 142 is for temporary insurance on death where the original term of the contract is 3 years or less ~~or for a pure reinsurer~~. Line 123 is for temporary insurance where the original term is 5 years or less but more than 3 years. Line 134 is for other class I, II or IX business. For a *pure reinsurer* the factor of 0.3% in column 1 of line 1-4-5 must be replaced by 0.1%.
2. In lines 11-1-4-5 columns 2 and 3 are the gross and net capital at risk in accordance with PRU 7.2.83R. For lines 142-134 the reinsurance factor is calculated in aggregate, so column 4 is the sum of lines 142-134 column 3 divided by the sum of lines 142-134 column 2, subject to a minimum of 0.5 in accordance with PRU 7.2.81R. For line 1-4-5 column 4 is column 3 divided by column 2, subject to a minimum of 0.5 in accordance with PRU 7.2.81R. Column 5 is column 1 x column 2 x column 4.
3. The *insurance health risk and life protection reinsurance capital component* in line 21 column 5 must be equal to the entry at line 43 in Form 12 for *long-term insurance business*, unless an estimate has been made in accordance with instruction 2 to Forms 11 and 12. In this case a supplementary note (code 6001) is required as described in that instruction.
4. For the purpose of calculating the *insurance expense risk capital component* and the *insurance market risk capital component* linked contracts must be allocated to:
 - lines 323 and 423 where the *firm* bears an investment risk,
 - lines 334 and 434 where the *firm* does not bear an investment risk but where the allocation to cover *management expenses* is fixed for a period exceeding 5 years from the commencement of the contract, and
 - lines 3-4-5 and 4-4-5, otherwise.Life protection reinsurance business and permanent health reinsurance business written by a pure reinsurer or a mixed insurer must be allocated to lines 31 and 41.
5. The *insurance expense risk capital component* for linked contracts where the *firm* bears no investment risk and the allocation to cover *management expenses* does not have a fixed upper limit for a period exceeding 5 years from the commencement of the contract in line 345 is 25% of net *administrative expenses* in accordance with PRU 7.2.88R(1).
6. The *insurance expense risk capital component* for class V in line 367 column 5 is 1% of the assets of the tontine in accordance with PRU 7.2.88R(2).
7. The *insurance expense risk capital component* for other business in lines 342, 323, 334, 356 and 378 column 5 is 1% of adjusted *mathematical reserves* after distribution of surplus in accordance with PRU 7.2.88R(3). Column 4 is column 3 divided by column 2, subject to a minimum of 85% (50% for a pure reinsurer) in accordance with PRU 7.2.90R. Column 5 is column 1 x column 2 x column 4.
8. The *insurance market risk capital component* in lines 434 and 4-4-5 column 5 for class III, VII and VIII contracts where the *firm* does not bear any investment risk and in line 456 for class V contracts is nil in accordance with PRU 7.2.89R.
9. The *insurance market risk capital component* in line 442, 423, 456 and 478 column 5 is 3% of adjusted *mathematical reserves* after distribution of surplus in accordance with PRU 7.2.89R. Column 4 is column 3 divided by column 2 subject to a minimum of 85% (50% for a pure reinsurer) in accordance with PRU 7.2.90R. Column 5 is column 1 x column 2 x column 4. The amount in line 49 column 3 must equal the amount in Form 14 line 11.
10. The *long term insurance capital requirement* in line 51 column 5 is the sum of column 5 in lines 156, 21, 389 and 489.

11. ...

12. Where the previous financial year ends before 31 December 2006, column 6 must be completed using the corresponding figures from the previous return, e.g. line 12 column 6 contains the amount previously shown in line 11 column 5.

Annex E

Amendments to the Supervision manual (SUP)

In this Annex, underlining indicates new text.

...

3.1.2 R Table: Applicable sections (see SUP 3.1.1R)

(1) Category of firm	(2) Sections applicable to the firm	(3) Sections applicable to its auditor
...		
(6) <i>Insurer, the Society of Lloyd's, underwriting agent or members' adviser, <u>UK ISPV</u></i> (Note 5)	SUP 3.1-SUP 3.7	SUP 3.1, SUP 3.2, SUP 3.8
...		

...

16.1.3 R Table: Application of different sections of SUP 16

(1) Section(s)	(2) Categories of firm to which section applies	(3) Applicable rules and guidance
...		
SUP 16.7	<i>Service company</i>	SUP 16.7.20R to SUP 16.7.21R
	<u><i>UK ISPV</i></u>	<u>SUP 16.7.21AR and SUP 16.7.21BR</u>
...		

...

16.7.5 G Table: Applicable rules and guidance on reports (see SUP 16.7.1G)

Firm category	Applicable rules and guidance
...	
<i>Service company</i>	SUP 16.7.20R – SUP 16.7.21R
<u><i>UK ISPV</i></u>	<u>SUP 16.7.21AR – SUP 16.7.21BR</u>
...	

...

Insert after SUP 16.7.21R

UK Insurance Special Purpose Vehicles

16.7.21A R A UK ISPV must submit reports to the FSA in accordance with SUP 16.7.21BR.

16.7.21B R Table: Financial reports required from UK Insurance Special Purpose Vehicles

<u>Report</u>	<u>Frequency</u>	<u>Due date</u>
<u>Annual audited financial statements</u>	<u>Annually</u>	<u>3 months after the <i>firm's</i> accounting reference date</u>

...

SUP App 1.3.1 G Table: Prudential categories and sub-categories used in the Interim Prudential sourcebooks and the Supervision manual

<i>Prudential categories</i> (Note 1)	Applicable prudential requirements (Note 2)	Prudential sub-categories
...		
<i>UCITS management company*</i>	IPRU(INV) 1,5 and 7	UCITS firm UCITS investment firm
<u>UK ISPV</u>		
...		

...

THE GENERAL PRUDENTIAL SOURCEBOOK INSTRUMENT 2006

Powers exercised

- A. The Financial Services Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):
- (1) section 138 (General rule-making power);
 - (2) section 149 (Evidential provisions);
 - (3) section 150(2) (Actions for damages);
 - (4) section 156 (General supplementary powers);
 - (5) section 157(1) (Guidance); and
 - (6) section 316(1) (Direction by Authority).
- B. The rule-making powers listed above are specified for the purpose of section 153(2) (Rule-making instruments) of the Act.

Commencement

- C. This instrument comes into force as follows:
- (1) Chapters 1 and 2 of the General Prudential Sourcebook (GENPRU) as they apply to insurers and insurance special purpose vehicles come into force on 31 December 2006.
 - (2) Sections 1.5 and 2.3 of GENPRU come into force on 31 December 2006.
 - (3) The remainder of this instrument comes into force on 1 January 2007.

Amendments to the Handbook

- D. (1) The Financial Services Authority creates GENPRU to form a new module within the Prudential Standards block of its Handbook of Rules and Guidance in accordance with the following provisions:
- (a) each provision of the Integrated Prudential Sourcebook (PRU) listed in column (1) of the table in Annex A is redesignated to form part of GENPRU in accordance with the corresponding entry in column (2) of the table in Annex A;
 - (b) each provision of the Lloyd's sourcebook (LLD) listed in column (1) of the table in Annex A is redesignated to form part of GENPRU in accordance with the corresponding entry in column (2) of the table in Annex A;

- (c) the provisions in (a) and (b) designated as "Restated text" in column (3) of the table in paragraph D(2) are amended so that they read as set out in Annex B to this instrument;
 - (d) the provisions in (a) designated as "Amended text" in column (3) of the table in paragraph D(2) are amended in accordance with Annex C to this instrument;
 - (e) the Financial Services Authority makes the rules, gives the guidance and makes the requirements designated as "New text" in column (3) of the table in paragraph D(2); and
 - (f) all the above provisions are combined so that they appear in the appropriate numerical order.
- (2) The table referred to in paragraph D(1)(c) to (e) is as follows:

GENPRU	Current designation in PRU or LLD (where applicable)	How dealt with in this instrument
GENPRU 1.1	N/A	New text
GENPRU 1.2	PRU 1.2	Restated text
GENPRU 1.3	PRU 1.3	Restated text
GENPRU 1.3.55R and GENPRU 1.3.56G	N/A	New text
GENPRU 1.4	N/A	New text
GENPRU 1.5	LLD 18	Restated text
GENPRU 2.1	PRU 2.1	Restated text
GENPRU 2.1.26R	N/A	New text
GENPRU 2.2	PRU 2.2	Restated text
GENPRU 2.3	LLD 19	Restated text
GENPRU 2 Annex 1R	PRU 2.2.14R	Restated text
GENPRU 2 Annex 2R	N/A	New text
GENPRU 2 Annex 3R	N/A	New text
GENPRU 2 Annex 4R	N/A	New text
GENPRU 2 Annex 5R	N/A	New text
GENPRU 2 Annex 6R	N/A	New text
GENPRU 2 Annex 7R	PRU 2 Annex 1R	Restated text
GENPRU 2 Annex 8G	PRU 2 Annex 2G	Restated text
GENPRU 3.1	PRU 8.4	Amended text
GENPRU 3.2	PRU 8.5	Amended text
GENPRU 3 Annex 1R	PRU 8 Annex 1R	Amended text
GENPRU 3 Annex 2R	PRU 8 Annex 2R	Amended text
GENPRU 3 Annex 3G	PRU 8 Annex 3G	Amended text
GENPRU 3 Annex 4R	PRU 8 Annex 4R	Amended text

Citation

E. This instrument may be cited as the General Prudential Sourcebook Instrument 2006.

By order of the Board
25 October 2006

Annex A

Redesignation of PRU and LLD

- (1) The table referred to in paragraph D(1) of this instrument is as follows.
- (2) Where a reference in the Table in this Annex A is to a chapter and section only, the whole of the section listed in column (1) is redesignated as set out in column (2). The module, chapter and section of each provision is redesignated as set out in column (2); otherwise the numbering of the paragraphs in the redesignated section remains the same.

PRU provision: current location	Destination
1.2.1 R	GENPRU 1.2.1 R (2)
1.2.2 R	GENPRU 1.2.3 R
1.2.3 R	GENPRU 1.2.2 R
1.2.4 R	GENPRU 1.2.4 R
1.2.5 R	GENPRU 1.2.5 R
1.2.6 R	GENPRU 1.2.6 R
1.2.7 R	GENPRU 1.2.1 R (2)
1.2.8 G	GENPRU 1.2.7 G
1.2.9 G	GENPRU 1.2.8 G
1.2.10 G	GENPRU 1.2.9 G
1.2.11 G	GENPRU 1.2.10 G
1.2.12 G	GENPRU 1.2.11 G
1.2.13 G	GENPRU 1.2.17 G
1.2.14 G	GENPRU 1.2.13 G
1.2.15 G	GENPRU 1.2.15 G
1.2.16 G	GENPRU 1.2.16 G
1.2.18 G	GENPRU 1.2.18 G
1.2.19 G	GENPRU 1.2.19 G (1)
1.2.20 G	GENPRU 1.2.21 G (1)
1.2.21 G	GENPRU 1.2.20 G
1.2.22 R	GENPRU 1.2.26 R
1.2.23 G	GENPRU 1.2.27 G
1.2.24 G	GENPRU 1.2.28 G
1.2.25 G	GENPRU 1.2.29 G
1.2.26 R	GENPRU 1.2.30 R (1)
1.2.27 R	GENPRU 1.2.35 R
1.2.29 G	GENPRU 1.2.40 G
1.2.30 G	GENPRU 1.2.41 G
1.2.31 R	GENPRU 1.2.30 R (2)
1.2.32 G (2)	GENPRU 1.2.32 G (2)

PRU provision: current location	Destination
	GENPRU 1.2.37 R (1)
1.2.34 G	GENPRU 1.2.38 G
1.2.35 R	GENPRU 1.2.42 R
1.2.36 G	GENPRU 1.2.43 G
1.2.37 R	GENPRU 1.2.60 R
1.2.38 R	GENPRU 1.2.61 R
1.2.39 G	GENPRU 1.2.62 G
1.2.41 G	GENPRU 1.2.64 G
1.2.42 G	GENPRU 1.2.65 G
1.2.44 G	GENPRU 1.2.63 G
1.2.45 G	GENPRU 1.2.67 G
1.2.46 G	GENPRU 1.2.68 G
1.2.47 G	GENPRU 1.2.69 G
1.2.48 G	GENPRU 1.2.70 G
1.2.49 G	GENPRU 1.2.71 G
1.2.50 G	GENPRU 1.2.72 G
1.2.51 G	GENPRU 1.2.73 G
1.2.52 G	GENPRU 1.2.74 G
1.2.54 G	GENPRU 1.2.77 G
1.2.55 G	GENPRU 1.2.78 G
1.3.1 R	GENPRU 1.3.1 R
1.3.4 G	GENPRU 1.3.2 G
1.3.5 R	GENPRU 1.3.4 R
1.3.5A R	GENPRU 1.3.9 R (1)
1.3.5B R	GENPRU 1.3.9 R (2)
1.3.5C R	GENPRU 1.3.10R
1.3.6 G	GENPRU 1.3.5 G
1.3.7 G	GENPRU 1.3.6 G
1.3.8 G	GENPRU 1.3.7 G
1.3.10 G	GENPRU 1.3.3 G (2)
1.3.11 R	GENPRU 1.3.41 R
1.3.12 R	GENPRU 1.3.14 R
1.3.13 G	GENPRU 1.3.15 R
1.3.14 R	GENPRU 1.3.16 R
1.3.15 R	GENPRU 1.3.17 R
1.3.16 R	GENPRU 1.3.18 R
1.3.17 R	GENPRU 1.3.19 R
1.3.18 R	GENPRU 1.3.20 R
1.3.19 R	GENPRU 1.3.21 R
1.3.20 R	GENPRU 1.3.22 R
1.3.21 R	GENPRU 1.3.23 R
1.3.22 R	GENPRU 1.3.24 R
1.3.23 G	GENPRU 1.3.25 R
1.3.24 R	GENPRU 1.3.26 R
1.3.25 G	GENPRU 1.3.27 G

PRU provision: current location	Destination
1.3.26 R	GENPRU 1.3.30 R
1.3.27 R	GENPRU 1.3.31 R
1.3.28 R	GENPRU 1.3.32 R
1.3.29 R	GENPRU 1.3.33 R
1.3.30 R	GENPRU 1.3.34 R
1.3.31 R	GENPRU 1.3.43 R
1.3.32 G	GENPRU 1.3.44 G
1.3.33 R	GENPRU 1.3.45 R
1.3.34 R	GENPRU 1.3.46 R
1.3.35 R	GENPRU 1.3.47 R
1.3.36 R	GENPRU 1.3.48 R
1.3.37 R	GENPRU 1.3.49 R
1.3.38 R	GENPRU 1.3.50 R
1.3.39 R	GENPRU 1.3.51 R
1.3.40 G	GENPRU 1.3.52 G
1.3.41 G	GENPRU 1.3.53 G
1.3.42 G	GENPRU 1.3.54 G
1.3.43 R	GENPRU 1.3.57 R
2.1.1 R	GENPRU 2.1.1 R (2)
2.1.2 G	GENPRU 2.1.2 G
2.1.3 R	GENPRU 2.1.3 R
2.1.4 G	GENPRU 2.1.4 G
2.1.5 G	GENPRU 2.1.5 G
2.1.6 G	GENPRU 2.1.6 G
2.1.7 G	GENPRU 2.1.7 G
2.1.8 G	GENPRU 2.1.8 G
2.1.9 R	GENPRU 2.1.13 R
2.1.10 R	GENPRU 2.1.14 R
2.1.11 G	GENPRU 2.1.15 G
2.1.12 G	GENPRU 2.1.16 G
2.1.13 G	GENPRU 2.1.12 G
2.1.14 R	GENPRU 2.1.17 R
2.1.15 R	GENPRU 2.1.18 R
2.1.16 R	GENPRU 2.1.19 R
2.1.17 R	GENPRU 2.1.20 R
2.1.18 G	GENPRU 2.1.21 G
2.1.19 G	GENPRU 2.1.22 G
2.1.20 R	GENPRU 2.1.23 R
2.1.21 R	GENPRU 2.1.24 R
2.1.22 R	GENPRU 2.1.25 R
2.1.23 G	GENPRU 2.1.27 G
2.1.24 G	GENPRU 2.1.28 G
2.1.25 R	GENPRU 2.1.29 R
2.1.26 R	GENPRU 2.1.30 R
2.1.27 R	GENPRU 2.1.31 G

PRU provision: current location	Destination
2.1.28 G	GENPRU 2.1.32 G
2.1.29 R	GENPRU 2.1.33 R
2.1.30 R	GENPRU 2.1.34 R
2.1.31 G	GENPRU 2.1.35 G
2.1.32 R	GENPRU 2.1.36 R
2.1.33 G	GENPRU 2.1.37 G
2.1.34 R	GENPRU 2.1.38 R
2.1.35 G	GENPRU 2.1.39 G
2.1.36 R	GENPRU 2.1.9R
2.1.37 G	GENPRU 2.1.10 G
2.1.38 R	GENPRU 2.1.11 R
2.2.1 R	GENPRU 2.2.1 R (2)
2.2.2 G	GENPRU 2.2.2 G and 2.2.3 G
2.2.3 G	GENPRU 2.2.8 G
2.2.4 G	GENPRU 2.2.8 G
2.2.5 G	GENPRU 2.2.9 G
2.2.6 G	GENPRU 2.2.10 G
2.2.7 G	GENPRU 2.2.11 G
2.2.8 G	GENPRU 2.2.14 G
2.2.9 G	GENPRU 2.2.16 G
2.2.10 G	GENPRU 2.2.22 G
2.2.11 G	GENPRU 2.2.23 G
2.2.12 R	GENPRU 2.2.17 R
2.2.14 R	GENPRU 2 Annex 1R
2.2.15 G	GENPRU 2.2.24 G
2.2.16 R	GENPRU 2.2.32 R
2.2.17 R	GENPRU 2.2.33 R
2.2.18 R	GENPRU 2.2.34 R
2.2.19 G	GENPRU 2.2.36 G
2.2.20 R (1)	GENPRU 2.2.29 R
2.2.20 R (2)	GENPRU 2.2.30 R
2.2.21 G	GENPRU 2.2.31 G
2.2.22 G	GENPRU 2.2.25 G
2.2.22 G	GENPRU 2.2.26 R
2.2.23 R	GENPRU 2.2.37 R
2.2.24 R	GENPRU 2.2.28 R
2.2.25 G	GENPRU 2.2.40 G
2.2.26 R	GENPRU 2.2.41 R
2.2.27 R	GENPRU 2.2.62 R
2.2.28 R	GENPRU 2.2.63 R
2.2.29 R	GENPRU 2.2.64 R
2.2.30 R	GENPRU 2.2.65 R
2.2.31 R	GENPRU 2.2.81 R
2.2.32 G	GENPRU 2.2.67 G
2.2.33 G	GENPRU 2.2.69 G

PRU provision: current location	Destination
2.2.34 G	GENPRU 2.2.66 G
2.2.35 R	GENPRU 2.2.80 R
2.2.36 R	GENPRU 2.2.83 R
2.2.37 G	GENPRU 2.2.84 G
2.2.38 R	GENPRU 2.2.70 R
2.2.39 R	GENPRU 2.2.76 R
2.2.40 R	GENPRU 2.2.64 R (2)
2.2.50 R	GENPRU 2.2.109 R
2.2.51 G	GENPRU 2.2.110 G
2.2.52 R	GENPRU 2.2.113 R
2.2.53 R	Deleted
2.2.54 R	GENPRU 2.2.114 R
2.2.55 G	GENPRU 2.2.115 G
2.2.56 R	GENPRU 2.2.116 R
2.2.57 G	GENPRU 2.2.117 G
2.2.58 R	GENPRU 2.2.118 R
2.2.59 G	GENPRU 2.2.117 G
2.2.60 R	GENPRU 2.2.120 R
2.2.62 R	GENPRU 2.2.121 R
2.2.63 R	GENPRU 2.2.147 R
2.2.64 R	GENPRU 2.2.153 R (1)
2.2.65 R	GENPRU 2.2.138 R (2)
2.2.66 R	GENPRU 2.2.139 R
2.2.67 R	GENPRU 2.2.140 R
2.2.68 R	GENPRU 2.2.141 R
2.2.69 R	GENPRU 2.2.142 R
2.2.70 R	GENPRU 2.2.145 R
2.2.72 R	GENPRU 2.2.74 R
2.2.73 G	GENPRU 2.2.11 G
2.2.75 R	GENPRU 2.2.146 R (1)
2.2.76 R	GENPRU 2.2.85 R
2.2.77 R	GENPRU 2.2.87 R
2.2.78 R	GENPRU 2.2.105 R
2.2.79 G	GENPRU 2.2.106 G
2.2.80 R	GENPRU 2.2.107 R (1)
2.2.81 R	GENPRU 2.2.107 R (2)
2.2.82 R	GENPRU 2.2.102 R
2.2.83 G	GENPRU 2.2.103 G
2.2.84 R	GENPRU 2.2.155 R
2.2.85 G	GENPRU 2.2.156 G
2.2.86 R	GENPRU 2.2.251 R
2.2.87 G	GENPRU 2.2.252 G
2.2.88 G	GENPRU 2.2.253 G
2.2.89 R	GENPRU 2.2.255 R
2.2.90 R	GENPRU 2.2.256 R

PRU provision: current location	Destination
2.2.91 G	GENPRU 2.2.257 G
2.2.92 G	GENPRU 2.2.258 G
2.2.93 R	GENPRU 2.2.271 R
2.2.94 G	GENPRU 2.2.272 G
2.2.95 G	GENPRU 2.2.273 G
2.2.96 G	GENPRU 2.2.274 G
2.2.97 G	GENPRU 2.2.275 G
2.2.98 G	GENPRU 2.2.157 G
2.2.99 G	GENPRU 2.2.158 G
2.2.100 G	GENPRU 2.2.176 G
2.2.101 R	GENPRU 2.2.177 R
2.2.103 R	GENPRU 2.2.180 R
2.2.104 G	GENPRU 2.2.117 G
2.2.105 R	GENPRU 2.2.181 R
2.2.106 G	GENPRU 2.2.117 G
2.2.108 R	GENPRU 2.2.159 R
2.2.109 G	GENPRU 2.2.165 G
2.2.110 G	GENPRU 2.2.167 G
2.2.111 R	GENPRU 2.2.163 R
2.2.112 G	GENPRU 2.2.69 G
2.2.113 R	GENPRU 2.2.169 R
2.2.114 G	GENPRU 2.2.66 G
2.2.115 G	GENPRU 2.2.164 G
2.2.116 R	GENPRU 2.2.171 R
2.2.116A R	GENPRU 2.2.172 R
2.2.117 R	GENPRU 2.2.174 R
2.2.119 R	GENPRU 2.2.151 R
2.2.120 R	GENPRU 2.2.153 R (2)
2.2.121 R	GENPRU 2.2.146 R (2)
2.2.122 G	GENPRU 2.2.154 G
2.2.122 A R	GENPRU 2.2.195 G
2.2.123 R	GENPRU 2.2.194 R
2.2.123 A R	GENPRU 2.2.197 R
2.2.124 R	GENPRU 2.2.196 R
2.2.126 G	GENPRU 2.2.267 G
2.2.127 G	GENPRU 2.2.268 G
2.2.128 G	GENPRU 2.2.269 G
2 Annex 1 R	GENPRU 2 Annex 7R
2 Annex 2 G	GENPRU 2 Annex 8G
8.4.1 R	GENPRU 3.1.1 R
8.4.2 G	GENPRU 3.1.2 G
8.4.3 G	GENPRU 3.1.3 G
8.4.4 G	GENPRU 3.1.4 G
8.4.5 R	GENPRU 3.1.5 R
8.4.6 R	GENPRU 3.1.6 R

PRU provision: current location	Destination
8.4.7 R	GENPRU 3.1.7 R
8.4.8 R	GENPRU 3.1.8 R
8.4.9 R	GENPRU 3.1.9 R
8.4.10 R	GENPRU 3.1.10 R
8.4.11 R	GENPRU 3.1.11 R
8.4.12 R	GENPRU 3.1.12 R
8.4.13 G	GENPRU 3.1.13 G
8.4.14 G	GENPRU 3.1.14 G
8.4.15 G	GENPRU 3.1.15 G
8.4.16 G	GENPRU 3.1.16 G
8.4.17 G	GENPRU 3.1.17 G
8.4.18 G	GENPRU 3.1.18 G
8.4.19 G	GENPRU 3.1.19 G
8.4.20 G	GENPRU 3.1.20 G
8.4.21 G	GENPRU 3.1.21 G
8.4.22 G	GENPRU 3.1.22 G
8.4.23 G	GENPRU 3.1.23 G
8.4.24 G	GENPRU 3.1.24 G
8.4.25 R	GENPRU 3.1.25 R
8.4.26 R	GENPRU 3.1.26 R
8.4.27 R	GENPRU 3.1.27 R
8.4.28 R	GENPRU 3.1.28 R
8.4.29 R	GENPRU 3.1.29 R
8.4.30 R	GENPRU 3.1.30 R
8.4.31 R	GENPRU 3.1.31 R
8.4.32 G	GENPRU 3.1.32 G
8.4.33 G	GENPRU 3.1.33 G
8.4.34 R	GENPRU 3.1.34 R
8.4.35 R	GENPRU 3.1.35 R
8.4.36 R	GENPRU 3.1.36 R
8.4.39 R	GENPRU 3.1.39 R
8.5	GENPRU 3.2
8 Annex 1 R	GENPRU 8 Annex 1 R
8 Annex 2 R	GENPRU 8 Annex 2 R
8 Annex 3 G	GENPRU 8 Annex 3 G
8 Annex 4 R	GENPRU 8 Annex 4 R

LLD provision: Current location	Destination
18.2.1 R	GENPRU 1.5.1 R
18.2.2 R	GENPRU 1.5.2 R
18.2.3 G	GENPRU 1.5.3 G

18.2.4 G	GENPRU 1.5.4 G
18.2.5 D	GENPRU 1.5.5 D
18.2.6 G	GENPRU 1.5.6 G
18.2.7 R	GENPRU 1.5.7 R
18.2.8 G	GENPRU 1.5.8 G
18.2.9 G	GENPRU 1.5.9 G
18.3.1 R	GENPRU 1.5.10 R
18.3.2 R	GENPRU 1.5.11 R
18.3.4 R	GENPRU 1.5.12 R
18.3.5 R	GENPRU 1.5.13 R
18.3.6 R	GENPRU 1.5.14 R
18.3.7 R	GENPRU 1.5.15 R
18.3.8 R	GENPRU 1.5.16 R
18.3.11 R	GENPRU 1.5.17 R
18.3.12 R	GENPRU 1.5.18 R
18.3.13 R	GENPRU 1.5.19 R
18.3.14 G	GENPRU 1.5.20 G
18.3.15 R	GENPRU 1.5.21 R
18.3.16 R	GENPRU 1.5.22 R
18.3.17 R	GENPRU 1.5.23 R
18.3.18 G	GENPRU 1.5.24 G
18.3.19 R	GENPRU 1.5.25 R
18.3.20 G	GENPRU 1.5.26 G
18.4.1 R	INSPRU 8.6.1 R
18.4.2 R	INSPRU 8.6.2 R
19.2.1 R	GENPRU 2.3.1 R
19.2.2 R	GENPRU 2.3.2 R
19.2.3 G	GENPRU 2.3.3 G
19.2.4 G	GENPRU 2.3.4 G
19.2.5 R	GENPRU 2.3.5 R
19.2.6 R	GENPRU 2.3.6 R
19.2.7 R	GENPRU 2.3.7 R
19.2.8 R	GENPRU 2.3.8 R
19.2.9 R	GENPRU 2.3.9 R
19.2.10 R	GENPRU 2.3.10 R
19.2.11 R	GENPRU 2.3.11 R
19.2.12 G	GENPRU 2.3.12 G
19.2.13 R	GENPRU 2.3.13 R
19.2.14 G	GENPRU 2.3.14 G
19.2.15 R	GENPRU 2.3.15 R
19.3.1 R	GENPRU 2.3.16 R
19.3.2 G	GENPRU 2.3.17 G
19.3.3 R	GENPRU 2.3.18 R
19.3.4 R	GENPRU 2.3.19 R
19.3.5 R	GENPRU 2.3.20 R
19.3.6 R	GENPRU 2.3.21 R
19.3.7 R	GENPRU 2.3.22 R
19.3.8 G	GENPRU 2.3.23 G

19.3.9 R	GENPRU 2.3.24 R
19.3.10 R	GENPRU 2.3.25 R
19.3.11 R	GENPRU 2.3.26 R
19.3.12 R	GENPRU 2.3.27 R
19.3.13 R	GENPRU 2.3.28 R
19.3.14 R	GENPRU 2.3.29 R
19.3.15 R	GENPRU 2.3.30 R
19.3.16 R	GENPRU 2.3.31 R
19.3.17 R	GENPRU 2.3.32 R
19.3.18 R	GENPRU 2.3.33 R
19.3.19 R	GENPRU 2.3.34 R
19.3.20 G	GENPRU 2.3.35 G

Annex B

Chapters 1 and 2 of GENPRU

In this Annex new text is not underlined and text that is deleted is not shown.

GENPRU 1.1 Application and scope

1.1 Application

Application

1.1.1 G There is no overall application statement for *GENPRU*. Each chapter or section has its own application statement.

1.1.2 G Broadly speaking however, *GENPRU* applies to:

- (1) an *insurer*;
- (2) a *bank*;
- (3) a *building society*;
- (4) a *BIPRU investment firm*; and
- (5) groups containing such *firms*.

Scope

1.1.3 R *GENPRU* applies to a *firm* in relation to the whole of its business, except where a particular provision provides for a narrower scope.

1.2 Adequacy of financial resources

Application

1.2.1 R This section applies to:

- (1) a *BIPRU firm*;
- (2) an *insurer*, unless it is:
 - (a) a *non-directive friendly society*; or
 - (b) a *Swiss general insurer*; or
 - (c) an *EEA-deposit insurer*; or
 - (d) an *incoming EEA firm*; or
 - (e) an *incoming Treaty firm*; and
- (3) a *firm* to which *GENPRU 1.2.2R* applies.

1.2.2 R The *firms* referred to in *GENPRU 1.2.1R(3)* are:

- (1) an *incoming EEA firm* which:
 - (a) is a *full BCD credit institution*; and
 - (b) has a *branch* in the *United Kingdom*; and
- (2) a *third country BIPRU firm* which:
 - (a) is a *bank*; and
 - (b) has a *branch* in the *United Kingdom*.

1.2.3 R This section applies to a *firm* in *GENPRU 1.2.2R* in relation to *liquidity risk* only. Accordingly, for such a *firm*, the systems, processes and resources required by this section are only those that are required with respect to *liquidity risk*.

1.2.4 R For a *firm* described in *GENPRU 1.2.2R*, this section applies only with respect to the *branch*.

1.2.5 R This section applies to an *incoming EEA firm* only to the extent that the relevant matter is not reserved by the relevant *Single Market Directive* to the *firm's Home State regulator*.

1.2.6 R If an *insurer* carries on:

- (1) *long-term insurance business*; and
- (2) *general insurance business*;

This section applies separately to each type of business.

- 1.2.7 G The *guidance* in this section is drafted with respect to a *firm* to which this section and the other provisions of *GENPRU* and *BIPRU* referred to in this section apply in full. The *guidance* in this section is also applicable to a *firm* that falls into *GENPRU* 1.2.2R. However, the *guidance* in this section only applies to such a *firm* in respect of *liquidity risk* and it should be read accordingly.
- 1.2.8 G In the case of an *incoming EEA firm* that is a *full BCD credit institution* and of a *third country BIPRU firm* that is a *bank*, this section only applies to its *United Kingdom branch*. However, as a *branch* is not itself a legal entity separate from the rest of a *firm*, this restriction does not mean that the rest of the *firm* can necessarily be left out of account when considering compliance with this section. For example, the availability of the *branch's* liquidity resources may be affected by general liquidity problems in the *firm*. Similarly, there may be liquidity resources elsewhere in the *firm* that are available to meet liquidity problems in the *branch*.
- 1.2.9 G One factor that may affect the degree to which it is necessary to take into account the *firm* as a whole is the extent to which the *firm* manages the liquidity of the *branch* on an autonomous basis, or includes the *branch* within integrated liquidity management of the *firm* as a whole. In the latter case, the requirement in the *general stress and scenario testing rule*, insofar as it applies to liquidity, to carry out scenario analyses may be satisfied by the *firm* meeting similar requirements set by the regulator in its home country in respect of the *firm* as whole, provided that the *firm* separately identifies the impacts on the *United Kingdom branch* of the scenarios analysed. However, in the case of an *incoming EEA firm*, the application of this section is further restricted by *GENPRU* 1.2.5R.
- 1.2.10 G The scope of application of this section is not restricted to *insurers* that are subject to the relevant EC Directives.
- 1.2.11 G The adequacy of a *firm's* financial resources needs to be assessed in relation to all the activities of the *firm* and the risks to which they give rise and so, except as described in *GENPRU* 1.2.8G, this section applies to a *firm* in relation to the whole of its business. In the case of a *UCITS investment firm* this means that this section is not limited to *designated investment business* excluding *scheme management activity*. It also applies to *scheme management activity* and to activities that are not *designated investment business*.

Purpose

- 1.2.12 G Adequate financial resources and adequate systems and controls are necessary for the effective management of prudential risks. This section therefore has requirements relating to both of these topics.
- 1.2.13 G This section amplifies *Principle 4*, under which a *firm* must maintain adequate financial resources. It is concerned with the adequacy of the financial resources that a *firm* needs to hold in order to be able to meet its liabilities as they fall due. These resources include both capital and liquidity resources.

- 1.2.14 G In the case of a *bank* or *building society* this section implements Article 123 and (in part) Annex XI of the *Banking Consolidation Directive*. In the case of a *BIPRU investment firm* this section implements Article 34 of the *Capital Adequacy Directive* so far as that Article applies Article 123 of the *Banking Consolidation Directive*.
- 1.2.15 G This section also has *rules* requiring a *firm* to identify and assess risks to its being able to meet its liabilities as they fall due, how it intends to deal with those risks, and the amount and nature of financial resources that the *firm* considers necessary. *GENPRU 1.2.60R* provides that a *firm* should document that assessment. The *FSA* will review that assessment as part of its own assessment of the adequacy of a *firm's* capital. This review by the *FSA* forms part of the *FSA's* ARROW assessment of a *firm*.
- 1.2.16 G This section also has *rules* requiring a *firm* to carry out appropriate stress tests and scenario analyses for the risks it has previously identified and to establish the amount of financial resources needed in each of the circumstances and events considered in carrying out the stress tests and scenario analyses.
- 1.2.17 G The basic requirements in this section are drafted to apply to a *firm* on a solo basis. This section then goes on to describe when its requirements do and do not apply on a solo basis and on a consolidated basis (see *GENPRU 1.2.45R* to *GENPRU 1.2.47R* and *GENPRU 1.2.57R* to *GENPRU 1.2.58R*). It also sets out some details about how the solo requirements are adjusted when they are applied on a consolidated basis (see *GENPRU 1.2.48R* to *GENPRU 1.2.56G* and *GENPRU 1.2.59R*).

Outline of other related provisions

- 1.2.18 G *GENPRU 2.1* sets out the minimum *capital resources requirements* for a *firm*. *GENPRU 2.2* sets out how *capital resources* are defined and measured for the purpose of meeting the requirements of *GENPRU 2.1*.
- 1.2.19 G (1) *BIPRU 2.2* (Internal capital adequacy standards) and *INSRU 7.1* (Individual capital assessment) set out detailed *guidance* on how a *firm* should carry out the assessment referred to in *GENPRU 1.2.15G*. The more thorough, objective, and prudent a *firm's* assessment is, and can be demonstrated as being, the more reliance the *FSA* will be able to place on the results of that assessment.
- (2) *BIPRU 2.2* and *INSRU 7.1* also have information on how the *FSA* will review and respond to the assessments referred to in *GENPRU 1.2.15G*. In particular they deal with the giving of individual capital *guidance* to a *firm*, which is *guidance* about the amount and quality of capital resources that the *FSA* thinks a *firm* should hold under the *overall financial adequacy rule* as it applies on a solo level and a consolidated level.
- 1.2.20 G *SYSC* sets out general *rules* and *guidance* on the establishment and maintenance of systems and controls.

- 1.2.21 G (1) SYSC 11 sets out material on systems and controls that apply specifically to *liquidity risk*.
- (2) Chapters LM and LS of IPRU(BANK) contain *guidance* on the *overall financial adequacy rule* so far as it relates to adequate liquidity for *banks* and the *firms* to which GENPRU 1.2.2R (Application of this section to certain non-EEA firms) applies.
- (3) Chapter 5 of volume 1 of IPRU(BSOC) contains *guidance* and an *evidential provision* on the *overall financial adequacy rule* so far as it relates to adequate liquidity for a *building society*.
- (4) SYSC 11.1.21E is an *evidential provision* relating to the *general stress and scenario testing rule* concerning stress testing and scenario analyses. SYSC 11.1.24E is *evidential provision* relating to the *overall Pillar 2 rule* about *contingency funding plans*.
- (5) GENPRU 2.2 (Adequacy of financial resources) requires certain BIPRU *investment firms* to deduct *illiquid assets* when calculating their *capital resources*.
- 1.2.22 G BIPRU 2.3 contains *rules* and *guidance* on interest rate risk in the *non-trading book*. That material elaborates on the general obligation in the *overall Pillar 2 rule*.
- 1.2.23 G For a BIPRU firm using a VaR model BIPRU 7.10.72R (Risk management standards: Stress testing) sets out certain stress tests that the firm should carry out.
- 1.2.24 G BIPRU 10.6.22R (Stress testing of credit risk concentrations) sets out further stress tests that a firm should carry out if it uses certain approaches to collateral for the purposes of the *rules* about concentration risk.
- 1.2.25 G For a BIPRU firm using the IRB approach BIPRU 4.3.39R to BIPRU 4.3.40R set out a recession credit rating migration stress test that the firm should carry out. Further *rules* and *guidance* on such stress tests are set out in BIPRU 2.2 (Internal capital adequacy standards).

Requirement to have adequate financial resources

- 1.2.26 R A firm must at all times maintain overall financial resources, including *capital resources* and liquidity resources, which are adequate, both as to amount and quality, to ensure that there is no significant risk that its liabilities cannot be met as they fall due.
- 1.2.27 G The liabilities referred to in the *overall financial adequacy rule* include a firm's contingent and prospective liabilities. It excludes liabilities that might arise from transactions that a firm has not entered into and which it could avoid, for example, by ceasing to trade. It includes liabilities or costs that arise as a consequence of strategies other than continuing as a going concern. It also includes claims that could be made against a firm, which ought to be paid in accordance with fair treatment of *customers*, even if such claims could not be legally enforced.

- 1.2.28 G A *firm* should therefore make its assessment of adequate financial resources on realistic valuation bases for assets and liabilities taking into account the actual amounts and timing of cash flows under realistic adverse projections.
- 1.2.29 G Risks may be addressed through holding capital to absorb losses that unexpectedly materialise. The ability to pay liabilities as they fall due also requires liquidity. Therefore, in assessing the adequacy of a *firm*'s financial resources, both capital and liquidity needs should be considered. A *firm* should also consider the quality of its financial resources such as the loss-absorbency of different types of capital and the time required to liquidate different types of asset. SYSC 11.1.24E is an *evidential provision* relating to the *overall financial adequacy rule* concerning *contingency funding plans*.

Systems, strategies, processes and reviews

- 1.2.30 R A *firm* must have in place sound, effective and complete processes, strategies and systems:
- (1) to assess and maintain on an ongoing basis the amounts, types and distribution of financial resources, *capital resources* and internal capital that it considers adequate to cover:
 - (a) the nature and level of the risks to which it is or might be exposed;
 - (b) the risk in the *overall financial adequacy rule*; and
 - (c) the risk that the *firm* might not be able to meet its *CRR* in the future; and
 - (2) that enable it to identify and manage the major sources of risks referred to in (1), including the major sources of risk in each of the following categories where they are relevant to the *firm* given the nature and scale its business:
 - (a) credit risk;
 - (b) *market risk*;
 - (c) *liquidity risk*;
 - (d) *operational risk*;
 - (e) insurance risk;
 - (f) concentration risk;
 - (g) residual risk;
 - (h) *securitisation* risk;
 - (i) business risk;

- (j) interest rate risk (including, in the case of a *BIPRU firm*, interest rate risk in the *non-trading book*); and
 - (k) pension obligation risk.
- 1.2.31 R (1) This *rule* defines some of the terms used in the *overall Pillar 2 rule*.
- (2) Residual risk means the risk that *credit risk mitigation* techniques used by the *firm* prove less effective than expected.
- (3) *Securitisation* risk includes the risk that the *capital resources* held by a *firm* in respect of assets which it has *securitised* are inadequate having regard to the economic substance of the transaction, including the degree of risk transfer achieved.
- (4) Business risk means any risk to a *firm* arising from changes in its business, including the risk that the *firm* may not be able to carry out its business plan and its desired strategy.
- (5) Pension obligation risk is the risk to a *firm* caused by its contractual or other liabilities to or with respect to a pension scheme (whether established for its employees or those of a related *company* or otherwise). It also means the risk that the *firm* will make payments or other contribution to or with respect to a pension scheme because of a moral obligation or because the *firm* considers that it needs to do so for some other reason.
- 1.2.32 G (1) This paragraph gives *guidance* on some of the terms used in the *overall Pillar 2 rule*.
- (2) Insurance risk refers to the inherent uncertainties as to the occurrence, amount and timing of insurance liabilities.
- (3) Interest rate risk in the *non-trading book* is explained in *BIPRU 2.3* (Interest rate risk in the non-trading book).
- (4) In a narrow sense, business risk is the risk to a *firm* that it suffers losses because its income falls or is volatile relative to its fixed cost base. However, in a broader sense, it is exposure to a wide range of macro-economic, geopolitical, industry, regulatory and other external risks that might deflect a *firm* from its desired strategy and business plan. *GENPRU 1.2.73G* provides further *guidance* on business risk.
- (5) Further material on pension obligation risk can be found in *GENPRU 1.2.79G - GENPRU 1.2.86G*.
- 1.2.33 R (1) This *rule* amplifies some of the obligations in the *overall Pillar 2 rule*.
- (2) In the case of a *BIPRU firm* the processes, strategies and systems relating to concentration risk must include those necessary to ensure compliance with *BIPRU 10* (Concentration risk requirements).

- (3) As part of its obligations in respect of *market risk*, a *BIPRU firm* must consider whether the value adjustments and provisions taken for *positions* and portfolios in the *trading book* enable the *firm* to sell or hedge out its *positions* within a short period without incurring material losses under normal market conditions.
- (4) The processes, strategies and systems required by the *overall Pillar 2 rule* must take into account stress tests and scenario analyses that the *firm* is required to carry out under any other provision of the *Handbook*.
- 1.2.34 G In the *overall Pillar 2 rule*, internal capital refers to the financial resources of a *firm* which it treats as being held against the risks listed in the *overall Pillar 2 rule*. The obligation in that *rule* to assess the distribution of such capital refers, in relation to a *firm* making an assessment on a solo basis, for example, to the need to take account of circumstances where part of a *firm's* financial resources are held by a *branch* of that *firm* which are subject to restrictions on its ability to transfer that capital. An assessment of internal capital distribution might also take account of such of a *firm's* financial resources as may be ring-fenced in the event of its insolvency.
- 1.2.35 R The processes, strategies and systems required by the *overall Pillar 2 rule* must be comprehensive and proportionate to the nature, scale and complexity of the *firm's* activities.
- 1.2.36 R As part of its obligations under *GENPRU* 1.2.30R(1) (Main requirement relating to risk processes, strategies and systems), a *firm* must identify separately the amount of *tier one capital*, *tier two capital*, *tier three capital*, other capital eligible to form part of its *capital resources* and each category of capital (if any) that is not eligible to form part of its *capital resources* which it considers adequate for the purposes described in *GENPRU* 1.2.30R(1).
- 1.2.37 R The processes and systems required by the *overall Pillar 2 rule* must:
- (1) include an assessment of how it intends to deal with each of the major sources of risk identified in accordance with *GENPRU* 1.2.30R(2); and
 - (2) take into account the impact of diversification effects and how such effects are factored into the *firm's* systems for measuring risks.
- 1.2.38 G Certain risks such as systems and controls weaknesses may not be adequately addressed by, for example, holding additional capital and a more appropriate response would be to rectify the weakness. In such circumstances, the amount of financial resources required to address these risks might be zero. However, a *firm* should consider whether holding additional capital might be an appropriate response until the identified weaknesses are rectified. A *firm*, should, in accordance with *GENPRU* 1.2.60R (Documentation of risk assessments), document the approaches taken to manage these risks.
- 1.2.39 R A *firm* must:
- (1) carry out regularly the assessments required by the *overall Pillar 2 rule*; and

- (2) carry out regularly assessments of the processes, strategies and systems required by the *overall Pillar 2 rule* to ensure that they remain compliant with *GENPRU 1.2.35R*.

- 1.2.40 G A *firm* should carry out assessments of the sort described in the *overall Pillar 2 rule* and *GENPRU 1.2.39R* at least annually, or more frequently if changes in the business, strategy, nature or scale of its activities or operational environment suggest that the current level of financial resources is no longer adequate. The appropriateness of the internal process, and the degree of involvement of senior management in the process, will be taken into account by the *FSA* when reviewing a *firm's* assessment as part of the *FSA's* own assessment of the adequacy of a *firm's* financial resources. The processes and systems should ensure that the assessment of the adequacy of a *firm's* financial resources is reported to its senior management as often as is necessary.
- 1.2.41 G The assessments undertaken by *firms in run-off* may not need to be as comprehensive or frequent compared to a *firm* not in run off since this may better reflect the reduced nature and complexity of its business and reduced access to new capital. Whilst a *firm in run-off* will still need to carefully monitor the progress of the run off, a more comprehensive assessment may only be appropriate on commencement of the run off or when considering a reduction in capital through the payment of a dividend or other capital distribution or if the *firm's* circumstances change materially.

Stress and scenario tests

- 1.2.42 R (1) As part of its obligation under the *overall Pillar 2 rule*, a *firm* must, for each of the major sources of risk identified in accordance with *GENPRU 1.2.30R(2)*, carry out stress tests and scenario analyses that are appropriate to the nature of those major sources of risk, as part of which the *firm* must:
- (a) take reasonable steps to identify an appropriate range of realistic adverse circumstances and events in which the risk identified crystallises; and
 - (b) estimate the financial resources the *firm* would need in each of the circumstances and events considered in order:
 - (i) to be able to meet its liabilities as they fall due;
 - (ii) to be able to meet the *CRR*;
 - (iii) to carry out the plans referred to in *GENPRU 1.2.37R(1)*; and
 - (iv) otherwise to meet, to the extent that it considers necessary, that major source of risk.
- (2) In carrying out the stress tests and scenario analyses in (1), a *BIPRU firm* with an *IRB permission* must incorporate and take into account the stress tests required to be carried out under *BIPRU 4.3.39R* to *BIPRU 4.3.40R* (Stress tests used in assessment of capital adequacy).

- (3) In carrying out the stress tests and scenario analyses in (1), a *BIPRU firm* must incorporate and take into account any other stress tests and scenario analyses that it is required to carry out under any other provision of the *Handbook*.

- 1.2.43 G Stress tests and scenario analyses should be carried out at least annually. A *firm* should, however, consider whether the nature of the major sources of risks identified by it in accordance with *GENPRU 1.2.30R(2)* (Main requirement relating to risk processes, strategies and systems) and their possible impact on its financial resources suggest that such tests and analyses should be carried out more frequently. For instance, a sudden change in the economic outlook may prompt a *firm* to revise the parameters of some of its stress tests and scenario analyses. Similarly, if a *firm* has recently become exposed to a particular sectoral concentration, it may wish to add some stress tests and scenario analyses in order to reflect that concentration. *SYSC 11.1.21E* is an *evidential provision* relating to the *general stress and scenario testing rule* concerning scenario analysis in relation to *liquidity risk*.

Application of this section on a solo and consolidated basis: General

- 1.2.44 G (1) *GENPRU 1.2.45R - GENPRU 1.2.56G* explain when the *ICAAP rules* apply on a solo basis and when they apply on a consolidated basis. This material also explains how the *ICAAP rules* are adjusted to apply on a consolidated basis.
- (2) *GENPRU 1.2.57R - GENPRU 1.2.59R* provide that the *overall financial adequacy rule* always applies on a solo basis. They also explain when and how it applies on a consolidated basis.

Application of this section on a solo and consolidated basis: Processes and tests

- 1.2.45 R If an *insurer* is a member of an *insurance group* and *INSPRU 6.1.9R*, *INSPRU 6.1.10R* or *INSPRU 6.1.15R* (Requirement to maintain group capital) apply to it with respect to that *insurance group* the *ICAAP rules*:
- (1) apply to that *insurer* on a consolidated basis; and
- (2) do not apply to it on a solo basis.
- 1.2.46 R The *ICAAP rules* do not apply on a solo basis to a *BIPRU firm* to which the *ICAAP rules*:
- (1) apply on a consolidated basis under *BIPRU 8.2.1R* (Basic consolidation rule for a *UK consolidation group*); or
- (2) apply on a sub-consolidated basis under *BIPRU 8.3.1R* (Basic consolidation rule for a *non-EEA sub-group*).
- 1.2.47 R The *ICAAP rules* apply on a solo basis:

- (1) to an *insurer* to which those *rules* do not apply on a consolidated basis under *GENPRU 1.2.45R*;
 - (2) to a *BIPRU firm* to which those *rules* do not apply on a consolidated or sub-consolidated basis as referred to in *GENPRU 1.2.46R* (including a *BIPRU investment firm* with an *investment firm consolidation waiver*); and
 - (3) a *firm* referred to in *GENPRU 1.2.2R* (Application of this section to certain non-EEA firms).
- 1.2.48 R The requirements of the *ICAAP rules* as they apply on a consolidated basis must be carried out on the basis of the consolidated position of:
- (1) (if *GENPRU 1.2.45R* applies) that *insurance group*;
 - (2) (if *BIPRU 8.2.1R* (Basic consolidation rule for a *UK consolidation group*) applies) the *UK consolidation group* of which the *firm* is a member ; and
 - (3) (if *BIPRU 8.3.1R* (Basic consolidation rule for a *non-EEA sub- group*) applies) the *non-EEA sub-group* of which the *firm* is a member.
- 1.2.49 R (1) In accordance with the general principles in *GENPRU 1.2.48R* and *BIPRU 8* (Group risk – consolidation), for the purpose of the *ICAAP rules* as they apply on a consolidated basis:
- (a) the *firm* must ensure that the relevant group as defined in (2) have the processes, strategies and systems required by the *overall Pillar 2 rule*;
 - (b) the risks to which the *overall Pillar 2 rule* and the *general stress and scenario testing rule* refer are those risks as they apply to each member of the relevant group;
 - (c) the reference in the *overall Pillar 2 rule* to amounts and types of financial resources, *capital resources* and internal capital (referred to in this *rule* as resources) must be read as being to the amounts and types that the *firm* considers should be held by the members of the relevant group as defined in (2);
 - (d) other references to resources must be read as being to resources of the members of the relevant group as defined in (2);
 - (e) references to the *CRR* are to the consolidated capital requirements applicable to the relevant group under *BIPRU 8* (Group risk - consolidation) or, as the case may be, *INSRU 6* (Group risk: Insurance groups);
 - (f) the reference in the *overall Pillar 2 rule* to the distribution of resources must be read as including a reference to the distribution between members of the relevant group as defined in (2); and

- (g) the reference in the *overall Pillar 2 rule* to the *overall financial adequacy rule* must be read as being to that *rule* as adjusted under *GENPRU 1.2.59R* (Application of the *overall financial adequacy rule* on a consolidated basis).
- (2) For the purpose of this *rule* the relevant group is the group referred to in *GENPRU 1.2.48R* and the members of that group are those *undertakings* that are included in the scope of consolidation with respect to the *insurance group, UK consolidation group* or, as the case may be, *non-EEA sub-group* in question.
- 1.2.50 G *GENPRU 1.2.49R* means that non-financial members of the *firm's* group are excluded from the *group* assessment. Notwithstanding the scope of *GENPRU 1.2.49R*, a *firm* should nevertheless take account of risks arising from the activities of those excluded members in its overall assessment of risk.
- 1.2.51 R (1) This *rule* relates to the assessment of the amounts, types and distribution of financial resources, *capital resources* and internal capital (referred to in this *rule* as "resources") under the *overall Pillar 2 rule* as applied on a consolidated basis and to the assessment of diversification effects as referred to in *GENPRU 1.2.37R(2)* as applied on a consolidated basis.
- (2) A *firm* must be able to explain how it has aggregated the risks referred to in the *overall Pillar 2 rule* and the resources required by each member of the relevant group as referred to in *GENPRU 1.2.49R(2)* and how it has taken into account any diversification benefits with respect to the group in question.
- (3) In particular, to the extent that the transferability of resources affects the assessment in (2), a *firm* must be able to explain how it has satisfied itself that resources are transferable between members of the group in question in the stressed cases and the scenarios referred to in the *general stress and scenario testing rule*.
- 1.2.52 R (1) A *firm* must allocate the total amount of financial resources, *capital resources* and internal capital identified as necessary under the *overall Pillar 2 rule* (as applied on a consolidated basis) between different parts of the relevant group (as defined in *GENPRU 1.2.49R*). *GENPRU 1.2.36R* (Identifying different tiers of capital) does not apply to this allocation.
- (2) The *firm* must carry out the allocation in (1) in a way that adequately reflects the nature, level and distribution of the risks to which the group is subject and the effect of any diversification benefits.
- 1.2.53 R A *firm* must also allocate the total amount of financial resources, *capital resources* and internal capital (referred to in this *rule* as "resources") identified as necessary under the *overall Pillar 2 rule* as applied on a consolidated basis between each *firm* which is a member of the relevant group (as defined in *GENPRU 1.2.49R*) on the following basis:

- (1) the amount allocated to each *firm* must be decided on the basis of the principles in *GENPRU* 1.2.52R(2); and
 - (2) if the process in (1) were carried out for each group member, the total so allocated would equal the total amount of resources identified as necessary under the *overall Pillar 2 rule* as applied on a consolidated basis.
- 1.2.54 G A *firm* to which the *ICAAP rules* apply on a consolidated basis need not prepare a consolidated basis assessment if such an assessment has been prepared by another member of its *group*. Where that is the case, a *firm* may adopt such an assessment as its own. A *firm* nevertheless remains responsible for the assessment.
- 1.2.55 G The purpose of *GENPRU* 1.2.51R - *GENPRU* 1.2.53R is to enable the *FSA* to assess the extent, if any, to which a *firm*'s assessment, calculated on a consolidated basis, is lower than it would be if each separate legal entity were to assess the amount of capital it would require to mitigate its risks (to the same level of confidence) were it not part of a group subject to consolidated supervision under *BIPRU* 8 (Group risk - consolidation) or *INSPRU* 6.1 (Group risk: Insurance groups). The reason the *FSA* wishes to make this assessment is so that individual capital *guidance* which it gives is fair and comparable as between different *firms* and groups. Group diversification benefits which a *firm* might assert exist can be a material consideration in a capital adequacy assessment. Understanding the methods used to aggregate the different risks (for example, the correlation assumptions) is crucial to a proper evaluation of such benefits.
- 1.2.56 G Whereas a single legal entity can generally use its capital to absorb losses wherever they arise, there are often practical and legal restrictions on the ability of a group to do so. For instance:
- (1) capital which is held by overseas regulated *firms* may not be capable of being remitted to a *firm* in the *UK* which has suffered a loss;
 - (2) a *firm* which is insolvent or likely to become so may be obliged to look to the interests of its creditors first before transferring capital to other group *companies*; and
 - (3) a parent *company* may have to balance the interests of its shareholders against the protection of the creditors of a *subsidiary undertaking* which is or might become insolvent and may, rationally, conclude that a *subsidiary undertaking* should be allowed to fail rather than provide capital to support it.

Application of this section on a solo and consolidated basis: Adequacy of resources

- 1.2.57 R The *overall financial adequacy rule* applies to a *firm* on a solo basis whether or not it also applies to the *firm* on a consolidated basis.
- 1.2.58 R The *overall financial adequacy rule* applies to a *firm* on a consolidated basis if the *ICAAP rules* apply to it on a consolidated basis.

- 1.2.59 R (1) When the *overall financial adequacy rule* applies on a consolidated basis, the *firm* must ensure that at all times its group maintains overall financial resources, including capital resources and liquidity resources, which are adequate, both as to amount and quality, to ensure that there is no significant risk that the liabilities of any members of its group cannot be met as they fall due.
- (2) The group referred to in (1) is the relevant group as defined in *GENPRU 1.2.49R*.
- (3) The members of the group referred to in (1) must be identified in accordance with *GENPRU 1.2.49R*.

Documentation of risk assessments

- 1.2.60 R A *firm* must make a written record of the assessments required under this section. These assessments include assessments carried out on a consolidated basis and on a solo basis. In particular it must make a written record of:
- (1) the major sources of risk identified in accordance with *GENPRU 1.2.30R(2)* (Main requirement relating to risk processes, strategies and systems);
- (2) how it intends to deal with those risks; and
- (3) details of the stress tests and scenario analyses carried out and the resulting financial resources estimated to be required in accordance with the *general stress and scenario testing rule*.
- 1.2.61 R A *firm* must retain the records of its assessments referred to in *GENPRU 1.2.60R* for at least three years.
- 1.2.62 G Where a *firm* assesses the adequacy of its *CRR* in its particular circumstances in accordance with *BIPRU 2.2* (Internal capital adequacy standards) and *INSRU 7.1* (Individual capital assessment) as a basis for deciding what financial resources are adequate, it should include this in the documentation produced in accordance with *GENPRU 1.2.60R*.

Additional guidance on stress tests and scenario analyses

- 1.2.63 G Both stress tests and scenario analyses can be undertaken by a *firm* to further a better understanding of the vulnerabilities that it faces under extreme conditions. They are based on the analysis of the impact of unlikely, but not impossible, events. These events can be financial, operational or legal or relate to any other risk that might have an economic impact on the *firm*.
- 1.2.64 G Stress testing typically refers to shifting the values of individual parameters that affect the financial position of a *firm* and determining the effect on the *firm's* financial position.

- 1.2.65 G Scenario analysis typically refers to a wider range of parameters being varied at the same time. Scenario analyses often examine the impact of adverse events on the *firm's* financial position, for example, simultaneous movements in a number of risk categories affecting all of a *firm's* business operations, such as business volumes, investment values and interest rate movements.
- 1.2.66 G There are three broad purposes of stress testing and scenario analysis. Firstly, it can be used as a means of quantifying how much capital might be absorbed if an adverse event or events occurred. As such it represents a simple 'what if' approach to estimating exposure to risks. This might be a proportionate approach to risk management for an unsophisticated business. Secondly, it can be used to provide a check on the outputs and accuracy of risk models; particularly, in identifying non-linear effects when aggregating risks. Thirdly, it can be used to explore the sensitivities in longer term business plans and how capital needs might change over time.
- 1.2.67 G The *general stress and scenario testing rule* requires a *firm*, as part of carrying out stress tests and scenario analyses, to take reasonable steps to identify an appropriate range of realistic circumstances and events in which a risk would crystallise. In particular:
- (1) a *firm* need only carry out stress tests and scenario analyses in so far as the circumstances or events are reasonably foreseeable, that is to say, their occurrence is not too remote a possibility; and
 - (2) a *firm* should also take into account the relative costs and benefits of carrying out the stress tests and scenario analyses in respect of the circumstances and events identified.
- 1.2.68 G Subject to *GENPRU 1.2.76G*, the purpose of stress tests and scenario analyses under the *general stress and scenario testing rule* is to test the adequacy of overall financial resources. Scenarios need only be identified, and their impact assessed, in so far as this facilitates that purpose. In particular, the nature, depth and detail of the analysis depend, in part, upon the *firm's* capital strength and the robustness of its risk prevention and risk mitigation measures.
- 1.2.69 G Both stress testing and scenario analyses are forward-looking analysis techniques, which seek to anticipate possible losses that might occur if an identified risk crystallises. In applying them, a *firm* should decide how far forward to look. This should depend upon:
- (1) how quickly it would be able to identify events or changes in circumstances that might lead to a risk crystallising resulting in a loss; and
 - (2) after it has identified the event or circumstance, how quickly and effectively it could act to prevent or mitigate any loss resulting from the risk crystallising and to reduce exposure to any further adverse event or change in circumstance.

- 1.2.70 G The time horizon over which stress tests and scenario analysis should be carried out should depend on the maturity and liquidity of the *positions* stressed. For example, for the *market risk* arising from the holding of investments this should depend upon:
- (1) the extent to which there is a regular, open and transparent market in those assets, which would allow fluctuations in the value of the investment to be more readily and quickly identified; and
 - (2) the extent to which the market in those assets is sufficiently liquid (and would remain liquid in the changed circumstances contemplated in the stress test or scenario analysis) to allow the *firm*, if needed, to sell, hedge or otherwise mitigate the risks relating to its holding so as to prevent or reduce exposure to future price fluctuations.
- 1.2.71 G In identifying scenarios, and assessing their impact, a *firm* should take into account, where material, how changes in circumstances might impact upon:
- (1) the nature, scale and mix of its future activities; and
 - (2) the behaviour of *counterparties*, and of the *firm* itself, including the exercise of choices (for example, options embedded in financial instruments or *contracts of insurance*).
- 1.2.72 G In determining whether it would have adequate financial resources in the event of each identified realistic adverse scenario, a *firm* should:
- (1) only include financial resources that could reasonably be relied upon as being available in the circumstances of the identified scenario; and
 - (2) take account of any legal or other restriction on the use of financial resources.
- 1.2.73 G
- (1) A *firm* should conduct stress tests and scenario analyses which project its financial position (both profitability and balance sheet position) so as to estimate both its *capital resources* and *capital resource requirements* throughout an economic or business cycle.
 - (2) A *firm* will need to consider the cycles it is most exposed to and whether these are general economic cycles or specific to particular markets, sectors or industries. The length of time over which such projections would be appropriate will therefore vary, but typically might be between three and five years.
 - (3) The projections should be based on the *firm's* business plan, but flexed to incorporate adverse trading conditions and any changes in strategy which the *firm* could and would take in response to those conditions.

- (4) Changes in strategy might be necessary for instance because capital needed to be able to continue its business at existing volumes is eroded. A *firm* may also alter its capital management strategy to restrict distributions of profits or to raise additional capital. The combined effect on capital and retained earnings should be estimated. A *firm* should document how it would react to such economic and business risks.
- (5) The *FSA* will take the projections referred to in this paragraph and the plan referred to in (4) into account as part of its *SREP*. The purpose of examining them is to enable the *FSA* to judge, at an appropriate level of certainty, whether the *firm* will be able to meet its obligations throughout a recession.
- 1.2.74 G A *firm* may consider scenarios in which expected future profits will provide capital reserves against future risks. However, it would only be appropriate to take into account profits that can be foreseen with a reasonable degree of certainty as arising before the risk against which they are being held could possibly arise. In estimating future reserves, a *firm* should deduct future dividend payment estimates from projections of future profits.
- 1.2.75 G (1) A *firm* should assess the nature and severity of the economic recession or business cycle changes which are relevant to it given the nature and scale of its business. When projecting its *capital resources* and *CRR* a *firm* should consider a range of stresses and scenarios both in nature and severity.
- (2) Stress and scenario analyses should, in the first instance, be aligned with the risk appetite of the *firm* and the calibration of such stress and scenario analyses should be reconciled back to a clear statement setting out the premise upon which the *firm's* internal capital assessment under the *overall Pillar 2 rule* is based.
- (3) A *firm* with an *IRB permission* should ensure that the range of stresses and scenarios considered encompasses the severity of recession specified in BIPRU 4.3.40R (Stress tests used in assessment of capital adequacy), which is one that might be expected to occur once in a 25 year period. Other firms may also find that this a useful reference point when discussing their assessments with the *FSA*.
- (4) A *firm* may also consider scenarios in which the amount of capital it currently holds would be exhausted. This would provide useful information about the reasonableness or remoteness of such scenarios arising. Where a *firm* uses capital models as part of its risk management processes, considering the sensitivity of model results to variations around the most likely ruin scenario focuses testing on the most relevant scenarios.
- 1.2.76 G A *firm* should use the results of its stress testing and scenario analysis not only to assess capital needs, but also to decide if measures should be put in place to minimise the adverse effect on the *firm* if the risk covered by the stress or scenario test actually materialises. Such measures might be a contingency plan or might be more concrete risk mitigation steps.

- 1.2.77 G Additional *guidance* on stress tests and scenario analyses for the assessment of *capital resources* is available in *BIPRU* 2.2 (Internal capital adequacy standards) and *INSPRU* 7.1 (Individual capital assessment).
- 1.2.78 G Additional *guidance* in relation to stress tests and scenario analysis for *liquidity risk* is available in *SYSC* 11 (Liquidity risk systems and controls).
- Pension obligation risk
- 1.2.79 G *GENPRU* 1.2.80G - *GENPRU* 1.2.86G contain *guidance* on the assessment required by *GENPRU* 1.2.30R(2)(k) (Pension risk).
- 1.2.80 G The pension scheme itself (i.e. the scheme's assets and liabilities) is not the focus of the risk assessment; it is the *firm's* obligations towards the pension scheme which is.
- 1.2.81 G If a *firm* has a current funding obligation in excess of normal contributions or there is a risk that such a funding obligation will arise then, when calculating available capital resources, it should reverse out any accounting deficit and replace this in its capital adequacy assessment with its best estimate, calculated in discussion with the scheme's actuaries or trustees, of the cash that will need to be paid into the scheme in addition to normal contributions over the foreseeable future. This may differ from the approach taken in assessing pension scheme risks for the purposes of calculating resources to meet the *CRR*, where a *firm* may not need to consider funding obligations beyond the next five years.
- 1.8.82 G A *firm* should assess the risks that increase its obligations towards the pension scheme that might lead to the *firm* not being able to pay its other liabilities as they fall due.
- 1.2.83 G A *firm* may wish to consider the following scenarios:
- (1) one in which the *firm* gets into difficulties with an effect on its ability to fund the pension scheme; and
 - (2) one in which the pension scheme position deteriorates (for example, because investment returns fall below expected returns or because of increases in life expectancy) with an effect on the *firm's* funding obligations; taking into account the management actions the *firm* could and would take.
- 1.2.84 G Scenarios in which a *firm's* employees suffer a loss or members of a pension scheme suffer a loss do not necessarily affect the *firm's* ability to pay its liabilities as they fall due.
- 1.2.85 G A *firm* should consider issues such as:
- (1) the extent to which trustees of the pension scheme or a pension regulator (such as the one created under the Pensions Act 2004) can compel a certain level of contributions or a one-off payment in adverse financial situations or in order to meet the minimum legal requirements under the scheme's trust deed and rules or under the applicable laws relating to the pension scheme;

- (2) whether the valuation bases used to set pension scheme contribution rates are consistent with the *firm's* current business plans and anticipated changes in the workforce; and
- (3) which valuation basis is appropriate given the expected investment return on scheme assets and actions the *firm* can take if those returns do not materialise.

1.2.86 G A *firm* should carry out analyses only to a degree of sophistication and complexity which is commensurate with the materiality of its pension risks.

1.3 Valuation

Application

1.3.1 R (1) This section of the *Handbook* applies to an *insurer*, unless it is:

(a) a *non-directive friendly society*;

(b) an *incoming EEA firm*; or

(c) an *incoming Treaty firm*.

(2) This section of the *Handbook* applies to a *BIPRU firm*.

(3) This section of the *Handbook* applies to a *UK ISPV*.

Purpose

1.3.2 G This section sets out, for the purposes of *GENPRU*, *BIPRU* and *INSPRU*, *rules* and *guidance* as to how a *firm* should recognise and value assets, liabilities, *exposures*, equity and income statement items.

1.3.3 G (1) In the case of a *BIPRU firm*, this section implements Article 74 of the *Banking Consolidation Directive*, Article 64(4) of the *Banking Consolidation Directive* (Own funds) and Article 33 and Part B of Annex VII of the *Capital Adequacy Directive*.

(2) In the case of an *insurer*, *GENPRU* 1.3.4R implements the requirements of Articles 23.3(viii) and 24.2(iv) of the *Consolidated Life Directive*.

General requirements: Accounting principles to be applied

1.3.4 R Subject to *GENPRU* 1.3.9R to *GENPRU* 1.3.10R and *GENPRU* 1.3.36R, except where a *rule* in *GENPRU*, *BIPRU* or *INSPRU* provides for a different method of recognition or valuation, whenever a *rule* in *GENPRU*, *BIPRU* or *INSPRU* refers to an asset, liability, *exposure*, equity or income statement item, a *firm* must, for the purpose of that *rule*, recognise the asset, liability, *exposure*, equity or income statement item and measure its value in accordance with whichever of the following are applicable:

(1) the *insurance accounts rules*, or the Friendly Societies (Accounts and Related Provisions) Regulations 1994;

(2) Financial Reporting Standards and Statements of Standard Accounting Practice issued or adopted by the Accounting Standards Board;

(3) Statements of Recommended Practice, issued by industry or sectoral bodies recognised for this purpose by the Accounting Standards Board;

(4) the Building Societies (Accounts and Related Provisions) Regulation 1998;

- (5) *international accounting standards*; and
- (6) the Companies Act 1985.

as applicable to the *firm* for the purpose of its external financial reporting (or as would be applicable if the *firm* was a company with its head office in the *United Kingdom*).

- 1.3.5 G Except where a *rule* in *GENPRU*, *BIPRU* or *INSPRU* makes different provision, *GENPRU* 1.3.4R applies whenever a *rule* in *GENPRU*, *BIPRU* or *INSPRU* refers to the value or amount of an asset, liability, *exposure*, equity or income statement item, including:
- (1) whether, and when, to recognise or de-recognise an asset or liability;
 - (2) the amount at which to value an asset, liability, *exposure*, equity or income statement item; and
 - (3) which description to place on an asset, liability, *exposure*, equity or income statement item.
- 1.3.6 G In particular, unless an exception applies, *GENPRU* 1.3.4R should be applied for the purposes of *GENPRU*, *BIPRU* and *INSPRU* to determine how to account for:
- (1) netting of amounts due to or from the *firm*;
 - (2) the securitisation of assets and liabilities (see also *GENPRU* 1.3.7G);
 - (3) leased tangible assets;
 - (4) assets transferred or received under a *sale and repurchase* or *stock lending* transaction; and
 - (5) assets transferred or received by way of initial or variation margin under a *derivative* or similar transaction.
- 1.3.7 G In the case of an *insurer* or a *UK ISPV*, where assets or liabilities are securitised, *GENPRU* 1.3.4R only permits de-recognition where Financial Reporting Standard 5 (or, where applicable, International Accounting Standard 39) permits either de-recognition or the linked presentation. However, the *FSA* will consider granting a *waiver* to permit de-recognition in other circumstances provided that the *firm* can demonstrate that securitisation has effectively transferred risk
- 1.3.8 G Articles 23.3(viii) and 24.2(iv) of the *Consolidated Life Directive* require assets of an *insurer* that are managed on its behalf by a *subsidiary undertaking* to be taken into account for the purposes of determining the *insurer's admissible assets* and its assets in excess of concentration limits. The application of *GENPRU* 1.3.4R will result in such assets remaining on the balance sheet of the *insurer*.

General requirements: Adjustments to accounting values

- 1.3.9 R For the purposes of *GENPRU*, *BIPRU* and *INSPRU*, except where a *rule* in *GENPRU*, *BIPRU* or *INSPRU* provides for a different method of recognition or valuation:
- (1) when a *firm*, upon initial recognition, designates its liabilities as at fair value through profit or loss, it must always adjust any value calculated in accordance with *GENPRU* 1.3.4R by subtracting any unrealised gains or adding back in any unrealised losses which are not attributable to changes in a benchmark interest rate;
 - (2) in respect of a *defined benefit occupational pension scheme*:
 - (a) a *firm* must derecognise any *defined benefit asset*;
 - (b) a *firm* may substitute for a *defined benefit liability* the *firm's deficit reduction amount*.
- 1.3.10 R An election made under *GENPRU* 1.3.9R(2) must be applied consistently for the purposes of *GENPRU*, *BIPRU* and *INSPRU* in respect of any one financial year.
- 1.3.11 G A *firm* should keep a record of and be ready to explain to its supervisory contacts in the *FSA* the reasons for any difference between the *deficit reduction amount* and any commitment the *firm* has made in any public document to provide funding in respect of a *defined benefit occupational pension scheme*.
- 1.3.12 G The provisions of *GENPRU* 1.3.9R to *GENPRU* 1.3.10R and *GENPRU* 1.3.36R apply only to the extent that the items referred to in those paragraphs would otherwise be recognised under the accounting requirements applicable to the *firm*. Some of those requirements may only be relevant to a *firm* subject to *international accounting standards*.

General requirements: Methods of valuation and systems and controls

- 1.3.13 R
- (1) Except to the extent that *GENPRU*, *BIPRU* or *INSPRU* provide for another method of valuation, *GENPRU* 1.3.14R to *GENPRU* 1.3.34R (Marking to market, Marking to model, Independent price verification, Adjustments or reserves) apply:
 - (a) for the purposes set out in *GENPRU* 1.3.41R;
 - (b) for the purposes set out in *GENPRU* 1.3.39R; and
 - (c) to any balance sheet position measured at market value or fair value.
 - (2) A *firm* must establish and maintain systems and controls sufficient to provide prudent and reliable valuation estimates.
 - (3) Systems and controls under (2) must include at least the following elements:

- (a) documented policies and procedures for the process of valuation, including clearly defined responsibilities of the various areas involved in the determination of the valuation, sources of market information and review of their appropriateness, frequency of independent valuation, timing of closing prices, procedures for adjusting valuations, month-end and ad-hoc verification procedures; and
- (b) reporting lines for the department accountable for the valuation process that are:
 - (i) clear and independent of the front office; and
 - (ii) ultimately to a main board executive director.

General requirements: Marking to market

- 1.3.14 R Wherever possible, a *firm* must use mark to market in order to measure the value of the investments and positions to which this *rule* applies under *GENPRU* 1.3.13R and *GENPRU* 1.3.38R to *GENPRU* 1.3.41R. Marking to market is valuation (on at least a daily basis in the case of the *trading book* positions of a *BIPRU firm*) at readily available close out prices from independent sources.
- 1.3.15 R For the purposes of *GENPRU* 1.3.14R, examples of readily available close out prices include exchange prices, screen prices, or quotes from several independent reputable brokers.
- 1.3.16 R When marking to market, a *firm* must use the more prudent side of bid/offer unless the *firm* is a significant market maker in a particular position type and it can close out at the mid-market price.

General requirements: Marking to model

- 1.3.17 R Where marking to market is not possible, a *firm* must use mark to model in order to measure the value of the investments and positions to which this *rule* applies under *GENPRU* 1.3.13R and *GENPRU* 1.3.38R to *GENPRU* 1.3.41R. Marking to model is any valuation which has to be benchmarked, extrapolated or otherwise calculated from a market input. *GENPRU* 1.3.18R to *GENPRU* 1.3.25R apply when marking to model.
- 1.3.18 R When the model used is developed by the *firm*, that model must be:
 - (1) based on appropriate assumptions which have been assessed and challenged by suitably qualified parties independent of the development process;
 - (2) independently tested, including validation of the mathematics, assumptions, and software implementation; and
 - (3) (in the case of a *BIPRU firm*) developed or approved independently of the front office.

- 1.3.19 R A *firm* must ensure that its senior management are aware of the positions which are subject to mark to model and understand the materiality of the uncertainty this creates in the reporting of the performance of the business of the *firm* and the risks to which it is subject.
- 1.3.20 R A *firm* must source market inputs in line with market prices so far as possible and assess the appropriateness of the market inputs for the position being valued and the parameters of the model on a frequent basis.
- 1.3.21 R A *firm* must use generally accepted valuation methodologies for particular products where these are available.
- 1.3.22 R A *firm* must establish formal change control procedures, hold a secure copy of the model, and periodically use that model to check valuations.
- 1.3.23 R A *firm* must ensure that its risk management functions are aware of the weaknesses of the models used and how best to reflect those in the valuation output.
- 1.3.24 R A *firm* must periodically review the model to determine the accuracy of its performance.
- 1.3.25 R Examples of periodical review are assessing the continued appropriateness of the assumptions, analysis of profit and loss versus risk factors and comparison of actual close out values to model outputs.

General requirements: Independent price verification

- 1.3.26 R In addition to marking to market or marking to model, a *firm* must perform independent price verification. This is the process by which market prices or model inputs are regularly verified for accuracy and independence.
- 1.3.27 G For independent price verification, where independent pricing sources are not available or pricing sources are more subjective (for example, only one available broker quote), prudent measures such as valuation adjustments may be appropriate.
- 1.3.28 R In the case of the *trading book* positions of a *BIPRU firm*, while daily marking to market may be performed by dealers, verification of market prices and model inputs must be performed by a unit independent of the dealing room, at least monthly (or, depending on the nature of the market/trading activity, more frequently).

General requirements: Valuation adjustments or reserves

- 1.3.29 R The recognition of any gains or losses arising from valuations subject to *GENPRU* 1.3.13R and *GENPRU* 1.3.38R to *GENPRU* 1.3.41R must be recognised for the purpose of calculating *capital resources* in accordance with *GENPRU* 1.3.14R to *GENPRU* 1.3.34R (Marking to market, Marking to model, Independent price verification, Adjustments or reserves). However if *GENPRU*, *BIPRU* or *INSPRU* provide for another treatment of such gains or losses, that other treatment must be applied.

- 1.3.30 R A *firm* must establish and maintain procedures for considering valuation adjustments or reserves. These procedures must be compliant with the requirements set out in *GENPRU* 1.3.33R.
- 1.3.31 R A *firm* using third-party valuations, or marking to model, must consider whether valuation adjustments are necessary.
- 1.3.32 R A *firm* must consider the need for establishing reserves for less liquid positions and, on an ongoing basis, review their continued appropriateness in accordance with the requirements set out in *GENPRU* 1.3.33R. Less liquid positions could arise from both market events and institution-related situations e.g. concentration positions and/or stale positions.
- 1.3.33 R (1) This paragraph sets out the requirements referred to in *GENPRU* 1.3.30R and *GENPRU* 1.3.32R.
- (2) A *firm* must consider the following adjustments or reserves: unearned credit spreads, close-out costs, operational risks, early termination, investing and funding costs, future administrative costs and, where appropriate, model risk.
- (3) A *firm* must consider several factors when determining whether a valuation reserve is necessary for less liquid positions. These factors include the amount of time it would take to hedge out the position/risks within the position; the average and volatility of bid/offer spreads; the availability of market quotes (number and identity of market makers); the average and volatility of trading volumes; market concentrations; the ageing of positions; the extent to which valuation relies on marking to model and the impact of other model risks.
- 1.3.34 R If the result of establishing adjustments or reserves under *GENPRU* 1.3.29R to *GENPRU* 1.3.33R is a valuation which differs from the fair value determined in accordance with *GENPRU* 1.3.4R, a *firm* must reconcile the two valuations.
- 1.3.35 G Reconciliation differences under *GENPRU* 1.3.34R should not be reflected in the valuations under *GENPRU* 1.3 but should be disclosed to the *FSA* in prudential returns.

Specific requirements: BIPRU firms

Adjustments to accounting values

- 1.3.36 R (1) For the purposes of *GENPRU* and *BIPRU*, the adjustments in (2) and (3) apply to values calculated pursuant to *GENPRU* 1.3.4R in addition to those required by *GENPRU* 1.3.9R to *GENPRU* 1.3.10R.
- (2) A *BIPRU firm* must not recognise either:
- (a) the fair value reserves related to gains or losses on cash flow hedges of financial instruments measured at amortised cost; or

- (b) any unrealised gains or losses on debt instruments held in the available-for-sale category.
 - (3) A *BIPRU investment firm* must deduct any asset in respect of deferred acquisition costs and add back in any liability in respect of deferred income (but exclude from the deduction or addition any asset or liability which will give rise to future cash flows), together with any associated deferred tax.
 - (4) The items referred to in (2) and (3) must be excluded from *capital resources*.
- 1.3.37 G Provisions for equity instruments held in the available-for-sale category can be found in *GENPRU 2.2.185R*.
- Trading book and revaluations
- 1.3.38 R *GENPRU 1.3.39R* to *GENPRU 1.3.40R* apply only to a *BIPRU firm*.
- 1.3.39 R *Trading book* positions are subject to prudent valuation rules as specified in *GENPRU 1.3.14R* to *GENPRU 1.3.34R* (Marking to market, Marking to model, Independent price verification, Adjustments or reserves). In accordance with those *rules*, a *firm* must ensure that the value applied to each of its *trading book* positions appropriately reflects the current market value. This value must contain an appropriate degree of certainty having regard to the dynamic nature of *trading book* positions, the demands of prudential soundness and the mode of operation and purpose of capital requirements in respect of *trading book* positions.
- 1.3.40 R *Trading book* positions must be re-valued at least daily.
- Specific requirements: firms carrying on insurance business
- Investments, derivatives and quasi-derivatives
- 1.3.41 R (1) For the purposes of *GENPRU* and *INSPRU*, an *insurer* or a *UK ISPV* must apply *GENPRU 1.3.14R* to *GENPRU 1.3.34R* (Marking to market, Marking to model, Independent price verification, Adjustments or reserves) to account for:
- (a) investments that are, or amounts owed arising from the disposal of:
 - (i) *debt securities*, bonds and other money- and capital-market instruments;
 - (ii) loans;
 - (iii) *shares* and other variable yield participations;
 - (iv) *units* in *UCITS schemes*, *non-UCITS retail schemes*, *recognised schemes* and any other *collective investment scheme* that invests only in *admissible assets* (including any *derivatives* or *quasi-derivatives* held by the scheme); and

(b) *derivatives and quasi-derivatives*

(2) In the case of an *insurer*, (1) is subject to *GENPRU 1.3.43R*.

Shares in and debts due from related undertakings

- 1.3.42 R *GENPRU 1.3.43R* to *GENPRU 1.3.57R* apply only to *insurers*.
- 1.3.43 R *GENPRU 1.3.13R* and *GENPRU 1.3.41R* do not apply to *shares* in, and *debts* due from a *related undertaking* that is:
- (1) a *regulated related undertaking*;
 - (2) an *ancillary services undertaking*; or
 - (3) any other *subsidiary undertaking*, the *shares* of which a *firm* elects to value in accordance with *GENPRU 1.3.47R*.
- 1.3.44 G The effect of *GENPRU 1.3.43R* is that *shares* in, and *debts* due from, *related undertakings* of the types referred to are not valued on a mark to market basis by *insurers*. As a result, *debts* due from these *undertakings*, and *shares* in *related undertakings* which are *ancillary services undertakings*, are valued at their accounting book value in accordance with *GENPRU 1.3.4R*. *Shares* in *related undertakings* referred to in *GENPRU 1.3.43R*(1) or (3) are valued by *insurers* in accordance with *GENPRU 1.3.45R* to *GENPRU 1.3.50R*.
- 1.3.45 R Except where the contrary is expressly stated in *GENPRU*, whenever a rule in *GENPRU* or *INSPRU* refers to *shares* held in, and *debts* due from, an *undertaking* referred to in *GENPRU 1.3.43R*(1) or *GENPRU 1.3.43R*(3), a *firm* must value the *shares* held in accordance with *GENPRU 1.3.47R*.
- 1.3.46 R In relation to *shares* in, and *debts* due from, an *undertaking* referred to in *GENPRU 1.3.43R*(1), *GENPRU 1.3.45R* does not apply for the purposes of *GENPRU 2.2.256R* (Adjustments for regulated related undertakings other than insurance undertakings) and *INSPRU 6.1* (Group risk: Insurance groups).
- 1.3.47 R For the purposes of *GENPRU 1.3.45R*, the value of the *shares* held in an *undertaking* referred to in *GENPRU 1.3.43R*(1) or *GENPRU 1.3.43R*(3) is the sum of:
- (1) the regulatory surplus value of that *undertaking*; less
 - (2) for the purposes of *GENPRU 2.2.256R* (Adjustments for regulated related undertakings other than insurance undertakings), the book value of the total investments in the *tier one capital resources* and *tier two capital resources* of that *undertaking* by the *firm* and its *related undertakings*; or
 - (3) for other purposes in *GENPRU* and *INSPRU*, the sum of:
 - (a) the book value of the investments by the *firm* and its *related undertakings* in the *tier two capital resources* of the *undertaking*; and

- (b) if the *undertaking* is an *insurance undertaking*, its ineligible surplus capital and any restricted assets of the *undertaking* which have been excluded under *INSPRU* 6.1.41R(1).
- 1.3.48 R For the purposes of *GENPRU* 1.3.47R(1), the regulatory surplus value of an *undertaking* referred to in *GENPRU* 1.3.43R(1) or *GENPRU* 1.3.43R(3) is, subject to *GENPRU* 1.3.49R, the sum of:
- (1) the total capital after deductions of the *undertaking*; less
 - (2) the *individual capital resources requirement* of the *undertaking*.
- 1.3.49 R (1) Subject to *GENPRU* 1.3.50R, for the purposes of *GENPRU* 1.3.48R, only the relevant proportion of the:
- (a) total capital after deductions of the *undertaking*; and
 - (b) *individual capital resources requirement* of the *undertaking*;
- is to be taken into account.
- (2) In (1), the relevant proportion is the proportion of the total number of *shares* issued by the *undertaking* held, directly or indirectly, by the *firm*.
- 1.3.50 R If the *individual capital resources requirement* of an *undertaking* in *GENPRU* 1.3.43R(1) that is a *subsidiary undertaking* exceeds total capital after deductions, then the full amount of the items referred to in *GENPRU* 1.3.49R(1) must be taken into account for the purposes of *GENPRU* 1.3.48R.
- 1.3.51 R For the purposes of *GENPRU* 1.3.47R to *GENPRU* 1.3.50R:
- (1) in relation to an *undertaking* referred to in *GENPRU* 1.3.43R(1):
 - (a) subject to (2), *individual capital resources requirement* has the meaning given by *INSPRU* 6.1.34R;
 - (b) total capital after deductions means:
 - (i) when used in relation to a *regulated related undertaking* that is subject to the *capital resources table*, the total capital after deductions (as calculated at stage M of the *capital resources table*) of the *undertaking*; and
 - (ii) when used in relation to a *regulated related undertaking* that is not subject to the *capital resources table*, the total capital after deductions calculated as if that *undertaking* were required to calculate its total capital after deductions in accordance with stage M of the calculation in the *capital resources table*, but with such adjustments being made to secure that the *undertaking's* calculation of its total capital after deductions complies with the relevant *sectoral rules* applicable to it; and

- (c) ineligible surplus capital has the meaning given by *INSPRU* 6.1.67R;
- (2) in relation to an *undertaking* referred to in *GENPRU* 1.3.43R(3),

- (a) the *individual capital resources requirement* is zero; and
- (b) the total capital after deductions means the total capital after deductions of the *undertaking* calculated as if the *undertaking* were an *insurance holding company* required to calculate its total capital resources in accordance with the *capital resources table* but with such adjustments being made to secure that the *undertaking's* calculation of its total capital after deductions complies with the *sectoral rules* for the *insurance sector*.

1.3.52 G *GENPRU* 1.3.47R to *GENPRU* 1.3.51R set out several different valuation bases for an *insurer's shares* in *related undertakings*. The regulatory surplus value (defined in *GENPRU* 1.3.48R) measures the *related undertaking's* own capital surplus or deficit. This is used: (i) in *GENPRU* 1.3.47R as a basis for calculating the impact on the firm's position of its investments in *related undertakings*; and (ii) in *INSPRU* 6.1 as a starting point for the calculation of ineligible surplus capital.

1.3.53 G *GENPRU* 1.3.47R determines how, for the purposes of the solo capital adequacy calculation of an *insurer*, that *insurer's capital resources* should be adjusted to take into account its investments in *related undertakings*.

1.3.54 G The *rules* that specify how, for the purposes of the adjusted solo capital calculation, an *insurer* should incorporate its *related undertakings* into its *capital resources* and *capital resources requirement* are set out in *INSPRU* 6.1.

Insurance Special Purpose Vehicles

1.3.55 R Except where a *rule* in *GENPRU* or *INSPRU* makes a different provision, an *insurer* must not place any value on amounts recoverable from an *ISPV* for the purposes of any *rule* in *GENPRU* or *INSPRU*.

1.3.56 G An *insurer* may value amounts recoverable from an *ISPV* if it obtains a *waiver* of *GENPRU* 1.3.55R under section 148 of the *Act*. The conditions that will need to be met, in addition to the statutory tests under section 148(4) of the *Act*, before the *FSA* will consider granting such a *waiver* are set out in *INSPRU* 1.6.13G to *INSPRU* 1.6.18G.

General insurance business: Community co-insurance operations -

1.3.57 R Where a *relevant insurer* determines the amount of a liability in order to make provision for outstanding *claims* under a *Community co-insurance operation*, then, if the *leading insurer* has informed the *relevant insurer* of the amount of the provision made by the *leading insurer* for such *claims*, the amount determined by the *relevant insurer*:

- (1) must be at least as great as the amount of the provision made by the *leading insurer*; or

- (2) in a case where it is not the practice in the *United Kingdom* to make such provision separately, must be sufficient, when all liabilities are taken into account, to include provision at least as great as that made by the *leading insurer* for such *claims*,

due regard being had in either case to the proportion of the risk covered by the *relevant insurer* and by the *leading insurer* respectively.

GENPRU 1.4 Actions for damages

1.4 Actions for damages

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

1.5 Application of GENPRU 1 to Lloyd's

Application of GENPRU 1.2

- 1.5.1 R *GENPRU 1.2 applies to managing agents and to the Society in accordance with:*
- (1) for *managing agents*, *INSPRU 8.1.4R*; and
 - (2) for the *Society*, *INSPRU 8.1.2R*.
- 1.5.2 R *GENPRU 1.5.7R applies to members, pursuant to the insurance market direction in GENPRU 1.5.5D.*
- Insurance market direction
- 1.5.3 G The *insurance market direction* in *GENPRU 1.5.5D* is given under section 316(1) of the *Act* (Direction by Authority) and applies to *members*.
- 1.5.4 G The purpose of the *insurance market direction* in *GENPRU 1.5.5D* is to enable the *FSA* to make the rule in *GENPRU 1.5.7R* applying to *members*, in order to:
- (1) protect *policyholders* against the risk that *members* may not have adequate financial resources to meet liabilities under or in respect of *contracts of insurance* as they fall due;
 - (2) promote confidence in the market at Lloyd's by requiring *members* to maintain financial resources which are adequate to meet their liabilities.
- 1.5.5 D With effect from 1 January 2005, Part X of the *Act* (Rules and Guidance) applies to the *members* of the *Society* taken together in relation to the *insurance market activities* of *effecting* and *carrying out contracts of insurance* written at Lloyd's, for the purpose of applying the *rules* and *guidance* in *GENPRU 1.5.7R* to *GENPRU 1.5.9G*.
- 1.5.6 G Part X of the *Act* is a *core provision* specified in section 317(1) of the *Act* (The core provisions). Section 317(2) provides that references in an applied *core provision* to an *authorised person* are to be read as references to a *person* in the class to which the *insurance market direction* applies. From 1 January 2005, references in Part X of the *Act* are to be read as references to *members* for the purposes of *GENPRU 1.5.7R* to *GENPRU 1.5.9G*.
- Members' obligation to maintain adequate financial resources
- 1.5.7 R The *members* taken together must at all times maintain overall financial resources, including capital and liquidity resources, that are adequate, both as to amount and quality, to ensure that there is no significant risk that

liabilities under or in respect of *contracts of insurance* written at Lloyd's will not be met as they fall due.

- 1.5.8 G Under *GENPRU*:
- (1) *managing agents* must ensure that adequate financial resources are available to support the *insurance business* carried on through each *syndicate* that they manage; and
 - (2) the *Society* must, having regard to the availability and value of the *central assets*, ensure that the financial resources supporting the *insurance business* of each *member* are adequate at all times.
- 1.5.9 G In practice, compliance with the requirements described in *GENPRU* 1.5.8G is likely to have the effect that *members* comply with *GENPRU* 1.5.7R.

Application of *GENPRU* 1.3

- 1.5.10 R *GENPRU* 1.3 applies to *managing agents* and to the *Society* in accordance with:

- (1) for *managing agents*, *INSPRU* 8.1.4R; and
- (2) for the *Society*, *INSPRU* 8.1.2R.

Amounts receivable but not yet received

- 1.5.11 R When recognising and valuing assets that are available to meet liabilities arising from a *member's insurance business*, neither the *Society* nor *managing agents* may attribute any value to any amounts receivable but not yet received from that *member* or another *member*, except for:
- (1) timing differences provided that a corresponding amount has been deducted from *syndicate assets* or *funds at Lloyd's*;
 - (2) the *Society's callable contributions*, which are valued according to *GENPRU* 1.5.17R to *GENPRU* 1.5.18R; and
 - (3) debts owed by a *member* to another *member* of the *Society* where the debt is a liability arising out of the *insurance business* he carries on at Lloyd's.

Letters of credit, guarantees and life assurance policies

- 1.5.12 R When recognising and valuing assets held as *members' funds at Lloyd's* the *Society* may, if the conditions in *GENPRU* 1.5.13R are satisfied, attribute a value to letters of credit and guarantees that it holds in respect of a *member's insurance business*.

- 1.5.13 R The conditions referred to in *GENPRU* 1.5.12R are that letters of credit and

guarantees must be:

- (1) in the form prescribed by the *Society* from time to time and notified to the *FSA*; and
 - (2) issued by a *credit institution* or an *insurance undertaking*.
- 1.5.14 R When recognising and valuing assets held as *members' funds at Lloyd's* the *Society* may attribute a value to verifiable sums arising out of life assurance policies.
- 1.5.15 R The *Society* must value any letter of credit, guarantee or life assurance policy at its net realisable value. The *Society* must make all appropriate deductions, including those in respect of:
- (1) the expenses of realisation; and
 - (2) any reduction in value that would be likely to occur if the asset needed to be realised at short notice to meet liabilities falling due earlier than expected.
- 1.5.16 R If a *member* relies on a value attributed to a letter of credit or guarantee to meet any applicable *capital resources requirement* and that letter of credit or guarantee will expire in less than one month, the *Society* must take appropriate steps to ensure that the applicable *capital resources requirement* will continue to be met, including taking steps to ensure that sums due under the letter of credit or guarantee are drawn down when due and carried to the appropriate *Lloyd's trust fund*.
- The *Society's* callable contributions
- 1.5.17 R For the purposes of *GENPRU* 1.5.15R(2), the amount assumed to be callable from a *member* must not exceed the lower of:
- (1) the maximum *callable contribution* that *member* is or may be liable to make in that *financial year*; and
 - (2) the amount by which the *member's* own *capital resources* exceed the *member's* own *capital resources requirement*.
- 1.5.18 R The *Society* must value *callable contributions* taking appropriate account of any legal, constructive or other limits on its ability to call for contributions from *members* or to realise the amount called.
- 1.5.19 R The *Society* must give the *FSA* adequate advance notice if it proposes to change the maximum amount of the *callable contribution* that *members* may be liable to make in any *financial year*.
- 1.5.20 G The *FSA* would normally expect not less than six months' notice under *GENPRU* 1.5.19R.

Liabilities

- 1.5.21 R Subject to *GENPRU* 1.5.22R, the *Society* must recognise and value all of a *member's* liabilities in respect of its *insurance business*.
- 1.5.22 R The *Society* need not recognise or value a *member's* liabilities that are recognised and valued at *syndicate* level by *managing agents* in accordance with *GENPRU* 1.3.
- 1.5.23 R For the purposes of calculating a *member's capital resources*, when valuing a *member's funds at Lloyd's* the *Society* must deduct the value of a *member's* liabilities determined under *GENPRU* 1.5.21R.
- 1.5.24 G The liabilities to be valued under *GENPRU* 1.5.21R and deducted under *GENPRU* 1.5.23R include:
- (1) amounts owing to *members' agents*;
 - (2) amounts owing to the *Society*;
 - (3) an appropriate accrual for tax payable on any profits;
 - (4) (where required under any applicable accounting principle in accordance with *GENPRU* 1.3.4R), any contingent liability relating to liabilities reinsured into Equitas Reinsurance Ltd; and
 - (5) amounts apportioned to *members* in respect of the *credit equalisation provision* under *INSPRU* 1.4.
- 1.5.25 R In recognising and valuing a *member's* liabilities, the *Society* and *managing agents* may, to the extent permitted by applicable accounting principles, leave out of account the liabilities in respect of 1992 and prior *general insurance business* reinsured by Equitas Reinsurance Limited.
- 1.5.26 G There may be contingent liabilities associated with the reinsurance into Equitas. *GENPRU* 1.3 requires *managing agents* and the *Society* to treat those contingent liabilities in accordance with applicable accounting principles: see *GENPRU* 1.3.4R. Depending on the circumstances, *managing agents* or the *Society* may need to disclose or account for such a liability.

2.1 Calculation of capital resources requirements

Application

- 2.1.1 R This section applies to:
- (1) a *BIPRU firm*; and
 - (2) an *insurer*, unless it is:
 - (a) a *non-directive friendly society*; or
 - (b) a *Swiss general insurer*; or
 - (c) an *EEA-deposit insurer*; or
 - (d) an *incoming EEA firm*; or
 - (e) an *incoming Treaty firm*.
- 2.1.2 G The scope of application of this section is not restricted to *firms* that are subject to the relevant EC Directives.
- 2.1.3 R (1) This section applies to a *firm* in relation to the whole of its business, except where a particular provision provides for a narrower scope.
- (2) Where an *insurer* carries on both *long-term insurance business* and *general insurance business*, except where a particular provision provides otherwise, this section applies separately to each type of business.
- 2.1.4 G The adequacy of a *firm's capital resources* needs to be assessed in relation to all the activities of the *firm* and the risks to which they give rise.
- 2.1.5 G The requirements in this section apply to a *firm* on a solo basis.

Purpose

- 2.1.6 G *Principle 4* requires a *firm* to maintain adequate financial resources. *GENPRU 2* sets out provisions that deal specifically with the adequacy of that part of a *firm's* financial resources that consists of *capital resources*. The adequacy of a *firm's* *capital resources* needs to be assessed both by that *firm* and the *FSA*. Through its *rules*, the *FSA* sets minimum *capital resources requirements* for *firms*. It also reviews a *firm's* own assessment of its capital needs, and the processes and systems by which that assessment is made, in order to see if the minimum *capital resources requirements* are appropriate (see *GENPRU 1.2* (Adequacy of financial resources), *BIPRU 2.2* (Internal capital adequacy standards) and *INSPRU 7.1* (Individual capital assessment)).

- 2.1.7 G This section sets *capital resources requirements* for a *firm*. *GENPRU 2.2* (Capital resources) sets out how, for the purpose of meeting *capital resources requirements*, the amounts or values of capital, assets and liabilities are to be determined. More detailed *rules* relating to capital, assets and liabilities are set out in *GENPRU 1.3* (Valuation) and, for an *insurer*, *INSPRU* and, for a *BIPRU firm*, *BIPRU*.
- 2.1.8 G (1) This section implements minimum EC standards for the *capital resources* required to be held by an *insurer* undertaking business that falls within the scope of the *Consolidated Life Directive* (2002/83/EC), the *Reinsurance Directive* (2005/68/EC) or the *First Non-Life Directive* (1973/239/EEC) as amended.
- (2) This section also implements provisions of the *Capital Adequacy Directive* and *Banking Consolidation Directive* concerning the level of *capital resources* which a *BIPRU firm* is required to hold. In particular it implements (in part) Articles 9, 10 and 75 of the *Banking Consolidation Directive* and Articles 5, 9, 10 and 18 of the *Capital Adequacy Directive*.
- (3) In the case of a *UCITS investment firm* this section implements (in part) Article 5a of the *UCITS Directive*.

Monitoring requirements

- 2.1.9 R A *firm* must at all times monitor whether it is complying with *GENPRU 2.1.13R* (the main capital adequacy *rule* for *insurers*) or the *main BIPRU firm Pillar 1 rules* and be able to demonstrate that it knows at all times whether it is complying with those *rules*.
- 2.1.10 G For the purposes of *GENPRU 2.1.9R*, a *firm* should have systems in place to enable it to be certain whether it has adequate *capital resources* to comply with *GENPRU 2.1.13R* and the *main BIPRU firm Pillar 1 rules* (as applicable) at all times. This does not necessarily mean that a *firm* needs to measure the precise amount of its *capital resources* and its *CRR* on a daily basis. A *firm* should, however, be able to demonstrate the adequacy of its *capital resources* at any particular time if asked to do so by the *FSA*.
- 2.1.11 R A *firm* must notify the *FSA* immediately of any breach, or expected breach, of *GENPRU 2.1.13R* (in the case of an *insurer*) or the *main BIPRU firm Pillar 1 rules* (in the case of a *BIPRU firm*).

Additional capital requirements

- 2.1.12 G The *FSA* may impose a higher capital requirement than the minimum requirement set out in this section as part of the *firm's Part IV permission* (see *GENPRU 1.2* (Adequacy of financial resources), *BIPRU 2.2* (Internal capital adequacy standards) and *INSPRU 7.1* (Individual capital assessment)).

Main requirement: Insurers

- 2.1.13 R (1) Subject to (2), an *insurer* must maintain at all times *capital resources* equal to or in excess of its *capital resources requirement (CRR)*.

- (2) An *insurer* which is a *participating insurance undertaking* and, in relation to its own *group capital resources*, is in compliance with *INSPRU 6.1.9R* (Requirement to maintain group capital), is deemed to comply with this *rule*.
- 2.1.14 R An *insurer* must comply with *GENPRU 2.1.13R* separately in respect of both its *long-term insurance business* and its *general insurance business* unless it is a *pure reinsurer* or a *captive reinsurer* which has a single *MCR* in respect of its entire business in accordance with *GENPRU 2.1.26R*.
- 2.1.15 G In order to comply with *GENPRU 2.1.14R*, an *insurer* carrying on both *general insurance business* and *long-term insurance business* will need to allocate its *capital resources* between its *general insurance business* and *long-term insurance business* so that the *capital resources* allocated to its *general insurance business* are equal to or in excess of its *CRR* for its *general insurance business* and the *capital resources* allocated to its *long-term insurance business* are equal to or in excess of its *CRR* for its *long-term insurance business*. Whereas *long-term insurance assets* cannot be used towards meeting a *firm's CRR* for its *general insurance business*, surplus *general insurance assets* may be used towards meeting the *CRR* for its *long-term insurance business* (see *INSPRU 1.5.30R* to *INSPRU 1.5.32G*). *INSPRU 1.5* (Internal-contagion risk) sets out the detailed requirements for the separation of *long-term* and *general insurance business*.
- 2.1.16 G *Insurers* commonly use different terminology for the various *GENPRU* requirements. For example, the *MCR* is traditionally known as the required minimum margin.

Calculation of the CRR for an insurer

- 2.1.17 R The *CRR* for any *insurer* carrying on *general insurance business* is equal to the *MCR* in *GENPRU 2.1.24R* or, for a *pure reinsurer* or a *captive reinsurer* carrying on both *general insurance business* and *long-term insurance business*, in *GENPRU 2.1.26R*.
- 2.1.18 R The *CRR* for any *insurer* to which this *rule* applies (see *GENPRU 2.1.19R* and *GENPRU 2.1.20R*) is the higher of:
- (1) the *MCR* in *GENPRU 2.1.25R*; and
 - (2) the *ECR* in *GENPRU 2.1.38R*.
- 2.1.19 R Subject to *GENPRU 2.1.20R*, *GENPRU 2.1.18R* applies to an *insurer* carrying on *long-term insurance business*, other than:
- (1) a *non-directive mutual*;
 - (2) an *insurer* which has no *with-profits insurance liabilities*; and
 - (3) an *insurer* which has *with-profits insurance liabilities* that are, and at all times since 31 December 2004 (the coming into force of *GENPRU 2.1.18R*) have remained, less than £500 million.

- 2.1.20 R *GENPRU* 2.1.18R also applies to an *insurer* of a type listed in *GENPRU* 2.1.19R(3) if:
- (1) the *insurer* makes an election that *GENPRU* 2.1.18R is to apply to it; and
 - (2) that election is made by written notice given to the *FSA* in a way that complies with the requirements for written notice in *SUP* 15.7 (Form and method of notification).
- 2.1.21 G The effect of *GENPRU* 2.1.19R(3) is that an *insurer* to which *GENPRU* 2.1.18R applies because it has *with-profits insurance liabilities* of £500 million or more, will continue to be subject to *GENPRU* 2.1.18R even if its *with-profits insurance liabilities* fall below £500 million. However, if that happens, it may apply for a *waiver* from *GENPRU* 2.1.18R under section 148 of the *Act*. In exercising its discretion under section 148 of the *Act*, the *FSA* will have regard (among other factors) to whether there has been a material and permanent change to the *insurer's* business and to the prospects of it continuing to have *with-profits insurance liabilities* of less than £500 million.
- 2.1.22 G An *insurer* that has always had *with-profits insurance liabilities* of less than £500 million since *GENPRU* 2.1.18R came into force may wish to “opt in” to *GENPRU* 2.1.18R and therefore become a *realistic basis life firm*. By doing so, it becomes obliged to calculate a *with-profits insurance capital component* (see *GENPRU* 2.1.38R and *INSPRU* 1.3 (With-profits insurance capital component)), but it also becomes entitled to certain modifications to the way that a *firm* is required to calculate its *mathematical reserves* (see *INSPRU* 1.2.46R (Future net premiums: adjustment for deferred acquisition costs) and *INSPRU* 1.2.76R (Persistency assumptions)). The *firm* is also then required to report its liabilities on a realistic basis (see *IPRU(INS)* rule 9.31R(b)). In order to “opt in”, the *insurer* must make an election under *GENPRU* 2.1.20R that *GENPRU* 2.1.18R is to apply to it. If an *insurer* that has elected to calculate and report its *with-profits insurance liabilities* on a realistic basis subsequently decides that it no longer wishes to do so, it may seek to “opt out” by applying for a *waiver* from *GENPRU* 2.1.18R under section 148 of the *Act*. In exercising its discretion under section 148 of the *Act*, the *FSA* will have regard (among other factors) to whether there has been a material and permanent change to the *firm's* business and to whether it continues to have *with-profits insurance liabilities* of less than £500 million.
- 2.1.23 R The *CRR* for an *insurer* carrying on *long-term insurance business*, but to which *GENPRU* 2.1.18R does not apply, is equal to the *MCR* in *GENPRU* 2.1.25R or, for a *pure reinsurer* or a *captive reinsurer* carrying on both *general insurance business* and *long-term insurance business*, in *GENPRU* 2.1.26R.

Calculation of the *MCR* (Insurer only)

- 2.1.24 R Subject to *GENPRU* 2.1.26R, for an *insurer* carrying on *general insurance business* the *MCR* in respect of that business is the higher of:
- (1) the *base capital resources requirement* for *general insurance business* applicable to that *firm*; and

(2) the *general insurance capital requirement*.

2.1.25 R Subject to GENPRU 2.1.26R, for an *insurer* carrying on *long-term insurance business* the *MCR* in respect of that business is the higher of:

(1) the *base capital resources requirement* for *long-term insurance business* applicable to that *firm*; and

(2) the sum of:

(a) the *long-term insurance capital requirement*; and

(b) the *resilience capital requirement*.

2.1.26 R For a *pure reinsurer* or a *captive reinsurer* carrying on both *general insurance business* and *long-term insurance business*:

(1) the *MCR* in respect of its *general insurance business* is the *general insurance capital requirement*; and

(2) the *MCR* in respect of its *long-term insurance business* is the sum of:

(a) the *long-term insurance capital requirement*; and

(b) the *resilience capital requirement*;

unless the sum of:

(3) the *general insurance capital requirement*; and

(4) the sum of:

(a) the *long-term insurance capital requirement*; and

(b) the *resilience capital requirement*;

is lower than the *base capital resources requirement*, in which case the *firm* has a single *MCR* in respect of its entire business equal to the *base capital resources requirement*.

- 2.1.27 G The *MCR* gives effect to the EC Directive minimum requirements. For *general insurance business*, the EC Directive minimum is the higher of the *general insurance capital requirement* and the relevant *base capital resources requirement*. For *long-term insurance business*, the EC Directive minimum is the higher of the *long-term insurance capital requirement* and the *base capital resources requirement*. For *pure reinsurers* and *captive reinsurers* carrying on both *general insurance business* and *long-term insurance business*, however, the *base capital resources requirement* is the EC Directive required minimum only when it is higher than the sum of the *general insurance capital requirement* and the *long-term insurance capital requirement*. The *base capital resources requirement* is the minimum guarantee fund for the purposes of article 29(2) of the *Consolidated Life Directive (2002/83/EC)*, article 17(2) of the *First Non-Life Directive (1973/239/EEC)* as amended and article 40(2) of the *Reinsurance Directive (2005/68/EC)*. The *resilience capital requirement* is an *FSA* requirement that is additional to the EC minimum requirement for *long-term insurance business*.
- 2.1.28 G The calculation of the *resilience capital requirement* is set out in *INSPRU 3.1 (Market Risk in insurance)*.

Calculation of the base capital resources requirement for an insurer

- 2.1.29 R The amount of an *insurer's base capital resources requirement* is set out in the table in *GENPRU 2.1.30R*. If an *insurer* falls within one or more of the descriptions of type of *firm* set out in *GENPRU 2.1.30R*, its *base capital resources requirement* is the highest amount set out against the different types of *firm* within whose description it falls.

2.1.30 R Table: Base capital resources requirement for an insurer
This table belongs to *GENPRU 2.1.29R*

<i>Firm category</i>		Amount: Currency equivalent of
<i>General insurance business</i>		
<i>Liability insurer (classes 10-15)</i>	<i>Directive mutual</i>	€2.4 million
	<i>Non-directive insurer</i>	€300,000
	<i>Other (including mixed insurer but excluding pure reinsurer and captive reinsurer)</i>	€3.2 million
<i>Other insurer</i>	<i>Directive mutual</i>	€1.65 million
	<i>Non-directive insurer (classes 1 to 8, 16 or 18)</i>	€225,000
	<i>Non-directive insurer (classes 9 or 17)</i>	€150,000
	<i>Mixed insurer</i>	€3.2 million
	<i>Other (excluding pure reinsurer and captive reinsurer)</i>	€2.2 million
<i>Long-term insurance business</i>		
<i>Mutual</i>	<i>Directive</i>	€2.4 million
	<i>Non-directive</i>	€600,000
<i>Any other insurer (including mixed insurer but excluding pure reinsurer and captive reinsurer)</i>		€3.2 million
<i>All business (general insurance business and long-term insurance business)</i>		
<i>Pure reinsurer</i>		€3.2 million
<i>Captive reinsurer</i>		€1 million

- 2.1.31 G (1) Under the *Insurance Directives* the amount of the *base capital resources requirement* specified in the last column of the table in *GENPRU 2.1.30R* for an *insurer* which is not a *non-directive insurer* is subject to annual review. The relevant amounts will be increased by the percentage change in the European index of consumer prices (comprising all EU member states, as published by Eurostat) from 20 March 2002, to the relevant review date, rounded up to a multiple of €100,000, provided that where the percentage change since the last increase is less than 5%, no increase will take place.
- (2) Similar provisions for the index-linking of the *base capital resources requirement* are included in the *Reinsurance Directive*, although in that case the index-linking starts from 10 December 2005. However, to ensure consistency as between all *firms* affected by the index-linking of the *base capital resources requirement* under the *Insurance Directives* and the *Reinsurance Directive*, the *FSA* intends, so far as possible, to amend the amounts in *GENPRU 2.1.30R* for all such *firms* (and *GENPRU 2.3.9R* for the *base capital resources requirements* applying to Lloyd's) when an index-linked increase is required by the *Insurance Directives*. The *FSA* may, however, have to depart from this approach where the result would be that the *base capital resources requirement* required for any type of *firm* under *GENPRU 2.1.30R* is less than the increased amount resulting from the operation of an index-linking provision to which it is subject.
- 2.1.32 G Any increases in the *base capital resources requirement* referred to in *GENPRU 2.1.31G* will be published on the *FSA* website.
- 2.1.33 R In the case of an *insurer* and for the purposes of the *base capital resources requirement*, the exchange rate from the Euro to the pound sterling for each year beginning on 31 December is the rate applicable on the last day of the preceding October for which the exchange rates for the currencies of all the European Union member states were published in the Official Journal of the European Union.

Calculation of the general insurance capital requirement (Insurer only)

- 2.1.34 R An *insurer* must calculate its *general insurance capital requirement* as the highest of:
- (1) the *premiums amount*;
 - (2) the *claims amount*; and
 - (3) the *brought forward amount*.
- 2.1.35 G The calculation of each of the *premiums amount*, *claims amount* and *brought forward amount* is set out in *INSPRU 1.1* (Capital resources requirement and technical provisions for insurance business).

Calculation of the long-term insurance capital requirement (Insurer only)

- 2.1.36 R An *insurer* must calculate its *long-term insurance capital requirement* as the sum of:

- (1) the *insurance death risk capital component*;
- (2) the *insurance health risk and life protection reinsurance capital component*;
- (3) the *insurance expense risk capital component*; and
- (4) the *insurance market risk capital component*.

2.1.37 G The calculation of each of the capital components is set out in *INSPRU 1.1* (Capital resources requirement and technical provisions for insurance business).

Calculation of the ECR (Insurer only)

2.1.38 R For an *insurer* carrying on *long-term insurance business* the *ECR* in respect of that business is the sum of:

- (1) the *long-term insurance capital requirement*;
- (2) the *resilience capital requirement*; and
- (3) the *with-profits insurance capital component*.

2.1.39 G Details of the *resilience capital requirement* and the *with-profits insurance capital component* are set out in *INSPRU 3.1* (Market Risk in insurance) and *INSPRU 1.3* (With-profits insurance capital component) respectively.

Main requirement: BIPRU firms

2.1.40 R A *BIPRU firm* must maintain at all times *capital resources* equal to or in excess of the amount specified in the table in *GENPRU 2.1.45R* (Calculation of the variable capital requirement for a BIPRU firm).

2.1.41 R A *BIPRU firm* must maintain at all times *capital resources* equal to or in excess of the *base capital resources requirement* (see the table in *GENPRU 2.1.48R*).

2.1.42 R At the time that it first becomes a *bank, building society* or *BIPRU investment firm*, a *firm* must hold *initial capital* of not less than the *base capital resources requirement* applicable to that *firm*.

2.1.43 G The purpose of the *base capital resources requirement* for a *BIPRU firm* is to act as a minimum capital requirement or floor. It has been written as a separate requirement as there are restrictions in *GENPRU 2.2* (Capital resources) on the types of capital that a *BIPRU firm* may use to meet the *base capital resources requirement* which do not apply to some other parts of the capital requirement calculation. In order to preserve the *base capital resources requirement's* role as a floor rather than an additional requirement, *GENPRU 2.2.60R* allows a *BIPRU firm* to meet the *base capital resources requirement* with capital that is also used to meet the variable capital requirements in *GENPRU 2.1.40R*.

- 2.1.44 G The *base capital resources requirement* and the variable capital requirement in *GENPRU 2.1.40R* are together called the *capital resources requirement (CRR)* in the case of a *BIPRU firm*.

Calculation of the variable capital requirement for a BIPRU firm

- 2.1.45 R Table: Calculation of the variable capital requirement for a BIPRU firm
This table belongs to *GENPRU 2.1.40R*

<i>Firm category</i>	<i>Capital requirement</i>	
<i>Bank, building society or full scope BIPRU investment firm</i>	the sum of the following:	
	(1)	the <i>credit risk capital requirement</i> ;
	(2)	the <i>market risk capital requirement</i> ; and
	(3)	the <i>operational risk capital requirement</i> .
<i>BIPRU limited activity firm</i>	the sum of the following:	
	(1)	the <i>credit risk capital requirement</i> ;
	(2)	the <i>market risk capital requirement</i> ; and
	(3)	the <i>fixed overheads requirement</i> .
<i>BIPRU limited licence firm (including UCITS investment firm)</i>	the higher of (1) and (2):	
	(1)	the sum of:
		(a) the <i>credit risk capital requirement</i> ; and
		(b) the <i>market risk capital requirement</i> ; and
	(2)	the <i>fixed overheads requirement</i> .

Adjustment of the variable capital requirement calculation for UCITS investment firms

- 2.1.46 R A *UCITS investment firm* must only calculate the variable capital requirement under *GENPRU 2.1.40R* in respect of *designated investment business*. For this purpose *scheme management activity* is excluded from *designated investment business*.

Calculation of the base capital resources requirement for a BIPRU firm

- 2.1.47 R The amount of a *BIPRU firm's base capital resources requirement* is set out in the table in *GENPRU 2.1.48R*.

- 2.1.48 R Table: Base capital resources requirement for a BIPRU firm
This table belongs to *GENPRU 2.1.47R*

<i>Firm category</i>	Amount: Currency equivalent of
<i>Bank</i>	€5 million
<i>Building society</i>	The higher of €1 million and £1 million
<i>BIPRU 730K firm</i>	€730,000
<i>BIPRU 125K firm</i>	€125,000
<i>BIPRU 50K firm</i>	€50,000
<i>UCITS investment firm</i>	The amount specified in <i>UPRU 2.1.2R(1)</i> (Financial resources requirement). However the capital that a <i>firm</i> must hold in respect of that requirement is as defined by <i>GENPRU</i> and not as specified in that <i>rule</i> . The reference in that <i>rule</i> to initial capital does not therefore apply.

Definition of BIPRU 730K firm, BIPRU 125K firm and BIPRU 50K firm

- 2.1.49 G The terms *BIPRU 730K firm*, *BIPRU 125K firm* and *BIPRU 50K firm* are defined in *BIPRU 1.1* (Application and purpose). However for convenience the table in *GENPRU 2.1.50G* briefly summarises them.
- 2.1.50 G Table: Definition of BIPRU 730K firm, BIPRU 125K firm and BIPRU 50K firm
This table belongs to *GENPRU 2.1.49G*

Category of BIPRU investment firm	Definition	
<i>BIPRU 50K firm</i>	(1)	it does not deal in any <i>financial instruments</i> for its own account or underwrite issues of <i>financial instruments</i> on a firm commitment basis;
	(2)	it offers one or more of the following services:
	(a)	reception and transmission of investors' orders for <i>financial instruments</i> ; or

Category of BIPRU investment firm	Definition		
		(b)	the execution of investors' orders for <i>financial instruments</i> ; or
		(c)	the management of individual portfolios of investments in <i>financial instruments</i> ; and
	(3)	it does not hold clients' money and/or securities and it is not authorised to do so (it should have a <i>limitation</i> or <i>requirement</i> prohibiting the holding of client money and its <i>permission</i> should not include <i>safeguarding and administering investments</i>).	
<i>BIPRU 125K firm</i>	(1)	it does not deal in any <i>financial instruments</i> for its own account or underwrite issues of <i>financial instruments</i> on a firm commitment basis;	
	(2)	it offers one or more of the following services:	
		(a)	reception and transmission of investors' orders for <i>financial instruments</i> ; or
		(b)	the execution of investors' orders for <i>financial instruments</i> ; or
		(c)	the management of individual portfolios of investments in <i>financial instruments</i> ; and
	(3)	it holds clients' money and/or securities or it is authorised to do so.	
<i>BIPRU 730K firm</i>	is subject to the <i>Capital Adequacy Directive</i> and is neither a <i>BIPRU 50K firm</i> nor a <i>BIPRU 125K firm</i> .		

Calculation of the credit risk capital requirement (BIPRU firm only)

2.1.51 R A *BIPRU firm* must calculate its *credit risk capital requirement* as the sum of:

- (1) the *credit risk capital component*;
- (2) the *counterparty risk capital component*; and
- (3) the *concentration risk capital component*.

Calculation of the market risk capital requirement (BIPRU firm only)

- 2.1.52 R (1) A *BIPRU firm* must calculate its *market risk capital requirement* as the sum of:
- (a) the *interest rate PRR* (including the basic *interest rate PRR* for equity derivatives set out in *BIPRU 7.3* (Equity PRR and basic interest rate PRR for equity derivatives));
 - (b) the *equity PRR*;
 - (c) the *commodity PRR*;
 - (d) the *foreign currency PRR*;
 - (e) the *option PRR*; and
 - (f) the *collective investment undertaking PRR*.
- (2) Any amount calculated under *BIPRU 7.1.9R - BIPRU 7.1.13R* (Instruments for which no PRR treatment has been specified) must be allocated between the *PRR* charges in (1) in the most appropriate manner.

Calculation of the fixed overheads requirement (BIPRU investment firm only)

- 2.1.53 R In relation to a *BIPRU investment firm* which is required to calculate a *fixed overheads requirement*, the amount of that requirement is equal to one quarter of the *firm's* relevant fixed expenditure calculated in accordance with *GENPRU 2.1.54R*.
- 2.1.54 R For the purpose of *GENPRU 2.1.53R*, and subject to *GENPRU 2.1.55R* to *GENPRU 2.1.57R*, a *BIPRU investment firm's* relevant fixed expenditure is the amount described as total expenditure in its most recent audited *annual report and accounts*, less the following items (if they are included within such expenditure):
- (1) staff bonuses, except to the extent that they are guaranteed;
 - (2) employees' and directors' shares in profits, except to the extent that they are guaranteed;
 - (3) other appropriations of profits;
 - (4) shared commission and fees payable which are directly related to commission and fees receivable, which are included within total revenue;
 - (5) interest charges in respect of borrowings made to finance the acquisition of the *firm's readily realisable investments*;
 - (6) interest paid to customers on *client money*;
 - (7) interest paid to counterparties;

- (8) fees, brokerage and other charges paid to *clearing houses*, exchanges and *intermediate brokers* for the purposes of *executing*, registering or clearing transactions;
 - (9) foreign exchange losses; and
 - (10) other variable expenditure.
- 2.1.55 R The relevant fixed expenditure of a *firm* in the following circumstances is:
- (1) where its most recent audited *annual report and accounts* do not represent a twelve month period, an amount calculated in accordance with *GENPRU 2.1.54R*, pro-rated so as to produce an equivalent annual amount; and
 - (2) where it has not completed twelve months' trading, an amount based on forecast expenditure included in the budget for the first twelve months' trading, as submitted with its application for *authorisation*.
- 2.1.56 R A *firm* must adjust its relevant fixed expenditure calculation so far as necessary if and to the extent that since the date covered by the most recent audited *annual report and accounts* or (if *GENPRU 2.1.55R(2)* applies) since the budget was prepared:
- (1) its level of fixed expenditure changes materially; or
 - (2) its *regulated activities* comprised within its *permission* change.
- 2.1.57 R If a *firm* has a material proportion of its expenditure incurred on its behalf by third parties and such expenditure is not fully recharged to that *firm* then the *firm* must adjust its relevant fixed expenditure calculation by adding back in the whole of the difference between the amount of the expenditure and the amount recharged.
- 2.1.58 G For the purpose of *GENPRU 2.1.57R*, the *FSA* would consider as material 10% of a *firm's* expenditure incurred on its behalf by third parties.
- 2.1.59 G For the purpose of *GENPRU 2.1.54R* to *2.1.57R*, fixed expenditure is expenditure which is inelastic relative to fluctuations in a *firm's* levels of business. Fixed expenditure is likely to include most salaries and staff costs, office rent, payment for the rent or lease of office equipment, and insurance *premiums*. It may be viewed as the amount of funds which a *firm* would require to enable it to cease business in an orderly manner, should the need arise. This is not an exhaustive list of such expenditure and a *firm* will itself need to identify (taking appropriate advice where necessary) which costs amount to fixed expenditure.

Calculation of base capital resources requirement for banks authorised before 1993

- 2.1.60 R (1) This *rule* applies to a *bank* that meets the following conditions:

- (a) on 31 December 2006 it had the benefit of *IPRU(BANK) rule 3.3.12* (Reduced minimum capital requirement for a *bank* that is a *credit institution* which immediately before 1 January 1993 was authorised under the Banking Act 1987);
 - (b) the relevant amount (as referred to in *IPRU(BANK) rule 3.3.12*) applicable to it was below €5 million as at 31 December 2006; and
 - (c) on 1 January 2007 it did not comply with the *base capital resources requirement* as set out in the table in *GENPRU 2.1.48R* (€5 million requirement).
 - (2) Subject to (3), the applicable *base capital resources requirement* as at any time (the "relevant time") is the higher of:
 - (a) the relevant amount applicable to it under *IPRU(BANK) rule 3.3.12* as at 31 December 2006 as adjusted under *GENPRU 2.1.62R(2)*; and
 - (b) the highest amount of eligible *capital resources* which that *bank* has held between 1 January 2007 and the relevant time.
 - (3) This *rule* ceases to apply when:
 - (a) that *bank's* eligible *capital resources* at any time since 1 January 2007 equal or exceed €5 million; or
 - (b) a *person* (other than an existing controller) becomes the *parent undertaking* of that *bank*.
 - (4) If this *rule* ceases to apply under (3)(a) it continues not to apply if the *bank's* eligible *capital resources* later fall below €5 million.
- 2.1.61 G Where two or more *banks* merge, all of which individually have the benefit of *GENPRU 2.1.60R*, the *FSA* may agree in certain circumstances that the *base capital resources requirement* for the *bank* resulting from the merger may be the sum of the aggregate *capital resources* of the merged *banks*, calculated at the time of the merger, provided this figure is less than €5 million.
- 2.1.62 R For the purpose of *GENPRU 2.1.60R*:
- (1) an existing controller of a *bank* means:
 - (a) a *person* who has been a *parent undertaking* of that *bank* since 31 December 2006 or earlier; or
 - (b) a *person* who became a *parent undertaking* of that *bank* after 31 December 2006 but who, when he became a *parent undertaking* of that *bank*, was a *subsidiary undertaking* of an existing controller of that *bank*;

- (2) the relevant amount of capital as referred to in *GENPRU* 2.1.60R(2)(a) is adjusted by identifying the time as of which the amount of capital it was obliged to hold under *IPRU(BANK) rule* 3.3.12 as referred to in *GENPRU* 2.1.60R(2)(a) was fixed and then recalculating the capital resources it held at that time in accordance with the definition of eligible *capital resources* (as defined in (3)); and
- (3) eligible *capital resources* mean *capital resources* eligible under *GENPRU* 2.2 (Capital resources) to be used to meet the *base capital resources requirement*.

2.2 Capital resources

Application

2.2.1 R This section applies to:

- (1) a *BIPRU firm*; and
- (2) an *insurer* unless it is:
 - (a) a *non-directive friendly society*; or
 - (b) a *Swiss general insurer*; or
 - (c) an *EEA-deposit insurer*; or
 - (d) an *incoming EEA firm*; or
 - (e) an *incoming Treaty firm*.

Purpose

2.2.2 G *GENPRU 2.1* (Calculation of capital resources requirement) sets out minimum *capital resources requirements* for a *firm*. This section (*GENPRU 2.2*) sets out how, for the purpose of these requirements, *capital resources* are defined and measured.

2.2.3 G This section implements minimum EC standards for the composition of *capital resources* required to be held by an *insurer* undertaking business that falls within the scope of the *Consolidated Life Directive* (2002/83/EC), the *First Non-Life Directive* (1973/239/EEC) as amended or the *Reinsurance Directive* (2005/68/EC).

2.2.4 G This section also implements minimum EC standards for the composition of *capital resources* required to be held by a *BIPRU firm*. In particular it implements Articles 56 – 61, Articles 63 – 64, Article 66 and Articles 120 – 122 of the *Banking Consolidation Directive* (2006/48/EC) and Articles 12 – 16, Article 17 (in part), Article 22(1)(c) (in part) and paragraphs 13 - 15 of Part B of Annex VII of the *Capital Adequacy Directive* (2006/49/EC).

Contents guide

2.2.5 G The table in *GENPRU 2.2.6G* sets out where the main topics in this section can be found.

2.2.6

G Table: Arrangement of GENPRU 2.2
This table belongs to *GENPRU 2.2.5G*

Topic	Location of text
Application and purpose of the <i>rules</i> in this section	<i>GENPRU 2.2.1R</i> to <i>GENPRU 2.2.4G</i>
<i>BIPRU firms</i> that only have simple types of <i>capital resources</i> (<i>simple capital issuers</i>)	<i>GENPRU 2.2.7G</i>
Principles underlying the definition of <i>capital resources</i>	<i>GENPRU 2.2.8G</i>
Which method of calculating <i>capital resources</i> applies to which type of <i>firm</i>	<i>GENPRU 2.2.17R</i> to <i>GENPRU 2.2.19R</i>
Purpose of the limits on the use of different forms of capital	<i>GENPRU 2.2.24G</i>
Use of higher tier capital in lower tiers	<i>GENPRU 2.2.25R</i> to <i>GENPRU 2.2.28R</i>
Calculation of <i>capital resources</i> for <i>insurers</i>	<i>GENPRU 2.2.22G</i> to <i>GENPRU 2.2.23G</i> ; <i>GENPRU 2 Annex 1R</i>
Limits on the use of different forms of capital for <i>insurers</i> (<i>capital resources gearing rules</i> for <i>insurers</i>)	<i>GENPRU 2.2.29R</i> to <i>GENPRU 2.2.41R</i>
Calculation of <i>capital resources</i> for <i>banks</i>	<i>GENPRU 2 Annex 2R</i>
Calculation of <i>capital resources</i> for <i>building societies</i>	<i>GENPRU 2 Annex 3R</i>
Limits on the use of different forms of capital for <i>banks</i> and <i>building societies</i> (certain types of <i>capital resources</i> cannot be used for certain purposes)	<i>GENPRU 2.2.42R</i> to <i>GENPRU 2.2.45R</i> ; <i>GENPRU 2.2.47R</i> to <i>GENPRU 2.2.48R</i>
Limits on the use of different forms of capital for <i>banks</i> and <i>building societies</i> (<i>capital resources gearing rules</i>)	<i>GENPRU 2.2.29R</i> to <i>GENPRU 2.2.31G</i> ; <i>GENPRU 2.2.46R</i> ; <i>GENPRU 2.2.49R</i>
Calculation of <i>capital resources</i> for <i>BIPRU investment firms</i>	<i>GENPRU 2.2.20G</i> to <i>GENPRU 2.2.21G</i> ; <i>GENPRU 2 Annex 4R</i> to <i>GENPRU 2 Annex 6R</i>

Topic	Location of text
Limits on the use of different forms of capital for <i>BIPRU investment firms</i> (certain types of <i>capital resources</i> cannot be used for certain purposes)	<i>GENPRU 2.2.42R to GENPRU 2.2.45R; GENPRU 2.2.47R to GENPRU 2.2.48R</i>
Limits on the use of different forms of capital for <i>BIPRU investment firms</i> (<i>capital resources gearing rules</i>)	<i>GENPRU 2.2.29R to GENPRU 2.2.31G; GENPRU 2.2.46R; GENPRU 2.2.50R</i>
Example of how the <i>capital resources</i> calculation for <i>BIPRU firms</i> works	<i>GENPRU 2.2.51G to GENPRU 2.2.59G</i>
Capital used to meet the <i>base capital resources requirement</i> for <i>BIPRU firms</i>	<i>GENPRU 2.2.60R to GENPRU 2.2.61G</i>
<i>Tier one capital instruments: general</i>	<i>GENPRU 2.2.9G to 2.2.10G; GENPRU 2.2.62R to 2.2.69G; GENPRU 2.2.80R to GENPRU 2.2.82G</i>
<i>Core tier one capital: permanent share capital</i>	<i>GENPRU 2.2.83R to GENPRU 2.2.84G</i>
<i>Core tier one capital: profit and loss account and other reserves: material applicable to all firms</i>	<i>GENPRU 2.2.85R; GENPRU 2.2.87R to GENPRU 2.2.89G; GENPRU 2.2.91G</i>
<i>Core tier one capital: profit and loss account and other reserves: material specific to BIPRU firms</i>	<i>GENPRU 2.2.86R; GENPRU 2.2.90R; GENPRU 2.2.92G</i>
<i>Core tier one capital: provisions relating to partnerships and limited liability partnerships</i>	<i>GENPRU 2.2.93R to GENPRU 2.2.100R</i>
<i>Core tier one capital: share premium account</i>	<i>GENPRU 2.2.101R</i>
<i>Core tier one capital: externally verified interim net profits</i>	<i>GENPRU 2.2.102R to GENPRU 2.2.103G</i>
<i>Core tier one capital: valuation differences and fund for future appropriations for insurers</i>	<i>GENPRU 2.2.104R to GENPRU 2.2.108R</i>
<i>Tier one capital: perpetual non-cumulative preference shares</i>	<i>GENPRU 2.2.109R to GENPRU 2.2.110G</i>

Topic	Location of text
<i>Tier one capital: PIBS</i>	<i>GENPRU 2.2.76R; GENPRU 2.2.111R to GENPRU 2.2.112G</i>
<i>Innovative tier one capital (excluding issues through SPVs)</i>	<i>GENPRU 2.2.76R; GENPRU 2.2.113R to GENPRU 2.2.122G</i>
<i>Innovative tier one capital (issues through SPVs)</i>	<i>GENPRU 2.2.123R to GENPRU 2.2.137R</i>
<i>Tier one capital: conversion ratio</i>	<i>GENPRU 2.2.138R to GENPRU 2.2.144G</i>
<i>Tier one capital: requirement to have sufficient unissued stock</i>	<i>GENPRU 2.2.145R</i>
<i>Deductions from tier one capital resources</i>	<i>GENPRU 2.2.155R to GENPRU 2.2.156G</i>
<i>Tier two capital</i>	<i>GENPRU 2.2.11G; GENPRU 2.2.157G to GENPRU 2.2.197G</i>
<i>Deductions from tier one capital resources and tier two capital resources</i>	<i>GENPRU 2.2.202R to GENPRU 2.2.240G</i>
<i>Tier three capital</i>	<i>GENPRU 2.2.12G; GENPRU 2.2.241R to GENPRU 2.2.249R</i>
<i>Deductions from total capital resources</i>	<i>GENPRU 2.2.14G to GENPRU 2.2.16G; GENPRU 2.2.250R to GENPRU 2.2.265R</i>
<i>The effect of swaps</i>	<i>GENPRU 2.2.198R to GENPRU 2.2.201R</i>
<i>Step-ups (tier one capital and tier two capital)</i>	<i>GENPRU 2.2.76R; GENPRU 2.2.146R to GENPRU 2.2.154G</i>
<i>Redemption of tier one instruments</i>	<i>GENPRU 2.2.64(3); GENPRU 2.2.70R to GENPRU 2.2.79G;</i>
<i>Redemption of tier two instruments</i>	<i>GENPRU 2.2.172R to GENPRU 2.2.174R; GENPRU 2.2.177R to GENPRU 2.2.178R (upper tier two instruments); GENPRU 2.2.194R to GENPRU 2.2.197G (lower tier two instruments)</i>
<i>Non-standard capital instruments</i>	<i>GENPRU 2.2.13G</i>

Topic	Location of text
Standard form documentation for subordinated debt	<i>GENPRU 2.2.164G</i>
Public sector guarantees	<i>GENPRU 2.2.276G</i>
Other capital resources for insurers: unpaid <i>share</i> capital or <i>unpaid initial funds</i> and calls for supplementary contributions	<i>GENPRU 2.2.266R to GENPRU 2.2.269G</i>
Additional requirements for <i>insurers</i> carrying on <i>with-profits insurance business</i>	<i>GENPRU 2.2.270R to GENPRU 2.2.275G</i>

Simple capital issuers

- 2.2.7 G Parts of this section are irrelevant to a *BIPRU firm* whose *capital resources* consist of straightforward *capital instruments*. Therefore the *FSA's* Personal handbooks facility available on its website allows a *BIPRU firm* to screen out those parts of this section that are not relevant to a *simple capital issuer*. A *simple capital issuer* is a *BIPRU firm* that meets the following conditions:
- (1) it does not raise capital through a special purpose vehicle;
 - (2) it only includes *capital instruments* in its *tier one capital resources* consisting of ordinary *shares*, *PIBS* (relevant to *building societies* only), perpetual non-cumulative preference *shares* or partnership or *limited liability partnership* capital accounts (relevant to partnerships or *limited liability partnership* only);
 - (3) it only includes non-redeemable and non-convertible *capital instruments* in its *tier one capital resources*; and
 - (4) (if it includes *capital instruments* in its *tier one capital resources* on which *coupons* are payable) such *coupons* are non-cumulative, non-mandatory, in cash and not subject to a *step-up*.

Principles underlying the definition of capital resources

- 2.2.8 G The *FSA* has divided its definition of capital into categories, or tiers, reflecting differences in the extent to which the *capital instruments* concerned meet the purpose and conform to the characteristics of capital listed in *GENPRU 2.2.9G*. The *FSA* generally prefers a *firm* to hold higher quality capital that meets the characteristics of permanency and loss absorbency that are features of *tier one capital*. *Capital instruments* falling into *core tier one capital* can be included in a *firm's* regulatory capital without limit. Typically, other forms of capital are either subject to limits (see the *capital resources gearing rules*) or, in the case of some specialist types of capital, may only be included with the express consent of the *FSA* (which takes the form of a *waiver* under section 148 of the *Act*). Details of the individual components of capital are set out in the *capital resources table*.

Tier one capital

- 2.2.9 G *Tier one capital* typically has the following characteristics:
- (1) it is able to absorb losses;
 - (2) it is permanent;
 - (3) it ranks for repayment upon winding up, administration or similar procedure after all other debts and liabilities; and
 - (4) it has no fixed costs, that is, there is no inescapable obligation to pay dividends or interest.
- 2.2.10 G The forms of capital that qualify for *tier one capital* are set out in the *capital resources table* and include, for example, *share capital*, reserves, partnership and *sole trader capital*, verified interim net profits and, for a *mutual*, the *initial fund* plus permanent members' accounts. *Tier one capital* is divided into *core tier one capital*, perpetual non-cumulative *preference shares*, *permanent interest-bearing shares (PIBS)* and *innovative tier one capital*.

Upper and lower tier two capital

- 2.2.11 G *Tier two capital* includes forms of capital that do not meet the requirements for permanency and absence of fixed servicing costs that apply to *tier one capital*. *Tier two capital* includes, for example:
- (1) capital which is perpetual (that is, has no fixed term) but cumulative (that is, servicing costs cannot be waived at the issuer's option, although they may be deferred – for example, cumulative *preference shares*); only perpetual *capital instruments* may be included in *upper tier two capital*;
 - (2) capital which is not perpetual (that is, it has a fixed term) or which may have fixed servicing costs that cannot generally be either waived or deferred (for example, most subordinated debt); such capital should normally be of a medium to long-term maturity (that is, an original maturity of at least five years); dated *capital instruments* are included in *lower tier two capital*;

- (3) (for *BIPRU firms*) certain revaluation reserves such as reserves arising from the revaluation of land and buildings, including any net unrealised gains for the fair valuation of equities held in the available-for-sale financial assets category; and
- (4) (for *BIPRU firms*) general/collective provisions.

Tier three capital

- 2.2.12 G *Tier three capital* consists of forms of capital conforming least well to the characteristics of capital listed in *GENPRU 2.2.9G*: either subordinated debt of short maturity (*upper tier three capital*) or net *trading book* profits that have not been externally verified (*lower tier three capital*).

Non-standard capital instruments

- 2.2.13 G There may be examples of *capital instruments* that, although based on a standard form, contain structural features that make the *rules* in this section difficult to apply. In such circumstances, a *firm* may seek individual *guidance* on the application of those *rules* to the *capital instrument* in question. See *SUP 9* (Individual guidance) for the process to be followed when seeking individual *guidance*.

Deductions from capital

- 2.2.14 G Deductions should be made at the relevant stage of the calculation of *capital resources* to reflect capital that may not be available to the *firm* or assets of uncertain value (for example, holdings of intangible assets and assets that are inadmissible for an *insurer*, or, in the case of a *bank* or *building society*, where that *firm* has made investments in a *subsidiary undertaking* or in another *financial institution* or in respect of *participations* that it holds).
- 2.2.15 G Deductions should also be made, in the case of certain *BIPRU investment firms* for *illiquid assets* (see *GENPRU 2.2.19R*).
- 2.2.16 G A full list of deductions from *capital resources* is shown in the *capital resources table* applicable to the *firm*.

Which method of calculating capital resources applies to which type of firm

- 2.2.17 R A *firm* must calculate its *capital resources* in accordance with the version of the *capital resources table* applicable to the *firm*, subject to the *capital resources gearing rules*. The version of the *capital resources table* that applies to a *firm* is specified in the table in *GENPRU 2.2.19R*.
- 2.2.18 R In the case of a *BIPRU firm* the *capital resources table* also sets out how the *capital resources requirement* is deducted from *capital resources* in order to decide whether its *capital resources* equal or exceed its *capital resources requirement*.

2.2.19 R Table: Applicable capital resources calculation
This table belongs to *GENPRU 2.2.17R*

Type of <i>firm</i>	Location of <i>rules</i>	Remarks
<i>Insurer</i>	<i>GENPRU 2 Annex 1R</i>	
<i>Bank</i>	<i>GENPRU 2 Annex 2R</i>	
<i>Building society</i>	<i>GENPRU 2 Annex 3R</i>	
<i>BIPRU investment firm without an investment firm consolidation waiver</i>	<i>GENPRU 2 Annex 4R (Deducts material holdings)</i>	Applies to a <i>BIPRU investment firm</i> not using <i>GENPRU 2 Annex 5R</i> or <i>GENPRU 2 Annex 6R</i>
<i>BIPRU investment firm without an investment firm consolidation waiver</i>	<i>GENPRU 2 Annex 5R (Deducts illiquid assets)</i>	A <i>BIPRU investment firm</i> must give one <i>Month's</i> prior notice to the <i>FSA</i> before starting to use or stopping using this method
<i>BIPRU investment firm with an investment firm consolidation waiver</i>	<i>GENPRU 2 Annex 6R (Deducts illiquid assets and material holdings)</i>	A <i>firm</i> with an <i>investment firm consolidation waiver</i> must use this method. No other <i>BIPRU investment firm</i> may use it.

Calculation of capital resources: Which rules apply to BIPRU investment firms

2.2.20 G *GENPRU 2.2.19R* sets out three different methods of calculating *capital resources* for *BIPRU investment firms*. The differences between the three methods relate to whether and how *material holdings* and *illiquid assets* are deducted when calculating *capital resources*. The method depends on whether a *firm* has an *investment firm consolidation waiver*. If a *firm* does have such a *waiver*, it should deduct *illiquid assets*, own *group material holdings* and certain contingent liabilities. If a *firm* does not have such a *waiver*, it should choose to deduct either *material holdings* or, subject to notifying the *FSA*, *illiquid assets*.

2.2.21 G A consequence of a *firm* deducting all of its *illiquid assets* under *GENPRU 2 Annex 5R* is that it is allowed a higher limit on short term subordinated debt under *GENPRU 2.2.49R*.

Calculation of capital resources: Insurers

2.2.22 G *Capital resources* for an *insurer* can be calculated either as the total of eligible assets less foreseeable liabilities (which is the approach taken in the *Insurance Directives*) or by identifying the components of capital. Both calculations give the same result for the total amount of *capital resources*. The approach taken in this section has been to specify the components of capital and the relevant deductions. This is set out in the *capital resources table*. This approach is the same as that used for the calculation of *capital resources* for *banks, building societies* and *BIPRU investment firms*. A simple example, showing the reconciliation of the two methods, is given in the table in *GENPRU 2.2.23G*.

2.2.23 G Table: Approaches to calculating capital resources
This table belongs to *GENPRU 2.2.22G*

Liabilities		Assets	
Borrowings	100	Admissible assets	350
Ordinary <i>shares</i>	200	Intangible assets	100
Profit and loss account and other reserves	100	Other inadmissible assets	100
Perpetual subordinated debt	150		
Total	<u>550</u>	Total	<u>550</u>
Calculation of <i>capital resources</i> : eligible assets less foreseeable liabilities			
Total assets		550	
less intangible assets		(100)	
less inadmissible assets		(100)	
less liabilities (borrowings)		(100)	
<i>Capital resources</i>		<u>250</u>	
Calculation of <i>capital resources</i> : components of capital			
Ordinary <i>shares</i>		200	
Profit and loss account and other reserves		100	
Perpetual subordinated debt		150	

less intangible assets	(100)
less inadmissible assets	(100)
<i>Capital resources</i>	<u>250</u>

Limits on the use of different forms of capital: General

- 2.2.24 G As the various components of capital differ in the degree of protection that they offer the *firm* and its *customers* and *consumers*, restrictions are placed on the extent to which certain types of capital are eligible for inclusion in a *firm's capital resources*. These *rules* are called the *capital resources gearing rules*.

Limits on the use of different forms of capital: Use of higher tier capital in lower tiers

- 2.2.25 R A *firm* may include in a *lower stage of capital*, *capital resources* which are eligible for inclusion in a *higher stage of capital* if the *capital resources gearing rules* would prevent the use of that capital in that *higher stage of capital*. However:
- (1) the *capital resources gearing rules* applicable to that *lower stage of capital* apply to *higher stage of capital* included in that *lower stage of capital*; and
 - (2) (subject to *GENPRU 2.2.26R*) the *rules* in *GENPRU* governing the eligibility of capital in that *lower stage of capital* continue to apply.
- 2.2.26 R An item of *tier one capital* which is included in a *firm's tier two capital resources* under *GENPRU 2.2.25R* is not subject to the requirement to obtain a legal opinion in *GENPRU 2.2.159R(12)*.
- 2.2.27 R A *BIPRU firm* may include in a *lower stage of capital*, *innovative tier one capital* that it is prohibited from using under *GENPRU 2.2.42R* (*BIPRU firms* may not use *innovative tier one capital* to meet the *CRR*). However:
- (1) the *capital resources gearing rules* applicable to that *lower stage of capital* apply to that *innovative tier one capital*; and
 - (2) (subject to *GENPRU 2.2.28R*) the *rules* in *GENPRU* governing the eligibility of capital in that *lower stage of capital* continue to apply.
- 2.2.28 R The requirement to obtain a legal opinion in *GENPRU 2.2.159R(12)* does not apply to *innovative tier one capital* treated under *GENPRU 2.2.27R* but the requirements to obtain a legal opinion in *GENPRU 2.2.118R* continue to apply.

Limits on the use of different forms of capital: Limits relating to tier one capital applicable to all firms except BIPRU investment firms

- 2.2.29 R In relation to the *tier one capital resources* of an *insurer, bank or building society*, calculated at stage F of the calculation in the *capital resources table* (Total tier one capital after deductions), at least 50% must be accounted for by *core tier one capital*.

Limits on the use of different forms of capital: Limits relating to tier one capital applicable to all firms

- 2.2.30 R In relation to the *capital resources* of an *insurer*, and subject to *GENPRU 2.2.42R* (Restriction on the use of *innovative tier one capital*), those of a *BIPRU firm*, calculated at stage F of the calculation in the *capital resources table* (Total tier one capital after deductions), no more than 15% may be accounted for by *innovative tier one capital*.

Limits on the use of different forms of capital: Limits relating to tier one capital: Purpose of the requirements

- 2.2.31 G The purpose of the requirement in *GENPRU 2.2.29R* is to ensure that at least 50% of the *firm's tier one capital resources* (net of *tier one capital* deductions) is met by *core tier one capital* which provides maximum loss absorbency on a going concern basis to protect the *firm* from insolvency. Although a perpetual non-cumulative *preference share* or a *PIBS* is in legal form a *share*, it behaves in many ways like a perpetual fixed interest debt instrument. Within the 50% limit on non-*core tier one capital*, *GENPRU 2.2.30R* places a further sub-limit on the amount of *innovative tier one capital* that a *firm* may include in its *tier one capital resources*. This limit is necessary to ensure that most of a *firm's tier one capital* comprises items of capital of the highest quality.

Limits on the use of different forms of capital: Insurers

- 2.2.32 R At least 50% of an *insurer's MCR* must be accounted for by the sum of:
- (1) the amount calculated at stage A of the calculation in the *capital resources table* (Core tier one capital); and
 - (2) notwithstanding *GENPRU 2.2.29R*, the amount calculated at stage B of the calculation in the *capital resources table* (Perpetual non-cumulative preference shares);

less the amount calculated at stage E of the calculation in the *capital resources table* (Deductions from tier one capital).

- 2.2.33 R An *insurer* carrying on *long-term insurance business* must meet the higher of:
- (1) $\frac{1}{3}$ of the *long-term insurance capital requirement*; and
 - (2) the *base capital resources requirement*;

with the sum of the items listed at stages A (Core tier one capital), B (Perpetual non-cumulative preference shares), G (Upper tier two capital) and H (Lower tier two capital) in the *capital resources table* less the sum of the items listed at stage E in the *capital resources table* (Deductions from tier one capital).

2.2.34 R An *insurer* carrying on *general insurance business* must meet the higher of:

- (1) 1/3 of the *general insurance capital requirement*; and
- (2) the *base capital resources requirement*;

with the sum of the items listed at stages A (Core tier one capital), B (Perpetual non-cumulative preference shares), G (Upper tier two capital) and H (Lower tier two capital) in the *capital resources table* less the sum of the items listed at stage E (Deductions from tier one capital) in the *capital resources table*.

2.2.35 R In *GENPRU 2.2.33R* and *GENPRU 2.2.34R*:

- (1) items listed at stage B (Perpetual non-cumulative preference shares) in the *capital resources table* may be included notwithstanding *GENPRU 2.2.29R*;
- (2) *innovative tier one capital* that meets the conditions (other than *GENPRU 2.2.159R(12)* (Requirement for a legal opinion)) for it to be included as *upper tier two capital* at stage G (Upper tier two capital) in the *capital resources table* may be treated as an item listed at stage G; and
- (3) an *insurer* must exclude from the calculation the higher of the following:
 - (a) the amount (if any) by which the sum of the items listed at stages G (Upper tier two capital) and H (Lower tier two capital) in the *capital resources table* exceeds the total (net of deductions) of the remaining constituents of adjusted stage M; and
 - (b) the amount (if any) by which the sum of the items listed at stage H in the *capital resources table* exceeds one-third of the total (net of deductions) of the remaining constituents of adjusted stage M;

where adjusted stage M means the amount calculated at stage M of the calculation in the *capital resources table* (Total capital after deductions) less the amount of any *innovative tier one capital* that is not treated as *upper tier two capital* for the purpose of *GENPRU 2.2.33R* or *GENPRU 2.2.34R*, as the case may be.

2.2.36 G The purposes of the requirements in *GENPRU 2.2.32R* to *GENPRU 2.2.34R* are to comply with the *Insurance Directives*' requirement that *insurers* maintain a *guarantee fund* of higher quality *capital resources* items and to ensure that at least 50% of the *insurer's capital resources* needed to meet its *MCR* provide maximum loss absorbency to protect the *insurer* from insolvency.

2.2.37 R Subject to *GENPRU 2.2.38R*, an *insurer* must exclude from the calculation of its *capital resources* the following:

- (1) the amount (if any) by which *tier two capital resources* exceed the amount calculated at stage F (Total tier one capital after deductions) of the calculation in the *capital resources table*; and
- (2) the amount (if any) by which *lower tier two capital resources* exceed 50% of the amount calculated at stage F of the calculation in the *capital resources table*.

2.2.38 R At least 75% of an *insurer's MCR* must be accounted for by the sum of:

- (1) the amount calculated at stage A (Core tier one capital) plus, notwithstanding *GENPRU 2.2.29R*, the amount calculated at stage B (Perpetual non-cumulative preference shares) less the amount calculated at stage E (Deductions from tier one capital) of the calculation in the *capital resources table*; and
- (2) the amount calculated at stage G (Upper tier two capital) of the calculation in the *capital resources table*.

2.2.39 G In *GENPRU 2.2.38R* the amount of any *innovative tier one capital* that meets the conditions for it to be included as *upper tier two capital* at stage G (Upper tier two capital) in the *capital resources table* may be included in the amount calculated at stage G.

2.2.40 G *GENPRU 2.2.37R* and *GENPRU 2.2.38R* give effect to the *Insurance Directives'* requirements that an *insurer's tier two capital resources* must not exceed its *tier one capital resources* and that no more than 25% of an *insurer's "required solvency margin"* should consist of *lower tier two capital resources*.

2.2.41 R An *insurer* that carries on both *long-term insurance business* and *general insurance business* must apply the relevant limits in *GENPRU 2.2.32R* to *GENPRU 2.2.38R* separately for each type of business.

Limits on the use of innovative tier one capital: BIPRU firm

2.2.42 R For the purpose of meeting the *main BIPRU firm Pillar 1 rules*, a *BIPRU firm* may not include *innovative tier one capital* in its *tier one capital resources*.

2.2.43 G A *BIPRU firm* may include *innovative tier one capital* in its *tier one capital resources* for the purpose of *GENPRU 1.2* (Adequacy of financial resources) and *BIPRU 10* (Concentration risk). A *firm* may also include it in its *upper tier two capital resources* under *GENPRU 2.2.25R* (Limits on the use of different forms of capital: Use of higher tier capital in lower tiers) for all purposes as long as it meets the conditions for treatment as *upper tier two capital*.

Limits on the use of different kinds of capital: Purposes for which tier three capital may not be used (BIPRU firm only)

2.2.44 R *Tier one capital* and *tier two capital* are the only type of *capital resources* that a *BIPRU firm* may use for the purpose of meeting:

- (1) the *credit risk capital component*;
- (2) the *operational risk capital requirement*;
- (3) the *counterparty risk capital component*; and
- (4) the *base capital resources requirement*.

2.2.45 R *GENPRU 2.2.44R* (and the *capital resources gearing rules* that relate to it) also applies for the purposes of any other requirement in the *Handbook* for which it is necessary to calculate the *capital resources* of a *BIPRU firm*, except for the purposes described in *GENPRU 2.2.47R* and except as may otherwise be stated in the relevant part of the *Handbook*.

Limits on the use of different kinds of capital: Tier two limits (BIPRU firm only)

2.2.46 R For the purpose of *GENPRU 2.2.44R*:

- (1) the amount of the items which may be included in a *BIPRU firm's tier two capital resources* must not exceed the amount calculated at stage F of the calculation in the *capital resources table* (Total tier one capital after deductions); and
- (2) the amount of the items which may be included in a *BIPRU firm's lower tier two capital resources* must not exceed 50% of the amount calculated at stage F of the calculation in the *capital resources table*.

Limits on the use of different kinds of capital: Purposes for which tier three capital may be used (BIPRU firm only)

2.2.47 R For the purposes of meeting:

- (1) the *market risk capital requirement*;
- (2) the *concentration risk capital component*; and
- (3) the *fixed overheads requirement* (where applicable);

a *BIPRU firm* may only use the following parts of its *capital resources*:

- (4) *tier one capital* to the extent that it is not required to meet the requirements in *GENPRU 2.2.44R* (*GENPRU 2.2.48R* explains how to calculate how much *tier one capital* is required to meet the requirements in *GENPRU 2.2.44R*);
- (5) *tier two capital* to the extent that it:
 - (a) comes within the limits in *GENPRU 2.2.46R* (100% limit for *tier two capital resources* and 50% limit for *lower tier two capital resources*); and
 - (b) it is not required to meet the requirements in *GENPRU 2.2.44R*;

(*GENPRU 2.2.48R* explains how to calculate how much *tier two capital* is required to meet the requirements in *GENPRU 2.2.44R*);

(6) *tier two capital* that cannot be used for the purposes in *GENPRU 2.2.44R* because it falls outside the limits in *GENPRU 2.2.46R*; and

(7) *tier three capital*.

2.2.48 R The amount of *tier one capital* and *tier two capital* that is not used to meet the requirements in *GENPRU 2.2.44R* as referred to in *GENPRU 2.2.47R*(4) and (5) is equal to the amount calculated at stage N of the calculation in the *capital resources table* (Total tier one capital plus tier two capital after deductions) less the parts of the *capital resources requirement* deducted immediately after stage N of the *capital resources table* (the parts of the *capital resources requirements* listed in *GENPRU 2.2.44R*).

Limits on the use of different kinds of capital: Combined tier two and tier three limits (BIPRU firm only)

2.2.49 R For the purpose of meeting the requirements in *GENPRU 2.2.47R*(1) to (3) and subject to *GENPRU 2.2.50R*, a *BIPRU firm* must not include any item in either:

(1) its *tier two capital resources* falling within *GENPRU 2.2.47R*(6) (excess *tier two capital*) ; or

(2) its *upper tier three capital resources*;

to the extent that the sum of (1) and (2) would exceed 250% of the amount resulting from the following calculation:

(3) calculate the amount at stage F of the calculation in the *capital resources table* (Total tier one capital after deductions); and

(4) deduct from (3) those parts of the *firm's tier one capital* used to meet the requirements in *GENPRU 2.2.44R* as established by *GENPRU 2.2.48R*.

2.2.50 R In relation to a *BIPRU investment firm* which calculates its *capital resources* under *GENPRU 2 Annex 4R* (Capital resources table for a BIPRU investment firm deducting material holdings), the figure of 200% replaces that of 250% in *GENPRU 2.2.49R*.

Example of how the capital resources calculation for BIPRU firms works

2.2.51 G *GENPRU 2.2.52G* to *GENPRU 2.2.59G* illustrate how to calculate a *BIPRU firm's capital resources* and how the *capital resources gearing rules* work. In this example the *BIPRU firm* has a credit risk requirement of £100 and a market risk requirement of £90, making a total capital requirement of £190. Its *capital resources* are as set out in the table in *GENPRU 2.2.52G*.

- 2.2.52 G Table: Example of the calculation of the capital resources of a BIPRU firm
This table belongs to *GENPRU 2.2.51G*

Description of the stage of the capital resources calculation	Stage in the <i>capital resources table</i>	Amount (£)
Total <i>tier one capital</i> after deductions (excluding <i>innovative tier one instruments</i> – see <i>GENPRU 2.2.53G</i>)	Stage F	80
Total <i>tier two capital</i> (including <i>innovative tier one instruments</i> – see <i>GENPRU 2.2.53G</i>)	Stage K	80
Deductions	Stage M	(20)
Total <i>tier one capital</i> and <i>tier two capital</i> after deductions	Stage N	140
<i>Upper tier three capital</i> (this example assumes the <i>firm</i> has no <i>lower tier three capital</i> (<i>trading book profits</i>))	Stage Q	50
Total <i>capital resources</i>	Stage T	190

- 2.2.53 G *GENPRU 2.2.42R* (Limits on the use of innovative tier one capital) prohibits the inclusion of *innovative tier one instruments* in the *tier one capital* of a *BIPRU firm* for the purpose of meeting the *capital resources requirement*. Thus they are not included in the calculation of stage F of the *capital resources table*. Instead all *innovative tier one instruments* have been included in *tier two capital* in accordance with *GENPRU 2.2.25R* (Use of higher tiers of capital in lower tiers).
- 2.2.54 G In the example in the table in *GENPRU 2.2.52G* the *firm* has total *tier one capital* after deductions of £80. Its *tier two capital* of £80 is therefore the maximum permitted under *GENPRU 2.2.46R* (Tier two limits), that is 100% of *tier one capital*.
- 2.2.55 G The *credit risk capital requirement* is deducted after stage N of the *capital resources table* and the market risk requirement following stage T of the *capital resources table*. These calculations are shown in the table in *GENPRU 2.2.56G*.
- 2.2.56 G Table: Example of how capital resources of a BIPRU firm are measured against its capital resources requirement
This table belongs to *GENPRU 2.2.55G*

Description of the stage of the capital resources calculation	Stage in the <i>capital resources table</i>	Amount (£)
Total <i>tier one capital</i> and <i>tier two capital</i> after deductions	Stage N	140
Credit risk requirement		(100)
<i>Tier one capital</i> and <i>tier two capital</i> available to meet market risk requirement		40
<i>Tier three capital</i>	Stage Q	50
Total capital available to meet market risk requirement		90
Market risk requirement		(90)
Market risk requirement met subject to meeting gearing limit set out in <i>GENPRU 2.2.49R</i> – see <i>GENPRU 2.2.57G</i>		

- 2.2.57 G The gearing limit in *GENPRU 2.2.49* (Combined tier two and tier three limits) requires that the *upper tier three capital* used to meet the market risk requirement does not exceed 250% of the *tier one capital* used to meet market risk.
- 2.2.58 G In this example it is assumed that the maximum possible amount of *tier one capital* is carried forward to meet the market risk requirement. There are other options as to the allocation of *tier one capital* and *tier two capital* to the credit risk requirement. Therefore in this example the various tiers of *capital resources* are applied to meet the market risk requirement as follows:
- (1) the *tier one capital* used to meet market risk is £40;
 - (2) 250% of *tier one capital* used to meet market risk is £100; and
 - (3) the *upper tier three capital* used to meet market risk is £50.
- 2.2.59 G The 250% gearing limit is met as the limit of £100 is greater than the *upper tier three capital* of £50 used in this example.
- Capital used to meet the base capital resources requirement (BIPRU firm only)
- 2.2.60 R A *BIPRU firm* may use the *capital resources* used to meet the *base capital resources requirement* to meet any other part of the *capital resources requirement*.

- 2.2.61 G The explanation for *GENPRU 2.2.60R* can be found in *GENPRU 2.1.43G* (Base capital resources requirement). In brief the reason is that the *base capital resources requirement* is not in practice meant to act as an additional capital resources requirement. It is meant to act as a floor to the *capital resources requirement*.

Tier one capital: General

- 2.2.62 R A *firm* may not include a *capital instrument* in its *tier one capital resources* unless it complies with the following conditions:

- (1) it is included in one of the categories in *GENPRU 2.2.63R*;
- (2) it complies with the conditions set out in *GENPRU 2.2.64R*;
- (3) it is not excluded under *GENPRU 2.2.65R* (Connected transactions); and
- (4) it is not excluded by any of the *rules* in *GENPRU 2.2*.

- 2.2.63 R The categories referred to in *GENPRU 2.2.62R(1)* are:

- (1) *permanent share capital*;
- (2) *eligible partnership capital*;
- (3) *eligible LLP members' capital*;
- (4) *sole trader capital*;
- (5) a perpetual non-cumulative *preference share*;
- (6) (in the case of a *building society*) *PIBS*; and
- (7) an *innovative tier one instrument*.

General conditions for eligibility as tier one capital

- 2.2.64 R The conditions that an item of capital of a *firm* must comply with under *GENPRU 2.2.62R(3)* are as follows:

- (1) it is issued by the *firm*;
- (2) it is fully paid and the proceeds of issue are immediately and fully available to the *firm*;
- (3) it:
 - (a) cannot be redeemed at all or can only be redeemed on a winding up of the *firm*; or

- (b) complies with the conditions in *GENPRU 2.2.70R* (Basic requirements for redeemability) and *GENPRU 2.2.76R* (Redeemable instrument subject to a *step-up*) ;
- (4) the item of capital meets the following conditions in relation to any *coupon*:
 - (a) the *firm* is under no obligation to pay a *coupon*; or
 - (b) (if the *firm* is obliged to pay the *coupon*) the *coupon* is payable in the form of an item of capital that is included in a *higher stage of capital* or the *same stage of capital* as that first item of capital;
- (5) any *coupon* is either:
 - (a) non-cumulative; or
 - (b) (if it is cumulative) it must, if deferred, be paid by the *firm* in the form of *tier one capital* complying with (4)(b);
- (6) it is able to absorb losses to allow the *firm* to continue trading and in particular it complies with *GENPRU 2.2.80R* to *2.2.81R* (Loss absorption) and, in the case of an *innovative tier one instrument*, *GENPRU 2.2.116R* to *2.2.118R* (*Innovative tier one instrument* should not constitute a liability);
- (7) the amount of the item included must be net of any foreseeable tax charge at the moment of its calculation or must be suitably adjusted in so far as such tax charges reduce the amount up to which that item may be applied to cover risks or losses;
- (8) it is available to the *firm* for unrestricted and immediate use to cover risks and losses as soon as these occur;
- (9) it ranks for repayment upon winding up, administration or any other similar process no higher than a *share* of a company incorporated under the Companies Act 1985 or the Companies (Northern Ireland) Order 1986 (whether or not it is such a *share*); and
- (10) the description of its characteristics used in its marketing is consistent with the characteristics required to satisfy (1) to (9) and, where it applies, *GENPRU 2.2.271R* (Other requirements: insurers carrying on with-profits business (Insurer only)).

2.2.65 R An item of capital does not qualify for inclusion as *tier one capital* if the issue of that item of capital by the *firm* is connected with one or more other transactions which, when taken together with the issue of that item, could result in that item of capital no longer displaying all of the characteristics set out in *GENPRU 2.2.64R*(1) to (9).

Guidance on certain of the general conditions for eligibility as tier one capital

- 2.2.66 G *GENPRU* 2.2.65R is an example of the general principle in *GEN* 2.2.1 (Purposive interpretation). Its purpose is to emphasise that an item of capital does not meet the conditions for inclusion in *tier one capital* if in isolation it does meet those requirements but it fails to meet those requirements when other transactions are taken into account. Examples of such connected transactions might include guarantees or any other side agreement provided to the holders of the *capital instrument* by the *firm* or a connected party or a related transaction designed, for example, to enhance their security or to achieve a tax benefit, but which may compromise the loss absorption capacity or permanence of the original capital item.
- 2.2.67 G *GENPRU* 2.2.64R(2) is stricter than the Companies Act definition of fully paid, which only requires an undertaking to pay.
- 2.2.68 G The *FSA* considers that dividend pushers diminish the quality of capital by breaching the principle of complete discretion over *coupons* set out in *GENPRU* 2.2.64R(4). A dividend pusher operates so that, in a given period of time, payments must be made on senior securities if payments have previously been made on junior securities or securities ranking *pari passu*. As such, dividend pushers may not be included in the terms of *tier one capital*, unless the *firm* has the option to fund the “pushed payment” in stock.
- 2.2.69 G An item of capital does not comply with *GENPRU* 2.2.64R(10) if it is marketed as a *capital instrument* that would only qualify for a lower level of capital or on the basis that investing in it is like investing in an instrument in a lower tier of capital. For example, an undated *capital instrument* should not be marketed as a dated *capital instrument* if the terms of the *capital instrument* include an option by the issuer to redeem the *capital instrument* at a specified date in the future.

Redemption of tier one instruments

- 2.2.70 R A *firm* may not include a *capital instrument* in its *tier one capital resources*, unless its contractual terms are such that:
- (1) (if it is redeemable other than in circumstances set out in *GENPRU* 2.2.64R(3)(a) (redemption on a winding up)) it is redeemable only at the option of the *firm*; and
 - (2) the *firm* cannot exercise that redemption right:
 - (a) before the fifth anniversary of its date of issue;
 - (b) unless it has given notice to the *FSA* in accordance with *GENPRU* 2.2.74R; and
 - (c) unless at the time of exercise of that right it complies with the *main BIPRU firm Pillar 1 rules* and will continue to do so after redemption.
- 2.2.71 R A *firm* may include a term in a *tier one instrument* allowing the *firm* to redeem it before the date in *GENPRU* 2.2.70R(2)(a) if the following conditions are satisfied:

- (1) the other conditions in *GENPRU 2.2.70R* are met;
- (2) the circumstance that entitles the *firm* to exercise that right is a change in law or regulation in any relevant jurisdiction or in the interpretation of such law or regulation by any court or authority entitled to do so;
- (3) it would be reasonable for the *firm* to conclude that it is unlikely that that circumstance will occur, judged at the time of issue or, if later, at the time that the term is first included in the terms of the *tier one instrument*; and
- (4) the *firm's* right is conditional on it obtaining the *FSA's* consent in the form of a *waiver* of *GENPRU 2.2.72R*.

2.2.72 R A *firm* must not redeem a *tier one instrument* in accordance with a term included under *GENPRU 2.2.71R*.

2.2.73 G The purpose of *GENPRU 2.2.71R* to *GENPRU 2.2.72R* is this. In general a *tier one instrument* should not be redeemable by the *firm* before its fifth anniversary. However there may be circumstances in which it would be reasonable for the *firm* to redeem it before then. *GENPRU 2.2.71R* allows the *firm* to include a right to redeem the instrument before the fifth anniversary in certain circumstances. A tax call is an example of a term that may be allowed. *GENPRU 2.2.71R* says that the terms of the *tier one instrument* should provide that the *firm* should not be able to exercise that right without the *FSA's* consent. Any such consent will be given in the form of a *waiver* allowing early repayment. Thus although a *firm* may include a right to redeem early in the terms of a *tier one instrument* without the need to apply for a *waiver* the actual exercise of that right will require a *waiver*.

2.2.74 R A *firm* must not redeem any *tier one instrument* that it has included in its *tier one capital resources* unless it has notified the *FSA* of its intention at least one month before it does so.

2.2.75 R If a *firm* gives notice of the redemption or repayment of any *tier one instrument*, the *firm* must no longer include that instrument in its *tier one capital resources*.

Step-ups and redeemable tier one instruments

2.2.76 R In relation to an *innovative tier one instrument* or a *PIBS* which is redeemable and which satisfies any of the following conditions:

- (1) it is or may become subject to a *step-up*; or
- (2) a reasonable *person* would think that:
 - (a) the *firm* is likely to redeem it before the tenth anniversary of its date of issue; or
 - (b) the *firm* is likely to have an economic incentive to redeem it before the tenth anniversary of its date of issue;

the redemption date in *GENPRU 2.2.70R(2)(a)* is amended by replacing "fifth anniversary" with "tenth anniversary".

Meaning of redemption

- 2.2.77 R (1) This *rule* applies to a *tier one instrument*, *tier two instrument* or *tier three instrument* (instrument A) that under its terms is exchanged for or converted into another instrument or is subject to a similar process.
- (2) This *rule* also applies to instrument A if under its terms it is redeemed out of the proceeds of the issue of new securities.
- (3) If the instrument with which instrument A is replaced is included in the *same stage of capital* or a *higher stage of capital* as instrument A, instrument A is treated as not having been redeemed or repaid for the purposes of *GENPRU 2.2.*
- (4) (3) does not apply to *GENPRU 2.2.114R* (Redeemable instrument likely to be repaid etc), *GENPRU 2.2.74R* (Notice of redemption of *tier one instruments*), *GENPRU 2.2.174R* (Notice of redemption of *tier two instruments*) or *GENPRU 2.2.245R* (so far as it relates to notice of redemption of *tier three instruments*).
- (5) (3) only applies if it would be reasonable (taking into account the economic substance) to treat the original instruments as continuing in issue on the same or a more favourable basis. The question of whether that basis is more or less favourable must be judged from the point of view of the adequacy of the *firm's capital resources*.
- 2.2.78 R (1) A *share* is not redeemable for the purposes of this section merely because the Companies Act 1985 or the Companies (Northern Ireland) Order 1986 allows the *firm* that issued it to purchase it.
- (2) A *capital instrument* is not redeemable for the purposes of this section merely because the *firm* that issued it has a right to purchase it similar to the right in (1).
- 2.2.79 G This section generally uses the term repay and redeem interchangeably.

Loss absorption

- 2.2.80 R A *firm* may not include a *share* in its *tier one capital resources* unless (in addition to complying with the other relevant *rules* in *GENPRU 2.2*):
- (1) (in the case of a *firm* that is a company as defined in the Companies Act 1985 or the Companies (Northern Ireland) Order 1986) it is "called-up *share* capital" within the meaning given to that term in that Act or, as the case may be, that Order; or
- (2) (in the case of a *building society*) it is a "deferred share" as defined in the Building Societies (Deferred Shares) Order 1991; or

- (3) (in the case of any other *firm*) it is:
- (a) in economic terms; and
 - (b) in its characteristics as capital (including loss absorbency, permanency, ranking for repayment and fixed costs);
- substantially the same as called-up *share* capital falling into (1).

2.2.81 R A *firm* may not include a *capital instrument* other than a *share* in its *tier one capital resources* unless it complies with GENPRU 2.2.80R(3).

2.2.82 G There are additional loss absorption requirements for *innovative tier one capital* in GENPRU 2.2.116R to 2.2.118R (*Innovative tier one instrument* should not constitute a liability).

Core tier one capital: permanent share capital

2.2.83 R *Permanent share capital* means an item of capital which (in addition to satisfying GENPRU 2.2.64R) meets the following conditions:

- (1) it is:
- (a) an ordinary *share*; or
 - (b) a *members' contribution*; or
 - (c) part of the *initial fund* of a *mutual*;
- (2) any *coupon* on it is not cumulative, the *firm* is under no obligation to pay a *coupon* in any circumstances and the *firm* has the right to choose the amount of any *coupon* that it pays; and
- (3) the terms upon which it is issued do not permit redemption and it is otherwise incapable of being redeemed to at least the same degree as an ordinary *share* issued by a company incorporated under the Companies Act 1985 or the Companies (Northern Ireland) Order 1986 (whether or not it is such a *share*).

2.2.84 G GENPRU 2.2.83R has the effect that the *firm* should be under no obligation to make any payment in respect of a *tier one instrument* if it is to form part of its *permanent share capital* unless and until the *firm* is wound up. A *tier one instrument* that forms part of *permanent share capital* should not therefore count as a liability before the *firm* is wound up. The fact that relevant company law permits the *firm* to make earlier repayment does not mean that the *tier one instruments* are not eligible. However, the *firm* should not be required by any contractual or other obligation arising out of the terms of that capital to repay *permanent share capital*. Similarly a *tier one instrument* may still qualify if company law allows dividends to be paid on this capital, provided the *firm* is not contractually or otherwise obliged to pay them. There should therefore be no fixed costs.

Core tier one capital: profit and loss account and other reserves: Losses

- 2.2.85 R (1) Negative amounts, including any interim net losses (but in the case of a *BIPRU investment firm*, only material interim net losses), must be deducted from profit and loss account and other reserves.
- (2) For these purposes material interim net losses mean unaudited interim losses arising from a *firm's trading book* and *non-trading book* business which exceed 10% of the sum of its *capital resources* calculated at stages A (Core tier one capital) and B (Perpetual non-cumulative preference shares) in the *capital resources table*.
- (3) If interim losses as referred to in (2) exceed the 10% figure in (2) then a *BIPRU investment firm* must deduct the whole amount of those losses and not just the excess.

Core tier one capital: profit and loss account and other reserves: Losses arising from valuation adjustments (BIPRU firm only)

- 2.2.86 R (1) This *rule* applies to *trading book* valuation adjustments or reserves referred to in *GENPRU 1.3.29R* to *GENPRU 1.3.35G* (Valuation adjustments and reserves). It applies to a *BIPRU firm*.
- (2) When valuation adjustments or reserves give rise to losses of the current financial year, a *firm* must treat them in accordance with *GENPRU 2.2.85R*.
- (3) Valuation adjustments or reserves which exceed those made under the accounting framework to which a *firm* is subject must be treated in accordance with (2) if they give rise to losses and under *GENPRU 2.2.248R* (Net interim *trading book* profits) otherwise.

Core tier one capital: profit and loss account and other reserves: Dividends

- 2.2.87 R Dividends must be deducted from reserves as soon as they are declared.

Core tier one capital: profit and loss account and other reserves: Capital contributions

- 2.2.88 R A *firm* must account for a capital contribution as an increase in reserves and may, notwithstanding *GENPRU 2.2.63R*, count that increase in reserves as *core tier one capital*.
- 2.2.89 G An item of capital qualifies as a capital contribution if it is a gift of capital (and, as such, is not repayable) and a *coupon* is not payable on it.

Core tier one capital: profit and loss account and other reserves: Securitisation (BIPRU firm only)

- 2.2.90 R In the case of a *BIPRU firm* which is the *originator* of a *securitisation*, net gains arising from the capitalisation of future income from the *securitised* assets and providing *credit enhancement* to *positions* in the *securitisation* must be excluded from profit and loss account and other reserves.

Core tier one capital: profit and loss account and other reserves: Valuation

- 2.2.91 G Profit and loss account and other reserves should be valued in accordance with the *rules* in *GENPRU* 1.3 (Valuation).

Core tier one capital: profit and loss account and other reserves: Revaluation reserves (BIPRU firm only)

- 2.2.92 G A revaluation reserve is not included as part of a *BIPRU firm's* profit and loss account and other reserves. It is dealt with separately and forms part of a *BIPRU firm's upper tier two capital*.

Core tier one capital: partnership capital account (BIPRU firm only)

- 2.2.93 R *Eligible partnership capital* means a partners' account:
- (1) into which capital contributed by the partners is paid; and
 - (2) from which under the terms of the partnership agreement an amount representing capital may be withdrawn by a partner only if:
 - (a) he ceases to be a partner and an equal amount is transferred to another such account by his former partners or any *person* replacing him as their partner; or
 - (b) the partnership is otherwise dissolved or wound up and either the *BIPRU firm* has ceased to be *authorised* or no longer has a *Part IV permission*.

Core tier one capital: Eligible LLP members' capital (BIPRU firm only)

- 2.2.94 R *Eligible LLP members' capital* means a members' account:
- (1) into which capital contributed by the members is paid; and
 - (2) from which under the terms of the *limited liability partnership* agreement an amount representing capital may be withdrawn by a member only if:
 - (a) he ceases to be a member and an equal amount is transferred to another such account by his former fellow members or any *person* replacing him as a member; or
 - (b) the *limited liability partnership* is otherwise dissolved or wound up and either the *BIPRU firm* has ceased to be *authorised* or no longer has a *Part IV permission*.

Core tier one capital: Eligible LLP members' and partnership capital accounts (BIPRU firm only)

- 2.2.95 R A *BIPRU firm* that is a partnership or a *limited liability partnership* may not include *eligible partnership capital* or *eligible LLP members' capital* in its *tier one capital resources* unless (in addition to *GENPRU 2.2.62R* (General conditions relating to *tier one capital*)) it complies with *GENPRU 2.2.83R(2)* (*Coupons* should not be cumulative or mandatory). However *GENPRU 2.2.64R(3)* (Redemption) is replaced by *GENPRU 2.2.93R* or *GENPRU 2.2.94R*.
- 2.2.96 G If a *firm* has surplus *eligible partnership capital* or *eligible LLP members' capital* that it wishes to repay in circumstances other than those set out in *GENPRU 2.2.93R* or *GENPRU 2.2.94R* it may apply to the *FSA* for a *waiver* to allow it to do so. If a *firm* applies for such a *waiver* the information that the *firm* supplies with the application might include:
- (1) a demonstration that the *firm* would have sufficient *capital resources* to meet its *capital resources requirement* immediately after the repayment;
 - (2) a demonstration that the *firm* would have sufficient financial resources to meet any *individual capital guidance* and the *firm's* latest assessment under the *overall Pillar 2 rule* immediately after the repayment; and
 - (3) a two to three year capital plan demonstrating that the *firm* would be able to meet the requirements in (1) and (2) at all times without needing further capital injections.

Core tier one capital: Other capital items for limited liability partnerships and partnerships (BIPRU firm only)

- 2.2.97 R The items *permanent share capital* and *share premium account* (which form part of *core tier one capital*) and perpetual non-cumulative *preference shares* (which forms stage B of the *capital resources table*) do not apply to a *BIPRU firm* that is a partnership or a *limited liability partnership*.
- 2.2.98 R Without prejudice to *GENPRU 2.2.62R* (Tier one capital: General), the item other reserves (which forms part of the item profit and loss and other reserves) applies to a *BIPRU firm* that is a partnership or a *limited liability partnership* to the extent the reserves correspond to reserves that are eligible for inclusion as other reserves in the case of a *BIPRU firm* that is incorporated under the Companies Act 1985 or the Companies (Northern Ireland) Order 1986.
- 2.2.99 G A *BIPRU firm* that is a partnership or a *limited liability partnership* should include profit and loss (taking into account interim losses or material interim net losses) in its *core tier one capital*.

Core tier one capital: partnership and limited liability partnership excess drawings (BIPRU firm only)

- 2.2.100 R A *BIPRU firm* which is a partnership or *limited liability partnership* must deduct at stage E of the calculation in the *capital resources table* (Deductions from tier one capital) the amount by which the aggregate of the amounts withdrawn by its partners or members exceeds the profits of that *firm*. Amounts of *eligible partnership capital* or *eligible LLP members' capital* repaid in accordance with *GENPRU 2.2.93R* or *GENPRU 2.2.94R* are not included in this calculation.

Core tier one capital: Share premium account

- 2.2.101 R (1) A *firm* must include *share* premium account relating to the issue of a *share* forming part of its *core tier one capital* in its *core tier one capital*.
- (2) A *firm* must include *share* premium account relating to the issue of a *share* forming part of another tier of capital in that other tier.
- (3) A *firm* that is incorporated under the Companies Act 1985 or the Companies (Northern Ireland) Order 1986 may include its *share* premium account as *core tier one capital* notwithstanding (2) to the extent that the terms of issue of the *share* concerned provide that any premium is not repayable on redemption.
- (4) (3) applies to a *firm* that is not incorporated under the Companies Act 1985 or the Companies (Northern Ireland) Order 1986 if its *share* premium account is subject to substantially the same or greater restraints on use than a *share* premium account falling into (3).

Core tier one capital: externally verified interim net profits

- 2.2.102 R Externally verified interim net profits are interim profits which have been verified by a *firm's* external auditors after deduction of tax, declared dividends and other appropriations.
- 2.2.103 G A *firm* may include interim profits before a formal decision has been taken only if these profits have been verified, in accordance with the relevant Auditing Practices Board's Practice Note, by *persons* responsible for the auditing of the accounts.

Core tier one capital: valuation differences (insurer only)

- 2.2.104 R *GENPRU 2.2.104R* to *GENPRU 2.2.107R* only apply to an *insurer*.
- 2.2.105 R Valuation differences are all differences between the valuation of assets and liabilities as valued in *GENPRU* and the valuation that the *insurer* uses for its external financial reporting purposes, except valuation differences which are dealt with elsewhere in the *capital resources table*. The sum of these valuation differences must either be added to (if positive) or deducted from (if negative) an *insurer's capital resources* in accordance with the *capital resources table*.

- 2.2.106 G Additions to and deductions from *capital resources* will arise from the application of asset and liability valuation and admissibility *rules* (see *GENPRU* 1.3 (Valuation), *GENPRU* 2.2.251R (Deductions from total capital: Inadmissible assets) and *GENPRU* 2 Ann 7R (Admissible assets in insurance)). Downward adjustments include *discounting* of *technical provisions* for *general insurance business* (which is optional for financial reporting but not permitted for regulatory valuation – see *GENPRU* 2.2.107R) and derecognition of any *defined benefit asset* in respect of a *defined benefit occupational pension scheme* (see *GENPRU* 1.3.9R(2) (General requirements: Adjustments to accounting values)). Details of valuation differences relating to *technical provisions* and liability adjustments for *long-term insurance business* are set out in *INSPRU* 1.2 (Mathematical reserves). In particular, contingent loans or other arrangements which are not valued as a liability under *INSPRU* 1.2.79R(2) (Reinsurance) result in a positive valuation difference.
- 2.2.107 R (1) Subject to (3), this *rule* applies to an *insurer* that carries on *general insurance business* and which *discounts* or reduces its *technical provisions* for *claims* outstanding.
- (2) An *insurer* of a kind referred to in (1) must deduct from its *capital resources* the difference between the undiscounted *technical provisions* or *technical provisions* before deductions, and the discounted *technical provisions* or *technical provisions* after deductions. This adjustment must be made for all *general insurance business classes*, except for risks listed under *classes* 1 and 2. For *classes* other than 1 and 2, no adjustment needs to be made in respect of the discounting of annuities included in *technical provisions*. For *classes* 1 and 2 (other than annuities), if the expected average interval between the settlement date of the *claims* being discounted and the accounting date is not at least four years, the *insurer* must deduct:
- (a) the difference between the undiscounted *technical provisions* and the discounted *technical provisions*; or
- (b) where it can identify a subset of *claims* such that the expected average interval between the settlement date of the *claims* and the accounting date is at least four years, the difference between the undiscounted *technical provisions* and the discounted *technical provisions* for the other *claims*.
- (3) This *rule* does not apply to a *pure reinsurer* which became a *firm in run-off* before 31 December 2006 and whose *Part IV permission* has not subsequently been varied to add back the *regulated activity* of *effecting contracts of insurance*.

Core tier one capital: fund for future appropriations (insurer only)

- 2.2.108 R In relation to an *insurer* the fund for future appropriations means the fund of the same name required by the *insurance accounts rules*, comprising all funds the allocation of which either to *policyholders* or to shareholders has not been determined by the end of the *financial year*, or the balance sheet items under *international accounting standards* which in aggregate represent as nearly as possible that fund.

Other tier one capital: perpetual non-cumulative preference shares

- 2.2.109 R A perpetual non-cumulative *preference share* may be included at stage B of the calculation in the *capital resources table* if (in addition to satisfying all the other requirements in relation to *tier one capital*) it satisfies the following conditions:

- (1) any *coupon* on it is not cumulative, and the *firm* is under no obligation to pay a *coupon* in any circumstances; and
- (2) it is not an *innovative tier one instrument*.

- 2.2.110 G The other main provisions relevant to the eligibility of a perpetual non-cumulative *preference share* for inclusion in *tier one capital* are *GENPRU 2.2.62R* (Tier one capital: General), *GENPRU 2.2.64R* (General conditions for eligibility as tier one capital), *GENPRU 2.2.65R* (Connected transactions), *GENPRU 2.2.70R* to *GENPRU 2.2.75R* (Redemption of *tier one instruments*) and *GENPRU 2.2.80R* (Loss absorption). The *rules* about *innovative tier one capital* are also relevant as they may result in perpetual non-cumulative *preference shares* being treated as *innovative tier one capital*. Perpetual non-cumulative *preference shares* should be perpetual and redeemable only at the *firm's* option. Perpetual *preference shares* should be non-cumulative if they are to be included at stage B of the calculation in the *capital resources table*. Any feature that, in conjunction with a call, would make a *firm* more likely to redeem perpetual non-cumulative *preference shares* would normally result in classification as an *innovative tier one instrument*. Such features would include, but not be limited to, a *step-up*, bonus *coupon* on redemption or redemption at a premium to the original issue price of the *share*.

Other tier one capital: permanent interest bearing shares (building societies only)

- 2.2.111 R A *building society* may include a *PIBS* at stage B of the calculation in the *capital resources table* if (in addition to satisfying all the other requirements in relation to *tier one capital*) it is a “deferred share” as defined in the Building Societies (Deferred Shares) Order 1991.

- 2.2.112 G The other main provisions relevant to inclusion of a *PIBS* in *tier one capital* are *GENPRU 2.2.62R* (Tier one capital: General), *GENPRU 2.2.64R* (General conditions for eligibility as tier one capital), *GENPRU 2.2.65R* (Connected transactions), *GENPRU 2.2.70R* to *GENPRU 2.2.75R* (Redemption of *tier one instruments*), *GENPRU 2.2.76R* (Step-ups and redeemable tier one instruments) and *GENPRU 2.2.80R* (Loss absorption). However many of the *rules* in this section about features of *capital instruments* that result in treatment as *innovative tier one capital* do not apply.

Other tier one capital: innovative tier one capital: general

- 2.2.113 R If an item of capital is stated to be an *innovative tier one instrument* by the *rules* in *GENPRU 2.2*, it cannot be included in stages A (Core tier one capital) or B (Perpetual non-cumulative preference shares) of the calculation in the *capital resources table*.

Other tier one capital: innovative tier one capital: redemption

- 2.2.114 R If a *tier one instrument*, other than a *PIBS*:
- (1) is redeemable; and
 - (2) a reasonable *person* would think that:
 - (a) the *firm* is likely to redeem it; or
 - (b) the *firm* is likely to have an economic incentive to redeem it;

that *tier one instrument* is an *innovative tier one instrument*.

- 2.2.115 G Any feature that in conjunction with a call would make a *firm* more likely to redeem a *tier one instrument*, other than a *PIBS*, would normally result in classification as *innovative tier one capital resources*. *Innovative tier one instruments* include but are not limited to those incorporating a *step-up* or principal stock settlement.

Other tier one capital: innovative tier one capital: loss absorption

- 2.2.116 R A *firm* may include a *capital instrument* that is not a *share* in its *innovative tier one capital resources* if (in addition to satisfying all the other requirements in relation to *tier one capital* and *innovative tier one capital*) it satisfies the condition in this *rule*. In addition a *firm* may not include any other capital in its *innovative tier one capital resources* unless it satisfies the condition in this *rule*. The condition in this *rule* is that the *firm's* obligations under the instrument either:
- (1) do not constitute a liability (actual, contingent or prospective) under section 123(2) of the Insolvency Act 1986; or
 - (2) do constitute such a liability but the terms of the instrument are such that:
 - (a) any such liability is not relevant for the purposes of deciding whether:
 - (i) the *firm* is, or is likely to become, unable to pay its debts; or
 - (ii) its liabilities exceed its assets;

- (b) a *person* (including, but not limited to, a holder of the instrument) is not able to petition for the winding up or administration of the *firm* or for any similar procedure in relation to the *firm* on the grounds that the *firm* is or may become unable to pay any such liability; and
- (c) the *firm* is not obliged to take into account such a liability for the purposes of deciding whether or not the *firm* is, or may become, insolvent for the purposes of section 214 of the Insolvency Act 1986 (wrongful trading).

2.2.117 G The effect of *GENPRU 2.2.116R* is that if a *potential tier one instrument* does constitute a liability, this should only be the case when the *firm* is able to pay that liability but chooses not to do so. As *tier one capital resources* should be undated, this will generally only be relevant on a solvent winding up of the *firm*. The holder should agree that the *firm* has no liability (including any contingent or prospective liability) to pay any amount to the extent to which that liability would cause the *firm* to become insolvent if it made the payment or to the extent that its liabilities exceed its assets or would do if the payment were made. The terms of the *capital instrument* should be such that the *directors* can continue to trade in the best interests of the senior creditors even if this prejudices the interests of the holders of the instrument.

2.2.118 R A *firm* may not include an *innovative tier one instrument*, unless it is a *preference share*, in its *tier one capital resources* unless it has obtained a properly reasoned independent legal opinion from an appropriately qualified individual confirming that the criteria in *GENPRU 2.2.64R(6)* (Loss absorption) and *GENPRU 2.2.80R* to *GENPRU 2.2.81R* (Loss absorption) are met.

2.2.119 G For the purpose of *GENPRU 2.2.118R*, an independent legal opinion may be given by an *employee* of that *firm*, but if an *employee* does so he should not be part of the business unit responsible for the transaction (including the drafting of the issue documentation).

Other tier one capital: innovative tier one capital: coupons

2.2.120 R A *tier one instrument*, other than a *PIBS*, with a cumulative or mandatory *coupon* is an *innovative tier one instrument*.

Other tier one capital: innovative tier one capital: step-ups

2.2.121 R If:

- (1) a *potential tier one instrument*, other than a *PIBS*, is or may become subject to a *step-up*; and
- (2) that *potential tier one instrument* is redeemable at any time (whether before, at or after the time of the *step-up*);

that *potential tier one instrument* is an *innovative tier one instrument*.

- 2.2.122 G See *GENPRU 2.2.146R* to *GENPRU 2.2.154G* for further *rules* and *guidance* on *step-ups*.
- Other tier one capital: innovative tier one capital: indirectly issued tier one capital (BIPRU firm only)
- 2.2.123 R *GENPRU 2.2.123R* to *GENPRU 2.2.137R* apply to a *BIPRU firm*.
- 2.2.124 R (1) *GENPRU 2.2.123R* - *GENPRU 2.2.137R* apply to capital of a *firm* if:
- (a) either or both of the conditions in (2) are satisfied; and
 - (b) any of the *SPVs* referred to in (2) is a *subsidiary undertaking* of the *firm*.
- (2) The conditions referred to in (1) are:
- (a) that capital is issued to an *SPV*; or
 - (b) the subscription for the capital issued by the *firm* is funded directly or indirectly by an *SPV*.
- (3) A *BIPRU firm* may not include capital coming within this *rule* in its *capital resources* unless the requirements in the following *rules* are satisfied:
- (a) (if (2)(a) applies and (2)(b) does not) *GENPRU 2.2.127R*, *GENPRU 2.2.129R* and *GENPRU 2.2.132R*; or
 - (a) (in any other case) *GENPRU 2.2.133R*.
- 2.2.125 R A *BIPRU firm* may only count capital to which *GENPRU 2.2.124R* applies as *innovative tier one capital*.
- 2.2.126 R For the purpose of *GENPRU 2.2*, an *SPV* is, in relation to a *BIPRU firm*, any *undertaking* whose main activity is to raise funds for that *firm* or for a *group* to which that *BIPRU firm* belongs.
- 2.2.127 R The *SPV* referred to in *GENPRU 2.2.124R*(2)(a) must satisfy the following conditions:
- (1) it is controlled by the *firm* and may not operate independently of the *firm*;
 - (2) the rights of investors in the *SPV* who do not belong to the *group* of the *BIPRU firm* in question are not such as to affect the ability of the *firm* to control the *SPV*; and
 - (3) all or virtually all of its *exposures* (calculated by reference to the amount) consist of *exposures* to the *firm* or to that *firm's group*.

- 2.2.128 G An *SPV* could take the form of a limited partnership. In such an arrangement, holders of a *capital instrument* issued by the *SPV* which do not belong to the *group* of the *BIPRU firm* in question should have no right to participate in the management of the partnership, whether under the partnership's constitutional documents or the transaction documents. In general, this means that they should be treated as limited partners. It is expected that the general partner, having control of the *SPV*, would be the *firm*.
- 2.2.129 R The *SPV* referred to in *GENPRU* 2.2.124R(2)(a) must fund its subscription for the capital issued by the *firm* by the issue of capital that satisfies the following conditions:
- (1) it must comply with the conditions for qualification as *tier one capital*, as amended by *GENPRU* 2.2.130R, as if the *SPV* was itself a *firm* seeking to include that capital in its *tier one capital resources*;
 - (2) its terms must include an obligation on the *firm* to substitute for the instrument issued by the *SPV* a *tier one instrument* issued by that *firm* that is not an *innovative tier one instrument* when the *capital resources* of the *firm* fall below, or are likely to fall below, its *capital resources requirement*;
 - (3) the conversion ratio in respect of the substitution described in (2) must be fixed when the *SPV* issues the *capital instrument*; and
 - (4) to the extent that investors have the benefit of an obligation by a *person* other than the *SPV*:
 - (a) that obligation must be one owed by a member of the *firm's group*; and
 - (b) the extent of that obligation must be no greater than would be permitted by *GENPRU* if that obligation formed part of the terms of a *capital instrument* issued by that member which complied with the *rules* in *GENPRU* relating to *innovative tier one capital*.
- 2.2.130 R For the purpose of *GENPRU* 2.2.129R and *GENPRU* 2.2.132R, *GENPRU* 2.2.118R (Requirement to obtain a legal opinion) does not apply.
- 2.2.131 R In relation to the obligation to substitute described in *GENPRU* 2.2.129R(2), a *firm* must take all reasonable steps to ensure that it has at all times authorised and unissued *tier one instruments* that are not *innovative tier one instruments* (and the authority to issue them) sufficient to discharge its obligation to substitute.
- 2.2.132 R The capital which the *firm* seeks to include in its *capital resources* under *GENPRU* 2.2.124R(3)(a) must satisfy the following conditions:
- (1) it meets the conditions for inclusion in *tier one capital* (subject to *GENPRU* 2.2.130R);
 - (2) its first call date (if any) must not arise before that on the instrument issued by the *SPV*; and

- (3) its terms relating to repayment must be the same as those of the instrument issued by the *SPV*.
- 2.2.133 R (1) This rule deals with any transaction:
- (a) under which an *SPV* directly or indirectly funds the subscription for capital issued by the *firm* as described in *GENPRU 2.2.124R*; or
- (b) that is directly or indirectly funded by a transaction in (1)(a).
- (2) Each *undertaking* that is a party to a transaction to which this *rule* applies (other than the *firm*) must be a *subsidiary undertaking* of the *firm*.
- (3) Each *SPV* that is a party to a transaction to which this *rule* applies must comply with *GENPRU 2.2.127R*.
- (4) Any capital to which (1) applies (other than the capital that is to be included in the *firm's capital resources*) must be in the form of capital that complies with *GENPRU 2.2.129R(1)* and (4), whether or not issued by an *SPV*.
- (5) The obligations in *GENPRU 2.2.129R(2)* and (3) only apply to capital issued by an *SPV* at the end of the chain of transactions beginning with the issue of capital by the *firm* referred to in *GENPRU 2.2.124R*.
- (6) *GENPRU 2.2.132R* applies to the capital issued by the *firm* as referred to in *GENPRU 2.2.124R*. For these purposes references in *GENPRU 2.2.132R* to the instrument issued by the *SPV* are to the instrument referred to in (5).
- 2.2.134 G The purpose of *GENPRU 2.2.133R* is to deal with a capital-raising under which the capital raised by a special purpose vehicle is passed through a number of *undertakings* before it is invested in the *firm*. If the *capital resources* of the *firm* fall below, or are likely to fall below, its *capital resources requirement* the *firm* should replace the capital issued by that first special purpose vehicle with a *tier one instrument* directly issued by the *firm* itself that is not an *innovative tier one instrument*.
- 2.2.135 R A *firm* which satisfies the conditions for the inclusion of capital set out in *GENPRU 2.2.124R*, must, in addition, if that transaction is in any respect unusual, notify the *FSA* at least one *Month* in advance of the date on which the *firm* intends to include that capital in its *capital resources*.
- 2.2.136 G The *FSA* is likely to consider as unusual a transaction which involves the raising by the *firm* of *tier one capital* through a *subsidiary undertaking* of that *firm* that is not an *SPV*. The *FSA* would expect a *firm* to request individual *guidance* in such circumstances.
- 2.2.137 R A *firm* must ensure that, in relation to a transaction falling within *GENPRU 2.2.124R*:

- (1) the marketing document for the transaction contains all the information which a reasonable third party would require to understand the transaction fully and its effect on the financial position of the *firm* and its *group*; and
- (2) the information in (1) and the transaction are easily comprehensible without the need for additional information about the *firm* and its *group*.

Tier one capital: Conversion ratio

- 2.2.138 R (1) This *rule* applies to a *potential tier one instrument* if:
- (a) it is redeemable by the *firm* (ignoring *GENPRU 2.2.77R* (Meaning of redemption));
 - (b) it provides that if the issuer does not exercise that right or does not do so in specified circumstances the issuer must or may have to redeem it in whole or in part through the issue of *shares* eligible for inclusion in the *firm's tier one capital resources* or the instrument converts or may convert into such *shares*; and
 - (c) *GENPRU 2.2.77R* means that the obligation in (1)(b) is treated as not being inconsistent with *GENPRU 2.2.70R(1)* (*Tier one capital* should not be redeemable at the option of the holder).
- (2) A *firm* must not include a *potential tier one instrument* to which this *rule* applies in its *tier one capital resources* if:
- (a) the conversion ratio as at the date of redemption may be greater than the conversion ratio as at the time of issue by more than 200%; or
 - (b) the market price of the conversion instruments issued in relation to one unit of the original capital item (plus any cash element of the redemption) may be greater than the issue price of that original capital item.
- (3) All determinations under this *rule* are made as at the date of issue of the original capital item.
- 2.2.139 R In *GENPRU 2.2.138R* to *GENPRU 2.2.142R*:
- (1) the original capital item means the capital item that is being redeemed; and
 - (2) the conversion instrument means the *tier one capital* to be issued on its redemption.
- 2.2.140 R In *GENPRU 2.2.138R* to *GENPRU 2.2.142R*, the conversion ratio means the ratio of:
- (1) the number of units of the conversion instrument that the *firm* must issue to satisfy its redemption obligation (so far as it is to be satisfied by the issue of conversion instruments) in respect of one unit of the original capital item; to

- (2) one unit of the original capital item.
- 2.2.141 R In *GENPRU* 2.2.138R to *GENPRU* 2.2.142R, the conversion ratio as at the date of issue of the original capital item is calculated as if the original capital item were redeemable at that time.
- 2.2.142 R If the conversion instruments or the original capital item are subdivided or consolidated or subject to any other occurrence that would otherwise result in like not being compared with like, the conversion ratio calculation in *GENPRU* 2.2.138R must be adjusted accordingly.
- 2.2.143 G (1) The significance of the limitations on conversion in *GENPRU* 2.2.138R(2) can be seen in the example in this paragraph.
- (2) A *firm* issues innovative notes with a par value of £100 each. The terms of the instrument provide that if the instrument is not called at par at the first call date the notes convert into a variable number of ordinary *shares*.
- (3) If the market price of the ordinary *shares* is 400 pence per share on the day of issue of the innovative notes then the maximum number of ordinary *shares* (M) that a single £100 par value innovative note can be converted into is calculated as follows:
- (a) $M = \text{Par value of innovative instrument} * 200\% / \text{market value of ordinary share};$
- (b) $M = £100 * 2 / £4 = 50 \text{ shares}.$
- (4) The practical effect is that conversion will result in the holder of an innovative capital note receiving ordinary *shares* equal to the par value of that note only when the market price of the ordinary *shares* remains above half the market price of the *shares* at the date of issue of the notes.
- (5) If the market price of the ordinary *shares* fell by half to 200 pence, the maximum permitted number of *shares* (50) would have to be issued in order to give an investor in the innovative note ordinary *shares* with a market value equal to £100. If the market price of the ordinary *shares* fell below 200 pence, the issue of the maximum permitted number of ordinary *shares* would have a market value below £100.
- 2.2.144 G (1) In addition to the maximum conversion ratio of 200%, *GENPRU* 2.2.138R(2) (b) does not permit a *firm* to issue *shares* that would have a market value that exceeds the issue price of the instrument being redeemed.
- (2) In the example in *GENPRU* 2.2.143G, if the market value of the ordinary *shares* was 250 pence at the conversion date, the maximum number of ordinary *shares* that may be issued to satisfy the redemption of one of the £100 par value innovative notes would be 40 (= £100 / £2.5).

Tier one capital: Requirement to have sufficient unissued stock

- 2.2.145 R (1) This *rule* applies to a *potential tier one instrument* of a *firm* where either:
- (a) the redemption proceeds; or
 - (b) any *coupon* on that capital item;
- can be satisfied by the issue of another *capital instrument*.
- (2) A *firm* may only include an item of capital to which this *rule* applies in its *tier one capital resources* if the *firm* has authorised and unissued *capital instruments* of the kind in question (and the authority to issue them):
- (a) that are sufficient to satisfy all such payments then due; and
 - (b) are of such amount as is prudent in respect of such payments that could become due in the future.

Step-ups: calculating the size of a step-up

- 2.2.146 R (1) Where a *rule* in this section says that a particular treatment applies to an item of capital that is subject to a *step-up* of a specified amount, the question of whether that *rule* is satisfied must be judged by reference to the cumulative amount of all *step-ups* since the issue of that item of capital rather than just by reference to a particular *step-up*.
- (2) Where a *step-up* arises through a change from paying a *coupon* on a debt instrument to paying a dividend on a *share* issued in settlement of the *coupon*, any net cost to the *firm* arising from the different tax treatment of the dividend compared to the tax treatment of interest may be ignored for the purpose of assessing the effect of that *step-up*.

Step-ups: Limits on the amount of step-ups on tier one and two capital

- 2.2.147 R (1) A *firm* may not include in its *tier one capital resources* a *tier one instrument* that is or may be subject to a *step-up* that does not meet the definition of moderate in the press release of the Basle Committee on Banking Supervision of 27th October 1998 called "Instruments eligible for inclusion in Tier 1 capital".
- (2) For the purpose of (1) the words in that press release "than, at national supervisory discretion, either" are replaced by "than the higher of the following two amounts".
- (3) The calculations required by this *rule* and *GENPRU 2.2.151R* must be carried out as at the date of issue of the relevant instrument.
- 2.2.148 G The effect of *GENPRU 2.2.147R* is that for inclusion in *tier one capital resources*, *step-ups* in instruments should be moderate. A moderate *step-up* for these purposes is one which results in an increase over the initial rate that is no greater than the higher of the following two amounts:

- (1) 100 basis points, less the swap spread between the initial index basis and the stepped-up index basis; or
 - (2) 50% of the initial credit spread, less the swap spread between the initial index basis and the stepped-up index basis.
- 2.2.149 G If a *coupon* paid on an item of capital is initially set at a specified spread above an index (the initial index basis), and the *coupon* moves to being set relative to another index (the stepped up index basis), there will be an implied *step-up* (positive or negative) even if the specified spread does not change. This is because each index may itself include a spread relative to the risk free rate and this spread may differ between the two indexes. The deduction of the swap spread in *GENPRU* 2.2.148G(1) and (2) above adjusts for this difference.
- 2.2.150 G Where the *step-up* involves a conversion from fixed to floating (or vice versa), or a switch in basis index, the swap spread should be fixed at pricing date, reflecting the differential in pricing between indices at the time. The significance of deducting the swap spread can be seen by the following example:
- (1) the pricing date:
 - (a) 10 year gilts (G) = 5.5% (the initial index basis);
 - (b) 3 month LIBOR is the stepped up index basis and the 10 year mid swap rate (L) = 5.9%;
 - (c) initial fixed *coupon* rate = G + 200bp;
 - (d) swap spread = 0.4% (= 5.9% - 5.5%);
 - (e) initial fixed coupon rate = 7.5%;
 - (f) the swap spread shows that there is 40bps of spread in the stepped up index basis relative to the initial index basis; and
 - (g) the initial fixed coupon rate of 7.5% is equivalent to the mid swap rate + 160bp, or L + 200bp – the swap spread;
 - (2) pricing of *stepped-up* rate at year 10 with *step-up* of 100bp without deducting swap spread:
 - (a) *stepped-up* floating rate = L + 200 + 100bp step-up = 8.9%; and
 - (b) effective *step-up* from initial fixed rate of 140bp (= 8.9% - 7.5%); and
 - (3) pricing of *stepped-up* rate at year 10 with step-up of 100bp with deduction of the swap spread:
 - (a) *stepped-up* floating *coupon* rate = L + 200 less 40bp swap spread (difference between 5.5% and 5.9%) + 100bp step-up = 8.5%

(b) effective *step-up* from initial rate of 100bp (= 8.5% - 7.5%).

2.2.151 R (1) Subject to (2), if a *tier two instrument* is or may be subject to a *step-up* that does not meet the definition of moderate in the press release of the Basle Committee on Banking Supervision referred to in *GENPRU 2.2.147R(1)* as adjusted under *GENPRU 2.2.147R(2)*, the first date that a *step-up* can take effect is deemed to be its final maturity date if that date is before its actual maturity date.

(2) If a *tier two instrument*:

(a) is or may be subject to a *step-up* during the period beginning on the fifth anniversary of the date of issue of that item and ending immediately before the tenth anniversary of the date of issue; and

(b) the *step-up* or possible *step-up* is one which may result in an increase over the initial rate that is greater than 50 basis points, less the swap spread between the initial index basis and the stepped-up index basis (all these terms must be interpreted in accordance with *GENPRU 2.2.147R*);

the first date that a *step-up* can take effect is deemed to be its final maturity date if that date is before its actual maturity date.

2.2.152 R An instrument does not breach *GENPRU 2.2.147R* or as the case may be, is not subject to a deemed maturity date under *GENPRU 2.2.151R*, even though it is or may be subject to a *step-up* that exceeds the amount specified in those *rules* if:

(1) the instrument is fungible with other instruments (the "existing stock") that are included in the *firm's tier one capital resources* (in the case of *GENPRU 2.2.147R*) or *tier two capital resources* (in the case of *GENPRU 2.2.151R*);

(2) (if there has been no more than one previous issue of the existing stock) the existing stock complied with those limits on its date of issue;

(3) (if there has been more than one previous issue of the existing stock) the first such issue of the existing stock complied with those limits on its date of issue; and

(4) the result of the *step-up* on the instrument to which this *rule* applies is that the *coupon* on that instrument and the *coupon* on the existing stock is the same.

2.2.153 R (1) A *firm* must not include in its *tier one capital resources* a *potential tier one instrument* that is or may become subject to a *step-up* if that *step-up* can arise earlier than the tenth anniversary of the date of issue of that item of capital.

(2) A *firm* must not include in its *tier two capital resources* a *capital instrument* that is or may become subject to a *step-up* if that *step-up* can arise earlier than the fifth anniversary of the date of issue of that item of capital.

- 2.2.154 G Debt instruments containing embedded options, e.g. issues containing options for the interest rate after the *step-up* to be at a margin over the higher of two (or more) reference rates, or for the interest rate in the previous period to act as a floor, may affect the funding costs of the borrower and imply a *step-up*. In such circumstances, a *firm* may wish to seek individual *guidance* on the application of the *rules* relating to *step-ups* to the *capital instrument* in question. See *SUP 9* (Individual guidance) for the process to be followed when seeking individual *guidance*.

Deductions from tier one: Intangible assets

- 2.2.155 R A *firm* must deduct from its *tier one capital resources* the value of intangible assets.
- 2.2.156 G Intangible assets include goodwill as defined in accordance with the requirements referred to in *GENPRU 1.3.4R* (General requirements: accounting principles to be applied) applicable to the *firm*. The treatment of deferred acquisition cost assets for *BIPRU investment firms* is dealt with in *GENPRU 1.3* (Valuation); they should not be deducted as an intangible asset.

Tier two capital: General

- 2.2.157 G *Tier two capital resources* are split into upper and lower tiers. A major distinction between *upper* and *lower tier two capital* is that only perpetual instruments may be included in *upper tier two capital* whereas dated instruments, such as fixed term *preference shares* and dated subordinated debt, may be included in *lower tier two capital*.
- 2.2.158 G *Tier two instruments* are *capital instruments* that combine the features of debt and equity in that they are structured like debt, but exhibit some of the loss absorption and funding flexibility features of equity.

General conditions for eligibility as tier two capital instruments

- 2.2.159 R A *capital instrument* must not form part of the *tier two capital resources* of a *firm* unless it meets the following conditions:
- (1) the claims of the creditors must rank behind those of all unsubordinated creditors;
 - (2) the only events of default must be non-payment of any amount falling due under the terms of the *capital instrument* or the winding-up of the *firm* and any such event of default must not prejudice the subordination in (1);
 - (3) to the fullest extent permitted under the laws of the relevant jurisdictions, the remedies available to the subordinated creditor in the event of non-payment or other breach of the terms of the *capital instrument* must (subject to *GENPRU 2.2.161R*) be limited to petitioning for the winding-up of the *firm* or proving for the debt in the liquidation or administration;
 - (4) any:

- (a) remedy permitted by (3);
- (b) remedy that cannot be excluded under the laws of the relevant jurisdictions as referred to in (3);
- (c) remedy permitted by *GENPRU 2.2.161R*; and
- (d) terms about repayment as referred to in (5);

must not prejudice the matters in (1) and (2) and in particular any damages permitted by (b) or (c) and repayment obligation must be subordinated in accordance with (1);

- (5) without prejudice to (1), the debt must not become due and payable before its stated final maturity date (if any) except on an event of default complying with (2) or as permitted by *GENPRU 2.2.172R* (Repayment at the option of the issuer) or *GENPRU 2.2.194R(2)* (Repayment of *lower tier two capital* at the option of the holder) and any remedy described in (4)(a) to (c) must not prejudice this requirement;
- (6) the debt agreement or terms of the *capital instrument* are governed by the law of England and Wales, or of Scotland or of Northern Ireland;
- (7) to the fullest extent permitted under the laws of the relevant jurisdictions, creditors must waive their right to set off amounts they owe the *firm* against subordinated amounts included in the *firm's capital resources* owed to them by the *firm*;
- (8) the terms of the *capital instrument* must be set out in a written agreement that contains terms that provide for the conditions set out in (1) to (7);
- (9) the debt must be unsecured and fully paid up;
- (10) the description of its characteristics used in its marketing is consistent with the characteristics required to satisfy (1) to (9) and, where it applies, *GENPRU 2.2.271R* (Other requirements: insurers carrying on with-profits business (Insurer only));
- (11) the amount of the item included must be net of any foreseeable tax charge at the moment of its calculation or must be suitably adjusted in so far as such tax charges reduce the amount up to which that item may be applied to cover risks or losses; and
- (12) the *firm* has obtained a properly reasoned independent legal opinion from an appropriately qualified individual stating that the requirements in (1) to (7) and (insofar as it relates to whether the *capital instrument* is unsecured) (9) have been met.

2.2.160 R A holder of a non-deferred share of a *building society* must be treated as a senior unsecured creditor of that *building society* for the purpose of *GENPRU 2.2.159R*.

General conditions for eligibility as tier two capital instruments: Additional remedies

- 2.2.161 R A *capital instrument* may be included in a *firm's tier two capital resources* even though the remedies available to the subordinated creditor go beyond those referred to in *GENPRU 2.2.159R(3)*, if the following conditions are satisfied:
- (1) those remedies are not available for failure to pay any amount of principal, interest or expenses or in respect of any other payment obligation; and
 - (2) those remedies do not in substance amount to remedies to recover payment of the amounts in (1).
- 2.2.162 G If damages are a remedy that cannot be excluded as referred to in *GENPRU 2.2.159R(3)* those damages should be subordinated in accordance with *GENPRU 2.2.159R(1)*. Damages permitted by *GENPRU 2.2.161R* should also be subordinated in accordance with *GENPRU 2.2.159R(1)*.

General conditions for eligibility as tier two capital instruments: Alternative governing laws

- 2.2.163 R *GENPRU 2.2.159R(6)* does not apply if the *firm* has obtained a properly reasoned independent legal opinion from an appropriately qualified individual confirming that the same degree of subordination has been achieved under the law that governs the debt and the agreement as that which would have been achieved under the laws of England and Wales, Scotland, or Northern Ireland.

General conditions for eligibility as tier two capital instruments: Standard form documentation

- 2.2.164 G The *FSA* is more concerned that the subordination provisions listed in *GENPRU 2.2.159R* should be effective than that they should follow a particular form. The *FSA* does not, therefore, prescribe that the loan agreement or *capital instrument* should be drawn up in a standard form.

Guidance on the general conditions for eligibility as tier two capital instruments

- 2.2.165 G For the purposes of *GENPRU 2.2.159R(5)* the debt agreement or terms of the instrument should not contain any clause which might require early repayment of the debt (e.g. cross default clauses, negative pledges and restrictive covenants). A cross default clause is a clause which says that the loan goes into default if any of the borrower's other loans go into default. It is intended to prevent one creditor being repaid before other creditors, e.g. obtaining full repayment through the courts. A negative pledge is a clause which puts the loan into default if the borrower gives any further charge over its assets. A restrictive covenant is a term of contract that directly, or indirectly, could lead to early repayment of the debt. Some covenants, e.g. relating to the provision of management information or ownership restrictions, are likely to comply with *GENPRU 2.2.159R(3)* as long as monetary redress is ruled out, or any payments are covered by the subordination clauses.

- 2.2.166 G *GENPRU 2.2.159R(3)* allows a *capital instrument* to form part of the *tier two capital resources* even though the laws of the relevant jurisdiction do not allow remedies to be limited in the way described there. For example it is not possible to limit certain remedies in the case of an issue in the United States that is SEC-registered and subject to the provisions of the Trust Indenture Act.
- 2.2.167 G The purpose of *GENPRU 2.2.159R(7)* is to ensure that all of the *firm's* assets are available to *consumers* ahead of subordinated creditors. The waiver should apply both before and during liquidation or administration.
- 2.2.168 G The *guidance* in *GENPRU 2.2.119G* (Employee may give legal opinion) also applies for the purpose of *GENPRU 2.2.159R(12)* and *GENPRU 2.2.163R*.

Tier two capital instruments: Connected transactions

- 2.2.169 R An item of capital does not comply with *GENPRU 2.2.159R* (General conditions for eligibility as tier two *capital instruments*) or *GENPRU 2.2.177R* (Upper tier two capital: General) if the issue of that item of capital by the *firm* is connected with one or more other transactions which, when taken together with the issue of that item, could result in that item of capital no longer displaying all of the characteristics set out in whichever of those *rules* apply.
- 2.2.170 G *GENPRU 2.2.66G* (*Guidance* on *GENPRU 2.2.65R*) applies to *GENPRU 2.2.169R* in the same way as it does to *GENPRU 2.2.65R* (The equivalent of *GENPRU 2.2.169R* in relation to *tier one capital*).

Amendment of tier two instruments

- 2.2.171 R A *firm* must not amend the terms of the capital or the documents referred to in *GENPRU 2.2.159R(8)* unless:
- (1) at least one *Month* before the amendment is due to take effect, the *firm* has given the *FSA* notice in writing of the proposed amendment and the *FSA* has not objected; and
 - (2) that notice includes confirmation that the legal opinions referred to in *GENPRU 2.2.159R(12)* and, if applicable, *GENPRU 2.2.163R* (General conditions for eligibility as tier two *capital instruments*: Alternative governing laws) and *GENPRU 2.2.181R* (Legal opinions for *upper tier two instruments*), continue in full force and effect in relation to the terms of the debt and documents after any proposed amendment.

Redemption of tier two instruments

- 2.2.172 R A *tier two instrument* may be redeemable at the option of the *firm*, but any term of the instrument providing for the *firm* to have the right to exercise such an option must not provide for that right to be exercisable earlier than the fifth anniversary of the date of issue of the instrument.

2.2.173 R *GENPRU 2.2.71R to GENPRU 2.2.73G (Tier one instruments may be redeemed by the issuer before the fifth anniversary in limited circumstances) apply to GENPRU 2.2.172R in the same way as they do to GENPRU 2.2.70R (The issuer should not redeem tier one capital before the fifth anniversary).*

2.2.174 R In relation to a *tier two instrument*, a *firm* must notify the *FSA*:

- (1) in the case of an *insurer*, six *Months*; and
- (2) in the case of a *BIPRU firm*, one *Month*;

before the date of the proposed repayment (unless that *firm* intends to repay an instrument on its final maturity date) providing details of how it will meet its *capital resources requirement* after such repayment.

Tier two capital: step-ups

2.2.175 G The *rules and guidance* in *GENPRU 2.2.146R to GENPRU 2.2.154G* on *step-ups* cover *tier two capital* as well as *tier one capital*.

Upper tier two capital: General

2.2.176 G Examples of *capital instruments* which may be eligible to count in *upper tier two capital resources* include the following:

- (1) perpetual cumulative *preference shares*;
- (2) perpetual subordinated debt; and
- (3) other instruments that have the same economic characteristics as (1) or (2).

2.2.177 R A *capital instrument* must (in addition to meeting the requirements of the *rules* about eligibility for inclusion in *tier two capital*) meet the following conditions before it can be included in a *firm's upper tier two capital resources*:

- (1) it must have no fixed maturity date;
- (2) the terms of the instrument must provide for the *firm* to have the option to defer any *coupon* on the debt, except that the *firm* need not have that right in the case of a *coupon* payable in the form of an item of capital that is included in the *same stage of capital* or a *higher stage of capital* as that first item of capital;
- (3) the terms of the instrument must provide for the loss-absorption capacity of the *capital instrument* and unpaid *coupons*, whilst enabling the *firm* to continue its business;
- (4) it meets the conditions in *GENPRU 2.2.169R* (Connected transactions) and *GENPRU 2.2.180R* (Loss absorption); and

- (5) the terms of the instrument are such that either the instrument or debt is not redeemable or repayable or it is repayable or redeemable only at the option of the *firm*.
- 2.2.178 R If a *firm* gives notice of the redemption or repayment of an *upper tier two instrument*, the *firm* must no longer include it in its *upper tier two capital resources*.
- 2.2.179 G For the purpose of *GENPRU 2.2.177R(2)*, *GENPRU 2.2.68G* (Dividend pushers) applies equally in relation to the inclusion of an instrument in *upper tier two capital resources*.

Upper tier two capital: Loss absorption

- 2.2.180 R A *capital instrument* may only be included in *upper tier two capital resources* if a *firm's* obligations under the instrument either:
- (1) do not constitute a liability (actual, contingent or prospective) under section 123(2) of the Insolvency Act 1986; or
 - (2) do constitute such a liability but the terms of the instrument are such that:
 - (a) any such liability is not relevant for the purposes of deciding whether:
 - (i) the *firm* is, or is likely to become, unable to pay its debts; or
 - (ii) its liabilities exceed its assets;
 - (b) a *person* (including but not limited to a holder of the instrument) is not able to petition for the winding up or administration of the *firm* or for any similar procedure in relation to the *firm* on the grounds that the *firm* is or may become unable to pay any such liability; and
 - (c) the *firm* is not obliged to take into account such a liability for the purposes of deciding whether or not the *firm* is, or may become, insolvent for the purposes of section 214 of the Insolvency Act 1986 (wrongful trading).

Upper tier two capital: Legal opinions

- 2.2.181 R A *firm* may not include an *upper tier two instrument* in its *upper tier two capital resources* unless it has obtained a properly reasoned independent legal opinion from an appropriately qualified individual confirming that the criteria in *GENPRU 2.2.177R(3)* and *GENPRU 2.2.180R* (Loss absorption) are met. This *rule* does not apply to a perpetual cumulative *preference share*.

Upper tier two capital: Guidance

- 2.2.182 G *GENPRU 2.2.180R* is an example of the general principle in *GENPRU 2.2.177R(3)*.

2.2.183 G The *guidance* in GENPRU 2.2.117G (There should be no liability to the extent that the *firm* would become insolvent, etc) also applies for the purpose of GENPRU 2.2.180R.

2.2.184 G The *guidance* in GENPRU 2.2.119G (Employee may give legal opinion) also applies for the purpose of GENPRU 2.2.181R.

Upper tier two capital: Revaluation reserves (BIPRU firm only)

- 2.2.185 R (1) This *rule* applies to a *BIPRU firm*.
- (2) A *BIPRU firm* must, in relation to equities held in the available-for-sale financial assets category:
- (a) deduct any net losses at stage E of the calculation in the *capital resources table* (Deductions from tier one capital); and
 - (b) include any net gains (after deduction of deferred tax) in revaluation reserves at stage G of the calculation in the *capital resources table* (Upper tier two capital).
- (3) A *BIPRU firm* must include any net gains, after deduction of deferred tax, on revaluation reserves of investment properties at stage G of the calculation in the *capital resources table*. A *firm* must include any losses on such revaluation reserves in profit and loss account and other reserves.
- (4) A *BIPRU firm* must include any net gains, after deduction of deferred tax, on revaluation reserves of land and buildings at stage G of the calculation in the *capital resources table*. A *firm* must include any losses on such revaluation reserves in profit and loss account and other reserves.
- (5) (2) only applies to a *firm* to the extent that the category of asset referred to in that paragraph exists under the accounting framework that applies to the *firm* as referred to in GENPRU 1.3.4R (General requirements: accounting principles to be applied).
- (6) (3) and (4) apply to a *firm* whatever the accounting treatment of those items is under the accounting framework that applies to the *firm* as referred to in GENPRU 1.3.4R.

2.2.186 G Subject to GENPRU 2.2.185R, a *BIPRU firm* should value its revaluation reserves in accordance with the *rules* in GENPRU 1.3 (Valuation).

Upper tier two capital: General/collective provisions (BIPRU firm only)

- 2.2.187 R A *BIPRU firm* which adopts the *standardised approach* to credit risk may include general/collective provisions in its *tier two capital resources* only if:
- (1) they are freely available to the *firm*;
 - (2) their existence is disclosed in internal accounting records; and

- (3) their amount is determined by the management of the *firm*, verified by independent auditors and notified to the *FSA*.

2.2.188 R The value of general/collective provisions which a *firm* may include in its *tier two capital resources* as referred to in *GENPRU 2.2.187R* may not exceed 1.25% of the sum of the following:

- (1) the sum of the *market risk capital requirement* and the *operational risk capital requirement* (if applicable), multiplied by a factor of 12.5; and
- (2) the sum of *risk-weighted* assets under the *standardised approach* for credit risk.

2.2.189 R Where a *firm* is unable to determine whether collective/general provisions relate only to *exposures* on either the *standardised approach* or the *IRB approach*, that *firm* must allocate them on a basis which is reasonable and consistent.

Upper tier two capital: Surplus provisions (BIPRU firm only)

2.2.190 R A *BIPRU firm* calculating *risk weighted exposure amounts* under the *IRB approach* may include in its *upper tier two capital resources* positive amounts resulting from the calculation in *BIPRU 4.3.8R* (Treatment of expected loss amounts), up to 0.6% of the *risk weighted exposure amounts* calculated under that approach.

2.2.191 R A *BIPRU firm* calculating *risk weighted exposure amounts* under the *IRB approach* may not include in its *capital resources* value adjustments and provisions included in the calculation in *BIPRU 4.3.8R* (Treatment of *expected loss* amounts under the *IRB approach* for *trading book exposures*) or value adjustments and provisions for *exposures* that would otherwise have been eligible for inclusion in general/collective provisions other than in accordance with *GENPRU 2.2.190R*.

2.2.192 R For the purpose of *GENPRU 2.2.190R* and *GENPRU 2.2.191R*, *risk weighted exposure amounts* must not include those calculated in respect of *securitisation positions* which have a *risk weight* of 1250%.

2.2.193 R If a *BIPRU firm* calculates *risk weighted exposure amounts* under the *IRB approach* for the purposes of *BIPRU 14* (Capital requirements for settlement and counterparty risk) it must not include valuation adjustments referred to in *BIPRU 14.2.18R(1)* (Treatment of expected loss amounts) in its *capital resources* except in accordance with that *rule*.

Lower tier two capital

2.2.194 R A *firm* may include a *capital instrument* in its *lower tier two capital resources* if (in addition to meeting the requirements of the *rules* about eligibility for inclusion in *tier two capital*) either the holder has no right to repayment or it satisfies either of the following conditions:

- (1) it has an original maturity of at least five years; or

- (2) it is redeemable on notice from the holder, but the period of notice of repayment required to be given by the holder is five years or more.
- 2.2.195 G A *firm* may include perpetual *capital instruments* that do not meet the conditions in *GENPRU 2.2.177R* (Eligibility conditions for *upper tier two capital*) in *lower tier two capital resources* if they meet the general conditions described in *GENPRU 2.2.159R* (General conditions for eligibility as tier two *capital instruments*).
- 2.2.196 R (1) For the purposes of calculating the amount of a *lower tier two instrument* which may be included in a *firm's capital resources*:
- (a) in the case of an instrument with a fixed maturity date, in the final five years to maturity; and
- (b) in the case of an instrument with or without a fixed maturity date but where five years' or more notice of redemption or repayment has been given, in the final five years to the date of redemption or repayment;
- the principal amount must be amortised on a straight line basis.
- (2) If a *firm* gives notice of the redemption or repayment of a *lower tier two instrument* and (1) does not apply, the *firm* must no longer include it in its *lower tier two capital resources*.
- 2.2.197 G If a *firm* wishes to include in *lower tier two capital resources* an instrument with or without a fixed maturity date but where less than five years' notice of redemption or repayment has been given, it should seek individual *guidance* from the *FSA*.

The effect of swaps on debt capital

- 2.2.198 R *GENPRU 2.2.198R* to *GENPRU 2.2.201R* apply to a *tier one instrument*, *tier two instrument* or *tier three instrument* of a *firm* that is treated as a liability under the accounting framework to which it is subject as referred to in *GENPRU 1.3.4R* (General requirements: accounting principles to be applied) (a "debt instrument").
- 2.2.199 R A *firm* must recognise for the purpose of this section any effect that changes in exchange rates or interest rates have on a debt instrument (as defined in *GENPRU 2.2.198R*) under the accounting framework to which the *firm* is subject as referred to in *GENPRU 1.3.4R* (General requirements: accounting principles to be applied).
- 2.2.200 R A *firm* must recognise, in accordance with *GENPRU 2.2.201R*, the effect of a *foreign currency* hedge on a debt instrument (as defined in *GENPRU 2.2.198R*) denominated in a *foreign currency* or of an interest rate hedge on a fixed rate *coupon* debt instrument if:
- (1) the accounting framework to which the *firm* is subject as referred to in *GENPRU 1.3.4R* (General requirements: accounting principles to be applied) provides for a fair value hedge accounting relationship between a liability and its related hedge;

- (2) such a relationship exists under that accounting framework between that debt instrument and that hedge;
- (3) (if the debt instrument is a *tier one instrument*) the *firm's* obligations under that hedge comply with the conditions in *GENPRU 2.2.64R* to *GENPRU 2.2.65R* (General conditions for eligibility as tier one capital);
- (4) (if the debt instrument is a *tier two instrument* or an *upper tier three instrument*) the *firm's* obligations under that hedge comply with the conditions in *GENPRU 2.2.159R* to *GENPRU 2.2.169R* (General conditions for eligibility as tier two capital instruments) as modified, in the case of an *upper tier three instrument*, by *GENPRU 2.2.244R* (Application of *tier two capital rules* to *tier three capital debt*) except as follows:
 - (a) *GENPRU 2.2.159R(9)* only applies to the extent that it requires that hedge to be unsecured; and
 - (b) *GENPRU 2.2.159R(12)* (legal opinion) does not apply.

2.2.201 R A *firm* must recognise the effect of a hedge as referred to in *GENPRU 2.2.200R* by including the net accounting fair value of the hedging instrument in the valuation of the debt instrument (as defined in *GENPRU 2.2.198R*).

Deductions from tiers one and two: Qualifying holdings (bank or building society only)

2.2.202 R *GENPRU 2.2.202R* to *GENPRU 2.2.207R* only apply to a *bank* or *building society*.

2.2.203 R A *qualifying holding* is a direct or indirect holding of a *bank* or *building society* in a non-financial *undertaking* which represents 10% or more of the capital or of the voting rights or which makes it possible to exercise a significant influence over the management of that *undertaking*.

2.2.204 R For the purpose of *GENPRU 2.2.203R*, a non-financial *undertaking* is an *undertaking* other than:

- (1) a *credit institution* or *financial institution*;
- (2) an *undertaking* whose exclusive or main activities are a direct extension of banking or concern services ancillary to banking, such as leasing, factoring, the management of unit trusts, the management of data processing services or any other similar activity; or
- (3) an *insurer*.

2.2.205 R The amount of *qualifying holdings* that a *bank* or *building society* must deduct in the calculation in the *capital resources table* is:

- (1) (if the *firm* has one or more *qualifying holdings* that exceeds 15% of its relevant *capital resources*) the sum of such excesses; and

- (2) to the extent not already deducted in (1), the amount by which the sum of each of that *firm's qualifying holdings* exceeds 60% of its relevant *capital resources*.

2.2.206 R The relevant *capital resources* of a *firm* mean for the purposes of this *rule* the sum of the amount of *capital resources* calculated at stages L (Total tier one capital plus tier two capital) and Q (Total tier three capital) of the calculation in the *capital resources table* as adjusted in accordance with the following:

- (1) the *firm* must not take into account the items referred to in any of the following:
 - (a) *GENPRU 2.2.190R* to *GENPRU 2.2.193R* (surplus provisions); or
 - (b) *GENPRU 2.2.236R* (*expected loss* amounts and other negative amounts); or
 - (c) *GENPRU 2.2.237R* (*securitisation positions*);
- (2) the *firm* must make the deductions to be made at stage S of the calculation in the *capital resources table* (Deductions from total capital); and
- (3) the *firm* need not deduct any *excess trading book position* under (2).

2.2.207 R The following are not included as *qualifying holdings*:

- (1) *shares* that are not held as investments; or
- (2) *shares* that are held temporarily during the normal course of underwriting; or
- (3) *shares* held in a *firm's* name on behalf of others.

Deductions from tiers one and two: Material holdings (BIPRU firm only)

2.2.208 R *GENPRU 2.2.208R* to *GENPRU 2.2.216G* only apply to a *BIPRU firm*.

2.2.209 R A *material holding* is:

- (1) a *BIPRU firm's* holdings of *shares* and any other interest in the capital of an individual *credit institution* or *financial institution* (held in the *non-trading book* or the *trading book* or both) exceeding 10% of the *share* capital of the issuer, and, where this is the case, any holdings of subordinated debt of the same issuer are also included as a *material holding*; the full amount of the holding is a *material holding*; or

- (2) a *BIPRU firm's* holdings of *shares*, any other interest in the capital and subordinated debt in an individual *credit institution* or *financial institution* (held in the *non-trading book* or the *trading book* or both) not deducted under (1) if the total amount of such holdings exceeds 10% of that *firm's capital resources* at stage N (Total tier one capital plus tier two capital after deductions) of the calculation in the *capital resources table* (calculated before deduction of its *material holdings*); only the excess amount is a *material holding*; or
 - (3) a *bank* or *building society's* aggregate holdings in the *non-trading book* of *shares*, any other interest in the capital, and subordinated debt in all *credit institutions* or *financial institutions* not deducted under (1) or (2) if the total amount of such *holdings* exceeds 10% of that *firm's capital resources* at stage N of the calculation in the *capital resources table* (calculated before deduction of its *material holdings*); only the excess amount is a *material holding*; or
 - (4) a *material insurance holding*.
- 2.2.210 G For the purpose of the definition of a *material holding*, *share* capital includes *preference shares*. *Share* premium should be taken into account when determining the amount of *share* capital.
- 2.2.211 R When calculating the size of its *material holdings* a *firm* must only include an actual holding (that is, a long cash position). A *firm* must not net such holdings with a short position.
- 2.2.212 R A *material insurance holding* means the holdings of a *BIPRU firm* of items of the type set out in *GENPRU 2.2.213R* in any:
- (1) *insurance undertaking*; or
 - (2) *insurance holding company*;
- that fulfils one of the following conditions:
- (3) it is a *subsidiary undertaking* of that *firm*; or
 - (4) that *firm* holds a *participation* in it.
- 2.2.213 R An item falls into this provision for the purpose of *GENPRU 2.2.212R* if it is:
- (1) an *ownership share*; or
 - (2) subordinated debt or another item of capital that falls into Article 16(3) of the *First Non-Life Directive* or, as applicable, Article 27(3) of the *Consolidated Life Directive*.
- 2.2.214 R The amount to be deducted with respect to each *material insurance holding* is the higher of:

- (1) the book value of the *material insurance holding*; and
 - (2) the *solo capital resources requirement* for the *insurance undertaking* or *insurance holding company* in question calculated in accordance with Part 3 of *GENPRU 3 Annex 1R* (Method 3 of the capital adequacy calculations for financial conglomerates).
- 2.2.215 R For the purpose of the definition of a *material holding*, holdings must be valued using the valuation method which the holder uses for its external financial reporting purposes.
- 2.2.216 G
- (1) This paragraph gives *guidance* on how the calculation under *GENPRU 2.2.214R(1)* should be carried out where an *insurance undertaking* is accounted for using the embedded value method.
 - (2) On acquisition, any “goodwill” element (that is, the difference between the acquisition value according to the embedded value method and the actual investment) should be deducted from *tier one capital resources*.
 - (3) The embedded value should be deducted from the total of *tier one capital resources* and *tier two capital resources*.
 - (4) Post-acquisition, where the embedded value of the *undertaking* increases, the increase should be added to reserves, while the new embedded value is deducted from total *capital resources*.
 - (5) This means that the net impact on the level of total *capital resources* is zero, although *tier two capital resources* headroom will increase with any increase in *tier one capital resources* reserves.
 - (6) Embedded value is the value of the *undertaking* taking into account the present value of the expected future inflows from existing life assurance business.

Deductions from tiers one and two: Reciprocal cross holdings (BIPRU firm only)

- 2.2.217 R *GENPRU 2.2.217R* to *GENPRU 2.2.220R* apply to a *BIPRU firm*.
- 2.2.218 R A *BIPRU firm* must deduct at stage M of the calculation in the *capital resources table* (Deductions from the totals of tier one and two) any *reciprocal cross-holdings*. However a *BIPRU firm* must not deduct such holdings to the extent that they fall to be deducted at Part 1 of stage M of the calculation in the *capital resources table* (Deductions for *material holdings*, *qualifying holdings* and certain other items).
- 2.2.219 R A *reciprocal cross-holding* means a holding of the *BIPRU firm* of *shares*, any other interest in the capital, and subordinated debt, whether in the *trading* or *non-trading* book, in:
- (1) a *credit institution*; or

(2) a *financial institution*;

that satisfies the following conditions:

- (3) the holding is the subject of an agreement or arrangement between the *BIPRU firm* and either the issuer of the instrument in question or a member of a *group* to which the issuer belongs;
- (4) under the terms of the agreement or arrangement described in (3) the issuer invests in the *BIPRU firm* or in a member of the *group* to which that *BIPRU firm* belongs; and
- (5) the effect of that agreement or arrangement on the capital position of the *BIPRU firm*, the issuer, or any member of a *group* to which either belongs, under any relevant rules is significantly more beneficial than it is in economic terms, taking into account the agreement or arrangement as a whole.

2.2.220 R For the purpose of *GENPRU 2.2.219R*, a relevant rule means a *rule* in *GENPRU*, *BIPRU* or *INSRU* or any other capital adequacy or solvency requirements of the *FSA* or any other regulator, territory or country.

Deductions from tiers one and two: Connected lending of a capital nature (bank only)

2.2.221 R *GENPRU 2.2.221R* to *GENPRU 2.2.235G* only apply to a *bank*.

2.2.222 R *Connected lending of a capital nature* means all lending within *GENPRU 2.2.227R* or *GENPRU 2.2.229R* and guarantees within *GENPRU 2.2.231R* or *GENPRU 2.2.233R*.

2.2.223 R A *bank* must not deduct any item as *connected lending of a capital nature* to the extent that it falls to be deducted at Part 1 of stage M of the calculation in the *capital resources table* (Deductions for *material holdings*, *qualifying holdings* and certain other items) or as a *reciprocal cross-holding*.

2.2.224 R For the purpose of the *rules* in this section about *connected lending of a capital nature* and in relation to a *bank*, a connected party means another *person* (“P”) who fulfils at least one of the following conditions and is not solo-consolidated with the *bank* under *BIPRU 2.1* (Solo consolidation):

- (1) P is *closely related* to the *bank*; or
- (2) P is an *associate* of the *bank*; or
- (3) the same *persons* significantly influence the *governing body* of P and the *bank*.

- 2.2.225 R For the purpose of *GENPRU 2.2.224R*, in relation to a *person* (“P”) to which a *bank* has an *exposure* when P is acting on his own behalf and also an *exposure* to P when P acts in his capacity as a trustee, custodian or general partner of an investment trust, unit trust, venture capital or other investment fund, pension fund or similar fund (a "fund") the *bank* may choose to treat this latter *exposure* as an *exposure* to the fund, unless such treatment would be misleading.
- 2.2.226 G *BIPRU 10.3.13G (Guidance on BIPRU 10.3.12R)* applies to *GENPRU 2.2.225R* as it applies to *BIPRU 10.3.12R* (Exposures to trustees for concentration risk purposes).
- 2.2.227 R A loan is *connected lending of a capital nature* if:
- (1) it is made by the *bank* to a connected party; and
 - (2) it falls into *GENPRU 2.2.228R*.
- 2.2.228 R A loan falls into this *rule* for the purposes of *GENPRU 2.2.227R(2)* if, whether through contractual, structural, reputational or other factors:
- (1) based on the terms of the loan and the other knowledge available to the *bank*, the borrower would be able to consider it from the point of view of its characteristics as capital as being similar to *share* capital or subordinated debt; or
 - (2) the position of the lender from the point of view of maturity and repayment is inferior to that of the senior unsecured and unsubordinated creditors of the borrower.
- 2.2.229 R A loan is also *connected lending of a capital nature* if:
- (1) it funds directly or indirectly a loan to a connected party of the *bank* falling into *GENPRU 2.2.229R* or an investment in the capital of a connected party of the *bank*; and
 - (2) it falls into *GENPRU 2.2.228R*.
- 2.2.230 G It is likely that a loan is not *connected lending of a capital nature* if:
- (1) it is secured by collateral that is eligible for the purposes of *credit risk mitigation* under the *standardised approach* to credit risk as set out in *BIPRU 5.4 (Financial collateral)* and *BIPRU 5.5 (Other funded credit risk mitigation)* ; or
 - (2) it is repayable on demand (and should be treated as such for accounting purposes by the borrower and lender) and the *bank* can demonstrate that there are no potential obstacles to exercising the right to repay, whether contractual or otherwise.
- 2.2.231 R A guarantee is *connected lending of a capital nature* if it is a guarantee by the *bank* of a loan from a third party to a connected party of the *bank* and:

- (1) the loan meets the requirements of *GENPRU 2.2.228R*; or
 - (2) the rights that the *bank* would have against the borrower with respect to the guarantee meet the requirements of *GENPRU 2.2.228R(2)*.
- 2.2.232 R A guarantee is also *connected lending of a capital nature* if it is a guarantee by the *bank* of a loan falling into *GENPRU 2.2.229R(1)*; and
- (1) the loan meets the conditions in *GENPRU 2.2.228R*; or
 - (2) the guarantee meets the conditions in *GENPRU 2.2.231R(2)*.
- 2.2.233 R The amount of a guarantee that constitutes *connected lending of a capital nature* that a *firm* must deduct is the amount guaranteed.
- 2.2.234 G A loan may initially fall outside the definition of *connected lending of a capital nature* but later fall into it. For example, if the initial lending to a connected party is subsequently downstreamed to another connected party the relationship between the *bank* and the ultimate borrower may be such that, looking at the arrangements as a whole, the *undertaking* to which the *bank* lends is able to regard the loan to it as being capable of absorbing losses.
- 2.2.235 G Lending to a connected party will not normally be *connected lending of a capital nature* where that party:
- (1) is acting as a vehicle to pass funding to an unconnected party; and
 - (2) has no other creditors whose claims could be senior to those of the lender.

Deductions from tiers one and two: Expected losses and other negative amounts (BIPRU firm only)

- 2.2.236 R A *BIPRU firm* calculating *risk weighted exposure amounts* under the *IRB approach* must deduct:
- (1) any negative amounts arising from the calculation in *BIPRU 4.3.8R* (Treatment of expected loss amounts); and
 - (2) any *expected loss amounts* calculated in accordance with *BIPRU 4.7.12R* (*Expected loss amounts* under the simple risk weight approach to calculating *risk-weighted exposure amounts* for *exposures* belonging to the *equity exposure IRB exposure class*) or *BIPRU 4.7.17R* (*Expected loss amounts* under the *PD/LGD approach*).

Deductions from tiers one and two: Securitisation positions (BIPRU firm only)

- 2.2.237 R A *BIPRU firm* calculating *risk weighted exposure amounts* under the *IRB approach* or the *standardised approach* to credit risk must deduct from its *capital resources* the exposure amount of *securitisation positions* which receive a *risk weight* of 1250% under *BIPRU 9* (Securitisation), unless the *firm* includes the *securitisation positions* in its calculation of *risk weighted exposure amounts* (see *BIPRU 9.10* (Reduction in risk-weighted exposure amounts)).

Deductions from tiers one and two: Special treatment of material holdings and other items (BIPRU firm only)

- 2.2.238 R *GENPRU 2.2.238R* to *GENPRU 2.2.241G* apply to a *BIPRU firm* and relate to the deductions in respect of:

- (1) *material holdings*;
- (2) *expected loss* amounts and other negative amounts referred to in *GENPRU 2.2.236R*; and
- (3) *securitisation positions* referred to in *GENPRU 2.2.237R*.

- 2.2.239 R (1) The treatment in the *capital resources table* of the deductions in *GENPRU 2.2.238R* only has effect for the purpose of the *capital resources gearing rules*.
- (2) In other cases (3) and (4) apply.
- (3) A *BIPRU firm* making the deductions described in *GENPRU 2.2.238R* must deduct 50% of the total amount of those deductions at stage E (Deductions from tier one capital) and 50% at stage J (Deductions from tier two capital) of the calculation in the *capital resources table* after the application of the *capital resources gearing rules*.
- (4) To the extent that half of the total of:
- (a) *material holdings*;
 - (b) *expected loss* amounts and other negative amounts; and
 - (c) *securitisation positions*;

exceeds the amount calculated at stage I (Total tier two capital) of that calculation, a *firm* must deduct that excess from the amount calculated at stage F (Total tier one capital after deductions) of the *capital resources table*.

- 2.2.240 G The alternative calculation in *GENPRU 2.2.239R*(3) to (4) is only relevant to *BIPRU 11* (Pillar 3 disclosures) and certain reporting requirements under *SUP*. However the deduction of *material holdings* at Part 2 of stage E of the *capital resources table* in the case of a *BIPRU investment firm* with an *investment firm consolidation waiver* has effect for all purposes.

Tier three capital: upper tier three capital resources (BIPRU firm only)

- 2.2.241 R *GENPRU 2.2.241R to GENPRU 2.2.245R only apply to a BIPRU firm.*
- 2.2.242 R *A BIPRU firm may include subordinated debt in its upper tier three capital resources only if:*
- (1) *it has an original maturity of at least two years or is subject to at least two years' notice of repayment; and*
 - (2) *payment of interest or principal is permitted only if, after that payment, the firm's capital resources would be not less than its capital resources requirement.*
- 2.2.243 R *A BIPRU firm which includes subordinated debt in its tier three capital resources must notify the FSA one month in advance of all payments of either interest or principal made when the firm's capital resources are less than 120% of its capital resources requirement.*
- 2.2.244 R *The rules in the table in GENPRU 2.2.245R apply to short term subordinated debt that a BIPRU firm includes in its tier three capital resources in the same way that they apply to a firm's tier two capital resources with the adjustments in that table.*
- 2.2.245 R *Table: Application of tier two capital rules to tier three debt
This table belongs to GENPRU 2.2.244R*

<i>Tier two capital rule</i>	<i>Adjustment</i>
<i>GENPRU 2.2.159R (General conditions for eligibility as tier two capital)</i>	<p>The references in <i>GENPRU 2.2.159R(5)</i> (Capital must not become repayable prior to stated maturity date except in specified circumstances) to repayment at the option of the holder are replaced by a reference to <i>GENPRU 2.2.242R(1)</i> (<i>Upper tier three capital</i> should have maturity or notice period of at least two years)</p> <p>The reference in <i>GENPRU 2.2.159R(10)</i> (Description of <i>tier two capital</i> in marketing documents) to <i>GENPRU 2.2.271R</i> (Other requirements: insurers carrying on with-profits business (Insurer only)) does not apply</p>
<i>GENPRU 2.2.160R (Holder of a non-deferred share of a building society to be treated as a senior creditor)</i>	

<i>Tier two capital rule</i>	Adjustment
<i>GENPRU 2.2.161R</i> (Additional remedies)	
<i>GENPRU 2.2.163R</i> (Legal opinion where debt subject to a law of a country outside the <i>United Kingdom</i>)	
<i>GENPRU 2.2.169R</i> (Ineligibility as <i>tier two capital</i> owing to connected transactions)	The reference to <i>GENPRU 2.2.177R</i> (General eligibility conditions for <i>upper tier two capital</i>) does not apply
<i>GENPRU 2.2.171R</i> (Amendments to terms of the <i>capital instrument</i>)	
<i>GENPRU 2.2.172R</i> to <i>GENPRU 2.2.173R</i> (Redeemability at the option of the issuer)	
<i>GENPRU 2.2.174R</i> (Notification of redemption)	
References in the <i>rules</i> in the first column to the fifth anniversary are amended so as to refer to the second anniversary.	

Tier three capital: lower tier three capital resources (BIPRU firm only)

- 2.2.246 R *GENPRU 2.2.246R* to *GENPRU 2.2.249R* only apply to a *BIPRU firm*.
- 2.2.247 R A *BIPRU firm's* net interim *trading book* profits mean its net *trading book* profits adjusted as follows:
- (1) they are net of any foreseeable charges or dividends and less net losses on its other business; and
 - (2) a *firm* must not take into account items that have already been included in the calculation of *capital resources* as part of the calculation of the following items:
 - (a) interim net profits (see stage (A) of the *capital resources table*); or
 - (b) interim net losses or material interim net losses (see stage (A) of the *capital resources table*); or
 - (c) profit and loss and other reserves (see stage (A) of the *capital resources table*).

- 2.2.248 R *Trading book* profits and losses, other than those losses to which *GENPRU* 2.2.86R(2) (Valuation adjustment and reserves) refers, originating from valuation adjustments or reserves as referred to in *GENPRU* 1.3.29R to *GENPRU* 1.3.35G (Valuation adjustments or reserves) must be included in the calculation of net interim *trading book* profits and be added to or deducted from *tier three capital resources*.
- 2.2.249 R *Trading book* valuation adjustments or reserves as referred to in *GENPRU* 1.3.29R to *GENPRU* 1.3.35G which exceed those made under the accounting framework to which a *firm* is subject must be treated in accordance with *GENPRU* 2.2.248R if not required to be treated under *GENPRU* 2.2.86R(2).

Deductions from total capital: Inadmissible assets (insurers only)

- 2.2.250 R *GENPRU* 2.2.250R to *GENPRU* 2.2.253G only apply to an *insurer*.
- 2.2.251 R For the purposes of the *capital resources table*, an *insurer* which is not a *pure reinsurer* must deduct from total *capital resources* the value of any asset which is not an *admissible asset* as listed in *GENPRU* 2 Ann 7R (Admissible assets in insurance), unless the asset is held to cover *property-linked liabilities* or *index-linked liabilities* under *INSPRU* 3.1.57R or *INSPRU* 3.1.58R (Covering linked liabilities).
- 2.2.252 G *GENPRU* 2.2.251R does not apply to intangible assets which should be deducted from *tier one capital resources* under *GENPRU* 2.2.155R (Deductions from tier one: Intangible assets).
- 2.2.253 G The list of *admissible assets* has been drawn with the aim of excluding assets:
- (1) for which a sufficiently objective and verifiable basis of valuation does not exist; or
 - (2) whose realisability cannot be relied upon with sufficient confidence; or
 - (3) whose nature presents an unacceptable custody risk; or
 - (4) the holding of which may give rise to significant liabilities or onerous duties.

Deductions from total capital: Adjustments for related undertakings

- 2.2.254 R *GENPRU* 2.2.254R to *GENPRU* 2.2.258G only apply to an *insurer*.
- 2.2.255 R An *insurer* must deduct from its *capital resources* the value of its investments in each of its *related undertakings* that is an *ancillary services undertaking*.

- 2.2.256 R In relation to each of its *related undertakings* that is a *regulated related undertaking* (other than an *insurance undertaking*) an *insurer* must add to (if positive), at stage J in the *capital resources table* (Positive adjustments for related undertakings), or deduct from (if negative), at stage L in the *capital resources table* (Deductions from total capital), its *capital resources* the value of its *shares* in that *undertaking* calculated in accordance with *GENPRU 1.3.47R* (Shares in and debts due from related undertakings).
- 2.2.257 G For the purposes of *GENPRU 2.2.255R*, investments must be valued at their accounting book value in accordance with *GENPRU 1.3.4R* (General requirements: accounting principles to be applied).
- 2.2.258 G *Related undertakings* which are also *insurance undertakings* are not included in *GENPRU 2.2.256R* because an *insurer* that is a *participating insurance undertaking* is subject to the requirements of *INSRU 6.1* (Group Risk: Insurance Groups).

Deductions from total capital: Illiquid assets (BIPRU investment firm only)

- 2.2.259 R *GENPRU 2.2.259R* to *GENPRU 2.2.262G* only apply to a *BIPRU investment firm*.
- 2.2.260 R *Illiquid assets* means illiquid assets including
- (1) tangible fixed assets (except land and buildings if they are used by a *firm* as security for loans, but this exclusion is only up to the value of the principal outstanding on the loans); or
 - (2) any holdings in the *capital resources* of *credit institutions* or *financial institutions*, except to the extent that:
 - (a) they have already been deducted as a *material holding*; or
 - (b) they are *shares* which are included in a *firm's trading book* and included in the calculation of the *firm's market risk capital requirement*; or
 - (3) holdings of other *securities* which are not *readily realisable securities*; or
 - (4) deficiencies of net assets in *subsidiary undertakings*; or
 - (5) deposits which are not repayable within 90 days (except for payments in connection with margined *futures* or *options* contracts); or
 - (6) loans and other amounts owed to a *firm* except where they are due to be repaid within 90 days; or
 - (7) physical stocks except for *positions* in *physical commodities* which are included in the calculation of a *firm's commodity PRR*.

- 2.2.261 G If a loan or other amount owing to a *firm* was originally due to be paid more than 90 days from the date of the making of the loan or the incurring of the payment obligation, as the case may be, it may be treated as liquid for the purposes of *GENPRU 2.2.260R(6)* where through the passage of time the remaining time to the contractual repayment date falls below 90 days.
- 2.2.262 G If a loan or other amount is due to be paid within 90 days (whether measured by reference to original or remaining maturity), a *firm* should consider whether it can reasonably expect the amount owing to be paid within that period. If the *firm* cannot reasonably expect it to be paid within that period the *firm* should treat it as illiquid.

Deductions from total capital: Excess trading book position (bank or building society only)

- 2.2.263 R *GENPRU 2.2.263R* to *GENPRU 2.2.265R* only apply to a *bank* or *building society*.
- 2.2.264 R (1) The *excess trading book position* is the excess of:
- (a) a *bank* or *building society's* aggregate net long (including notional *trading book positions* in *shares*, subordinated debt or any other interest in the capital of *credit institutions* or *financial institutions*;
- over;
- (b) 25% of that *firm's* *capital resources* calculated at stage T (Total capital after deductions) of the *capital resources table* (calculated before deduction of the *excess trading book position*).
- (2) Only the excess amount calculated under (1) must be deducted.
- 2.2.265 R The *standard market risk PRR rules* apply for establishing what is a net *position* and the amount and value of that *position* for the purposes of *GENPRU 2.2.264R*, ignoring *rules* which would otherwise exclude such *positions* from *BIPRU 7.2* (Interest rate PRR) or *BIPRU 7.3* (Equity PRR and basic interest rate PRR for equity derivatives) on the basis that they are to be deducted from a *bank* or *building society's* *capital resources*, or for any other reason.

Other capital resources: Unpaid share capital or initial funds and calls for supplementary contributions (Insurer only)

- 2.2.266 G *GENPRU 2.2.266G* to *GENPRU 2.2.269G* only apply to an *insurer*.
- 2.2.267 G Unpaid *share* capital or, in the case of a *mutual*, *unpaid initial funds* and calls for supplementary contributions are excluded from the *capital resources* of a *firm* except to the extent allowed in a *waiver* under section 148 of the *Act* (Modification or waiver of rules).

- 2.2.268 G Subject to a *waiver*, under the *Insurance Directives* a maximum of one half of unpaid *share* capital or, in the case of a *mutual*, one half of the *unpaid initial fund* may be included in an *insurer's capital resources*, once the paid-up part amounts to 25% of that *share* capital or fund, up to 50% of total *capital resources*.
- 2.2.269 G In the case of a *mutual* carrying on *general insurance business* and subject to a *waiver*, calls for supplementary contributions within the *financial year* may only be included in a *firm's capital resources* up to a maximum of 50% of the difference between the maximum contributions and the contributions actually called in, subject to a limit of 50% of total *capital resources*. In the case of a *mutual* carrying on *long-term insurance business*, the *Consolidated Life Directive* does not permit calls for supplementary contributions to be included in a *firm's capital resources*.

Other requirements: insurers carrying on with-profits business (Insurer only)

- 2.2.270 R *GENPRU 2.2.270R* to *GENPRU 2.2.275G* only apply to an *insurer*.
- 2.2.271 R An *insurer* carrying on *with-profits insurance business* must, in addition to the other requirements in respect of *capital resources* elsewhere in *GENPRU 2.2*, meet the following conditions before a *capital instrument* can be included in that *insurer's capital resources*:
- (1) the *insurer* must manage the *with-profits fund* so that discretionary benefits under a *with-profits insurance contract* are calculated and paid disregarding, insofar as is necessary for its *customers* to be treated fairly, any liability the *firm* may have to make payments under the *capital instrument*;
 - (2) the intention to manage the *with-profits fund* on the basis set out in (1) must be disclosed in the *firm's Principles and Practices of Financial Management*; and
 - (3) no amounts, whether interest, principal, or other amounts, must be payable by the *firm* under the *capital instrument* if the *firm's* assets would then be insufficient to enable it to declare and pay under a *with-profits insurance contract* discretionary benefits that are consistent with the *firm's* obligations under *Principle 6* (Customers' interests).
- 2.2.272 G The purpose of *GENPRU 2.2.271R* is to achieve practical subordination of *capital instruments* if they are to qualify as *capital resources* to the liabilities an *insurer* has to *with-profits policyholders*, including liabilities which arise from the regulatory duty to treat *customers* fairly in setting discretionary benefits. (*Principle 6* (Customers' interests) requires a *firm* to pay due regard to the interests of its customers and treat them fairly.) It is not sufficient for a *capital instrument* to be subordinated to such liabilities only on winding up of the *firm* because such liabilities to *policyholders* may have been reduced by the inappropriate use of management discretion to enable funds to be applied in repaying subordinated *capital instruments* before winding up proceedings commence.

- 2.2.273 G *GENPRU 2.2.271R* is an additional requirement to all other *rules* in this section concerning the eligibility of a *capital instrument* to count as a component of an *insurer's capital resources*. Subordinated debt instruments will be the main type of *capital instrument* to which this *rule* is relevant, including both *upper tier two* (undated) and *lower tier two* (dated) subordinated debt instruments. Subordinated debt instruments which are issued by a *related undertaking* are not intended to be covered by this *rule* and may be included in *group capital resources* as appropriate if the other eligibility criteria are met.
- 2.2.274 G *GENPRU 2.2.64R(10)* and *GENPRU 2.2.159R(10)* contain provisions concerning the marketing of a *capital instrument*. In relation to a *firm* to which *GENPRU 2.2.271R* applies, in order to comply with *GENPRU 2.2.64R(10)* and *GENPRU 2.2.159R(10)*, it should draw to the attention of subscribers the risk that payments may be deferred or cancelled in order to operate the *with-profits fund* so as to give priority to the payment of discretionary benefits to *with-profits policyholders*.
- 2.2.275 G (1) *Upper tier two instruments* should meet the requirements of *GENPRU 2.2.177R(3)* which goes beyond the requirement in *GENPRU 2.2.271R(3)* since it requires a *firm* to have the option to defer payments in all circumstances, not just if necessary to treat *customers* fairly. However, for *lower tier two instruments*, *GENPRU 2.2.271R(3)* represents an additional requirement since a failure to pay amounts of interest or principal on a due date must not constitute an event of default under *GENPRU 2.2.159R(2)* for *firms* carrying on *with-profits insurance business*.
- (2) For *firms* which are *realistic basis life firms* compliance with *GENPRU 2.2.271R(3)* would usually be achieved if the *capital instrument* provides that no amounts will be payable under it unless the *firm's capital resources* exceed its *capital resources requirement*. However, such *firms* should ensure that the terms of the *capital instrument* refer to *FSA capital resources requirements* in force from time to time, including the current realistic reserving requirements and are not restricted to former minimum capital requirements based only on the *Insurance Directives'* required minimum margin of solvency. For *firms* which are not *realistic basis life firms*, compliance with *GENPRU 2.2.271R(3)* will probably require specific reference to be made to treating *customers* fairly in the terms of the *capital instrument*.

Public sector guarantees

- 2.2.276 R A *BIPRU firm* may not include a guarantee from a state or public authority in its *capital resources*.

2.3 Application of GENPRU 2 to Lloyd's

Application of GENPRU 2.1

- 2.3.1 R *GENPRU 2.1 applies to the Society in accordance with INSPRU 8.1.2R.*
- 2.3.2 R *GENPRU 2.1.38R to GENPRU 2.1.39G apply to managing agents in accordance with INSPRU 8.1.4R.*
- 2.3.3 G *GENPRU 2.1.13R requires the Society to ensure, in relation to each member's insurance business, that capital resources equal to or in excess of the member's capital resources requirement (CRR) are maintained. GENPRU 2.1 sets out the overall framework of the CRR. INSPRU 1.1 sets out the calculation of the components of the general insurance capital requirement and the long-term insurance capital requirement.*
- 2.3.4 G *Managing agents are required to calculate the ECR for the purposes of carrying out syndicate ICAs under INSPRU 7.1. As with-profits insurance business is not carried on through any syndicate, the calculation of the with-profits insurance capital component will not be applicable. INSPRU 1.3 is not applied to Lloyd's.*

Calculation of the MCR

- 2.3.5 R For the purposes of *GENPRU 2.1.24R*, the *Society* must calculate the *MCR* in respect of the *general insurance business* of each *member* as the higher of:
- (1) the *member's* share of the *base capital resources requirement* in respect of *general insurance business* for the *members* in aggregate; and
 - (2) the *general insurance capital requirement* for the *member*, calculated according to *GENPRU 2.3.11R*.
- 2.3.6 R For the purposes of *GENPRU 2.3.5R(1)*, the *Society* must determine the *member's* share by apportioning the *base capital resources requirement* in respect of *general insurance business* for the *members* in aggregate between *members* in proportion to the result for each *member* of *GENPRU 2.3.11R*.
- 2.3.7 R For the purposes of *GENPRU 2.1.25R*, the *Society* must calculate the *MCR* in respect of the *long-term insurance business* of each *member* as the higher of:
- (1) the *member's* share of the *base capital resources requirement* in respect of *long-term insurance business* for the *members* in aggregate; and
 - (2) the sum of, for each *member*:

- (a) the *long-term insurance capital requirement*; and
- (b) the *resilience capital requirement*.

2.3.8 R For the purposes of *GENPRU 2.3.7R(1)*, the *Society* must determine the *member's* share by applying to the aggregate long-term business *base capital resources requirement* the ratio of the result for the *member* of *GENPRU 2.3.7R(2)* to the aggregate of the results of *GENPRU 2.3.7R(2)* for all *members*.

Calculation of the base capital resources requirement

2.3.9 R The amount of the *base capital resources requirement* for the *members* in aggregate is:

- (1) for *general insurance business*, €3.2 million; and
- (2) for *long-term insurance business*, €3.2 million.

Calculation of the general insurance capital requirement

2.3.10 R For the purposes of *GENPRU 2.1.34R*, the *Society* must calculate the *general insurance capital requirement* for the *members* in aggregate as the higher of:

- (1) the aggregate for all *members* of the higher of, for each *member*, the result of the *premiums amount* and the *claims amount*; and
- (2) the *brought forward amount*.

2.3.11 R The *Society* must determine the *general insurance capital requirement* for each *member* by apportioning the result of *GENPRU 2.3.10R* between *members* on a fair and reasonable basis, provided that the *general insurance capital requirement* for a *member* must not be less than the higher of the result of the *premiums amount* and the *claims amount* for that *member*.

2.3.12 G The *Society* should calculate the *premiums amount* and the *claims amount* for each *member* on the basis of the *member's* own *general insurance business*, including *insurance business* that attaches to the reinsuring *member* for the purposes of *GENPRU* following an *approved reinsurance to close* (see *INSPRU 8.2.16R*).

2.3.13 R The *Society* must calculate the *general insurance capital requirement* it would have to determine under *GENPRU 2.1.34R* if it were an *insurer* carrying on all the *general insurance business* carried on by its *members*, but eliminating *inter-syndicate reinsurance* (the *Society GICR*).

2.3.14 G For the purpose of *GENPRU 2.3.13R* the *Society* may make appropriate approximations, taking reasonable care to avoid underestimating the *Society*

GICR.

- 2.3.15 R The *Society* must determine each *member's* share of the *Society GICR* by allocating the *Society GICR* between the *members* in proportion to the result for each *member* of *GENPRU 2.3.11R*.

Application of *GENPRU 2.2*

- 2.3.16 R Subject to *GENPRU 2.3.18R*, *GENPRU 2.3.19R* and *GENPRU 2.3.21R*, *GENPRU 2.2* applies to *managing agents* and to the *Society* in accordance with:

- (1) for *managing agents*, *INSPRU 8.1.4R*; and
- (2) for the *Society*, *INSPRU 8.1.2R*.

- 2.3.17 G *GENPRU 2.1* sets out minimum *capital resources requirements* for a *firm* and for Lloyd's *members*. *GENPRU 2.2* sets out how, for the purpose of these requirements, *capital resources* are defined and measured. *GENPRU 2.2* applies:

- (1) to *managing agents* for their calculation of the *capital resources* managed by them in respect of each *syndicate* they manage (by reference, where there is a change in the underlying capital provision, to each open *syndicate* year); and
- (2) to the *Society* for its calculation of:
 - (a) each *member's capital resources*; and
 - (b) its own *capital resources*.

- 2.3.18 R *GENPRU 2.2.32R* to *GENPRU 2.2.41R* (Limits on the use of different forms of capital) do not apply to *managing agents*.

- 2.3.19 R *GENPRU 2.2.32R* to *GENPRU 2.2.41R* (Limits on the use of different forms of capital) do apply to the *Society* with respect to:

- (1) the *capital resources* requirements for the *members* in aggregate; and
- (2) the aggregate *capital resources* supporting the *insurance business* of all the *members*.

- 2.3.20 R *GENPRU 2.2.74R* does not apply to the *Society* or to *managing agents*.

- 2.3.21 R In this section (*GENPRU 2.3*), "the aggregate *capital resources* supporting the *insurance business* of all the *members*" are:

- (1) the aggregate of all the *members' capital resources* calculated under

GENPRU 2.3.25R; and

- (2) the *Society's capital resources* excluding callable contributions.

Calculation of capital resources

- 2.3.22 R *The capital resources table* applies with the modifications that:
- (1) *core tier one capital* includes *Lloyd's members' contributions* in accordance with GENPRU 2.3.34R, subject, in the case of letters of credit, guarantees and verifiable sums arising out of life assurance policies, to compliance with GENPRU 1.5.8R to GENPRU 1.5.12R; and
- (2) the *Society* may also recognise and value *callable contributions*, pursuant to GENPRU 2.3.24R.
- 2.3.23 G *Lloyd's member's contributions* are *admissible assets* under GENPRU 2.3.34R and include letters of credit, guarantees and verifiable sums arising out of life assurance policies held as *funds at Lloyd's*. Assets that may be valued as part of *capital resources* under PRU are not necessarily, however, permitted investments for *members* under the terms of any *Lloyd's trust deed*.
- 2.3.24 R In calculating its *capital resources*, the *Society* may, subject to GENPRU 1.5.13R to GENPRU 1.5.14R, recognise and value *callable contributions*.
- 2.3.25 R The *Society* must calculate each *member's capital resources* as the sum of:
- (1) a *member's* proportionate share of the *capital resources* held at *syndicate* level for each *syndicate* in which the *member* participates; and
- (2) the value of a *member's funds at Lloyd's* after deducting liabilities in compliance with GENPRU 1.5.18R.
- 2.3.26 R In order to comply with GENPRU 2.1.13R the *Society* must ensure at all times that:
- (1) each *member's capital resources requirement* is covered by:
- (a) that *member's capital resources*, calculated according to GENPRU 2.3.25R; and
- (b) to the extent that (a) is insufficient, by the *Society's own capital resources*; and
- (2) the *Society GICR* is covered by the aggregate *capital resources* supporting the *insurance business* of all the *members*.

2.3.27 R For the purposes of *GENPRU 2.3.26R(1)(b)*, the *Society* must maintain at all times *capital resources* sufficient to meet the aggregate of, for each *member*, the amount, if any, by which the *member's capital resources* fall short of the *member's capital resources requirement*.

2.3.28 R The *Society* must calculate each *member's* share of the amount of *capital resources* required to comply with *GENPRU 2.2.33R* as the higher of:

- (1) 1/3 of the *long-term insurance capital requirement* for the *members* in aggregate; and
- (2) the *base capital resources requirement*;

allocated between the *members* in proportion to the result for each *member* of *GENPRU 2.3.7R(2)*.

2.3.29 R For the purposes of *GENPRU 2.2.34R*, the *Society* must ensure that the aggregate *capital resources* supporting the *insurance business* of all the *members* meet the higher of:

- (1) 1/3 of the *general insurance capital requirement* for the *members* in aggregate;
- (2) 1/3 of the *Society GICR*; and
- (3) the *base capital resources requirement*;

with the sum of the items listed in *GENPRU 2.2.34R*.

2.3.30 R The *Society* must calculate each *member's* share of the amount of *capital resources* required to comply with *GENPRU 2.2.34R* as the higher of:

- (1) 1/3 of the *general insurance capital requirement* for the *members* in aggregate;
- (2) 1/3 of the *Society GICR*; and
- (3) the *base capital resources requirement*;

allocated between the *members* in proportion to the result for each *member* of *GENPRU 2.3.11R*.

Characteristics of tier one capital

2.3.31 R A *Lloyd's member's contribution* may be included in *tier one capital resources* to the extent that:

- (1) the proceeds are immediately and fully available in respect of the *member's insurance business* at *Lloyd's*;

- (2) (except in relation to letters of credit), it complies with *GENPRU 2.2.64R(3)* or cannot be repaid to a *member* until all of the *member's* liabilities in respect of its *insurance business* at Lloyd's have been extinguished, covered or reinsured by an *approved reinsurance to close*;
- (3) it otherwise complies with *GENPRU 2.2.64R(5)* to *GENPRU 2.2.64R(10)*.

Adjustments for related undertakings

- 2.3.32 R *GENPRU 2.2.256R* (Adjustment for regulated related undertakings other than insurance undertakings) applies to the *Society* with the modification that the *Society* must also value its *insurance undertakings* in accordance with *GENPRU 2.2.256R*.
- 2.3.33 R If a *related undertaking* is an *insurance undertaking* which has a deficit in the *capital resources* available to cover its *capital resources requirement*, the *Society* must make provision for:
- (1) its proportionate share of that deficit; or
 - (2) in the case of a *subsidiary undertaking*, the whole of that deficit.

Modification of *GENPRU 2 Annex 7R* for Lloyd's

- 2.3.34 R In the case of *members*, *Lloyd's members' contributions* are included in *GENPRU 2 Annex 7R* and include:
- (1) letters of credit;
 - (2) guarantees; and
 - (3) verifiable sums arising out of life assurance policies;

held as *funds at Lloyd's*.

- 2.3.35 G The effect of *GENPRU 2.3.34R* is that *Lloyd's members' contributions*, including letters of credit, guarantees and life assurance policies, are *admissible assets*.

GENPRU 2 Annex 1R

Capital resources table for an insurer

Capital resources calculation for an insurer		
Type of capital	Related text	Stage
Core tier one capital		(A)
<i>Permanent share capital</i>	<i>GENPRU 2.2.83R</i>	
Profit and loss account and other reserves (taking into account interim net losses)	<i>GENPRU 2.2.85R;</i> <i>GENPRU 2.2.87R to</i> <i>GENPRU 2.2.88R</i>	
<i>Share premium account</i>	<i>GENPRU 2.2.101R</i>	
Externally verified interim net profits	<i>GENPRU 2.2.102R</i>	
Positive valuation differences	<i>GENPRU 2.2.105R</i>	
Fund for future appropriations	<i>GENPRU 2.2.108R</i>	
Perpetual non-cumulative preference shares		(B)
Perpetual non-cumulative <i>preference shares</i>	<i>GENPRU 2.2.109R</i>	
Innovative tier one capital		(C)
<i>Innovative tier one instruments</i>	<i>GENPRU 2.2.113R to</i> <i>GENPRU 2.2.121R</i>	
Total tier one capital before deductions = A+B+C		(D)
Deductions from tier one capital		(E)
Investments in own <i>shares</i>	None	
Intangible assets	<i>GENPRU 2.2.155R</i>	
Amounts deducted from <i>technical provisions</i> for discounting and other negative valuation differences	<i>GENPRU 2.2.105R to</i> <i>GENPRU 2.2.107R</i>	
Total tier one capital after deductions = D-E		(F)

Capital resources calculation for an insurer		
Type of capital	Related text	Stage
Upper tier two capital		(G)
Perpetual cumulative <i>preference shares</i>	<i>GENPRU 2.2.159R to GENPRU 2.2.181R</i>	
Perpetual subordinated debt	See previous entry	
Perpetual subordinated securities	See previous entry	
Lower tier two capital		(H)
Fixed term <i>preference shares</i>	<i>GENPRU 2.2.159R to GENPRU 2.2.175G; GENPRU 2.2.194R to GENPRU 2.2.196R</i>	
Long term subordinated debt	See previous entry	
Fixed term subordinated securities	See previous entry	
Total tier two capital = G+H		(I)
Positive adjustments for related undertakings		(J)
<i>Related undertakings that are regulated related undertakings (other than insurance undertakings)</i>	<i>GENPRU 2.2.256R</i>	
Total capital after positive adjustments for insurance undertakings but before deductions = F + I + J		(K)
Deductions from total capital		(L)
Inadmissible assets	<i>GENPRU 2.2.250R to GENPRU 2.2.251R; GENPRU 2 Annex 7R</i>	
Assets in excess of <i>market risk and counterparty</i> limits	<i>INSPRU 2.1.22R</i>	
<i>Related undertakings that are ancillary services undertakings</i>	<i>GENPRU 2.2.255R</i>	

Capital resources calculation for an insurer		
Type of capital	Related text	Stage
Negative adjustments for <i>related undertakings</i> that are <i>regulated related undertakings</i> (other than <i>insurance undertakings</i>)	<i>GENPRU 2.2.256R</i>	
Total capital after deductions = K - L		(M)
Other capital resources*		(N)
Unpaid <i>share</i> capital or, in the case of a <i>mutual, unpaid initial funds</i> and calls for supplementary contributions	<i>GENPRU 2.2.266G</i> to <i>GENPRU 2.2.269G</i>	
<i>Implicit items</i>	<i>GENPRU 2 Annex 8G</i>	
Total capital resources after deductions = M + N		(O)
* Items in section (N) of the table can be included in <i>capital resources</i> if subject to a <i>waiver</i> under section 148 of the <i>Act</i> .		
Note: Where the table refers to related text, it is necessary to refer to that text in order to understand fully what is included in the descriptions of capital items and deductions set out in the table.		

GENPRU 2 Annex 2R

Capital resources table for a bank

The capital resources calculation for a bank		
Type of capital	Related text	Stage
Core tier one capital		(A)
<i>Permanent share capital</i>	<i>GENPRU 2.2.83R</i>	
Profit and loss account and other reserves (taking into account interim net losses)	<i>GENPRU 2.2.85R to 2.2.90R</i>	
<i>Eligible partnership capital</i>	<i>GENPRU 2.2.93R; GENPRU 2.2.95R</i>	
<i>Eligible LLP members' capital</i>	<i>GENPRU 2.2.94R; GENPRU 2.2.95R</i>	
<i>Share premium account</i>	<i>GENPRU 2.2.101R</i>	
Externally verified interim net profits	<i>GENPRU 2.2.102R</i>	
Perpetual non-cumulative preference shares		(B)
Perpetual non-cumulative <i>preference shares</i>	<i>GENPRU 2.2.109R</i>	
Innovative tier one capital		(C)
<i>Innovative tier one instruments</i>	<i>GENPRU 2.2.113R to GENPRU 2.2.137R</i>	
Total tier one capital before deductions = A+B+C		(D)
Deductions from tier one capital		(E)
Investments in own <i>shares</i>	None	
Intangible assets	<i>GENPRU 2.2.155R</i>	
Excess of drawings over profits for partnerships and <i>limited liability partnerships</i>	<i>GENPRU 2.2.100R</i>	
Net losses on equities held in the available-for- sale financial asset category	<i>GENPRU 2.2.185R</i>	

The capital resources calculation for a bank		
Type of capital	Related text	Stage
(For certain limited purposes only certain additional deductions are made here)	<i>GENPRU 2.2.239R(2) to (4)</i>	
Total tier one capital after deductions = D-E		(F)
Upper tier two capital		(G)
Perpetual cumulative <i>preference shares</i>	<i>GENPRU 2.2.159R to GENPRU 2.2.181R</i>	
Perpetual subordinated debt	See previous entry	
Perpetual subordinated securities	See previous entry	
Revaluation reserves	<i>GENPRU 2.2.185R</i>	
General/collective provisions	<i>GENPRU 2.2.187R to GENPRU 2.2.189R</i>	
Surplus provisions	<i>GENPRU 2.2.190R to GENPRU 2.2.193R</i>	
Lower tier two capital		(H)
Fixed term <i>preference shares</i>	<i>GENPRU 2.2.159R to GENPRU 2.2.174R; GENPRU 2.2.194R to GENPRU 2.2.196R</i>	
Long term subordinated debt	See previous entry	
Fixed term subordinated securities	See previous entry	
Total tier two capital = G+H		(I)
Deductions from tier two capital		(J)
(For certain limited purposes only certain additional deductions are made here)	<i>GENPRU 2.2.239R(2) to (4)</i>	
Total tier two capital after deductions = I - J		(K)
Total tier one capital plus tier two capital = F+K		(L)

The capital resources calculation for a bank		
Type of capital	Related text	Stage
Deductions from the totals of tier one and two		(M)
<i>Qualifying holdings</i>	<i>GENPRU 2.2.202R to GENPRU 2.2.207R</i>	(Part 1 of stage M)
<i>Material holdings</i>	<i>GENPRU 2.2.208R to GENPRU 2.2.215R</i>	
<i>Expected loss amounts and other negative amounts</i>	<i>GENPRU 2.2.236R</i>	
<i>Securitisation positions</i>	<i>GENPRU 2.2.237R</i>	
<i>Reciprocal cross-holdings</i>	<i>GENPRU 2.2.217R to GENPRU 2.2.220R</i>	
Investments in <i>subsidiary undertakings</i> and <i>participations</i> which are not <i>material holdings</i> or <i>qualifying holdings</i>	None	(Part 2 of stage M)
<i>Connected lending of a capital nature</i>	<i>GENPRU 2.2.221R to GENPRU 2.2.233R</i>	
Total tier one capital plus tier two capital after deductions = L-M		(N)
<p>In calculating whether a <i>bank's capital resources</i> exceed its <i>capital resources requirement</i>: (1) the <i>credit risk capital component</i>, the <i>operational risk capital requirement</i> and the <i>counterparty risk capital component</i>; or (2) the <i>base capital resources requirement</i>; as the case may be, must be deducted here.</p>		
Upper tier three		(O)
Short term subordinated debt	<i>GENPRU 2.2.241R to GENPRU 2.2.245R</i>	
Lower tier three		(P)
Net interim <i>trading book</i> profit and loss	<i>GENPRU 2.2.246R to GENPRU 2.2.249R</i>	

The capital resources calculation for a bank		
Type of capital	Related text	Stage
Total tier three capital=O+P		(Q)
Total capital before deductions = N+Q		(R)
Deductions from total capital		(S)
<i>Excess trading book position</i>	<i>GENPRU 2.2.263R to GENPRU 2.2.265R</i>	
<i>Free deliveries</i>	<i>BIPRU 14.4</i>	
Total capital after deductions (R – S)		(T)
<p>In calculating whether a bank's capital resources exceed its capital resources requirement, the market risk capital requirement and the concentration risk capital component must be deducted here.</p>		

Note (1): Where the table refers to related text, it is necessary to refer to that text in order to understand fully what is included in the descriptions of capital items and deductions set out in the table.

Note (2): If the amount calculated at:

(a) stage N less the deductions in respect of the *capital resources requirement* made immediately following stage N; or

(b) stage T less the deductions in respect of the *capital resources requirement* made immediately following stages N and T;

is a negative number the *bank's capital resources* are less than its *capital resources requirement*.

Note (3): Stage C must be omitted except where *capital resources* are being used for a purpose for which *innovative tier one capital* may be used (see *GENPRU 2.2.27R*).

GENPRU 2 Annex 3R

Capital resources table for a building society

The capital resources calculation for a building society		
Type of capital	Related text	Stage
Core tier one capital		(A)
Profit and loss account and other reserves (taking into account interim net losses)	<i>GENPRU 2.2.85R to 2.2.90R</i>	
Externally verified interim net profits	<i>GENPRU 2.2.102R</i>	
Perpetual non-cumulative preference shares		(B)
<i>PIBS</i>	<i>GENPRU 2.2.111R</i>	
Innovative tier one capital		(C)
<i>Innovative tier one instruments</i>	<i>GENPRU 2.2.113R to GENPRU 2.2.137R</i>	
Total tier one capital before deductions = A+B+C		(D)
Deductions from tier one capital		(E)
Investments in own <i>shares</i>	None	
Intangible assets	<i>GENPRU 2.2.155R</i>	
Net losses on equities held in the available-for-sale financial asset category	<i>GENPRU 2.2.185R</i>	
(For certain limited purposes only certain additional deductions are made here)	<i>GENPRU 2.2.239R(2) to (4)</i>	
Total tier one capital after deductions = D-E		(F)
Upper tier two capital		(G)
Perpetual subordinated debt	<i>GENPRU 2.2.159R to GENPRU 2.2.181R</i>	
Perpetual subordinated securities	See previous entry	

The capital resources calculation for a building society		
Type of capital	Related text	Stage
Revaluation reserves	<i>GENPRU 2.2.185R</i>	
General/collective provisions	<i>GENPRU 2.2.187R to GENPRU 2.2.189R</i>	
Surplus provisions	<i>GENPRU 2.2.190R to GENPRU 2.2.193R</i>	
Lower tier two capital		(H)
Long term subordinated debt	<i>GENPRU 2.2.159R to GENPRU 2.2.174R; GENPRU 2.2.194R to GENPRU 2.2.196R</i>	
Fixed term subordinated securities	See previous entry	
Total tier two capital = G+H		(I)
Deductions from tier two capital		(J)
(For certain limited purposes only certain additional deductions are made here)	<i>GENPRU 2.2.239R(2) to (4)</i>	
Total tier two capital after deductions = I - J		(K)
Total tier one capital plus tier two capital = F+K		(L)
Deductions from the totals of tier one and two		(M)
<i>Qualifying holdings</i>	<i>GENPRU 2.2.202R to GENPRU 2.2.207R</i>	
<i>Material holdings</i>	<i>GENPRU 2.2.208R to GENPRU 2.2.215R</i>	(Part 1 of stage M)
<i>Expected loss amounts and other negative amounts</i>	<i>GENPRU 2.2.236R</i>	
<i>Securitisation positions</i>	<i>GENPRU 2.2.237R</i>	

The capital resources calculation for a building society		
Type of capital	Related text	Stage
<i>Reciprocal cross-holdings</i>	<i>GENPRU 2.2.217R to GENPRU 2.2.220R</i>	(Part 2 of stage M)
Investments in <i>subsidiary undertakings</i> and <i>participations</i> which are not <i>material holdings</i> or <i>qualifying holdings</i>	None	
Total tier one capital plus tier two capital after deductions = L-M		(N)
<p>In calculating whether a <i>building society's</i> capital resources exceed its capital resources requirement:</p> <p>(1) the <i>credit risk capital component</i>, the <i>operational risk capital requirement</i> and the <i>counterparty risk capital component</i>; or</p> <p>(2) the <i>base capital resources requirement</i>;</p> <p>as the case may be, must be deducted here.</p>		
Upper tier three		(O)
Short term subordinated debt	<i>GENPRU 2.2.241R to GENPRU 2.2.245R</i>	
Lower tier three		(P)
Net interim <i>trading book</i> profit and loss	<i>GENPRU 2.2.246R to GENPRU 2.2.249R</i>	
Total tier three capital=O+P		(Q)
Total capital before deductions = N+Q		(R)
Deductions from total capital		(S)
<i>Excess trading book position</i>	<i>GENPRU 2.2.263R to GENPRU 2.2.265R</i>	
<i>Free deliveries</i>	<i>BIPRU 14.4</i>	
Total capital after deductions (R – S)		(T)

The capital resources calculation for a building society		
Type of capital	Related text	Stage
<p>In calculating whether a <i>building society's capital resources</i> exceed its <i>capital resources requirement</i>, the <i>market risk capital requirement</i> and the <i>concentration risk capital component</i> must be deducted here.</p>		

Note (1): Where the table refers to related text, it is necessary to refer to that text in order to understand fully what is included in the descriptions of capital items and deductions set out in the table.

Note (2): If the amount calculated at:

- (a) stage N less the deductions in respect of the *capital resources requirement* made immediately following stage N; or
 - (b) stage T less the deductions in respect of the *capital resources requirement* made immediately following stages N and T;
- is a negative number the *building society's capital resources* are less than its *capital resources requirement*.

Note (3): Stage C must be omitted except where *capital resources* are being used for a purpose for which *innovative tier one capital* may be used (see *GENPRU 2.2.27R*).

GENPRU 2 Annex 4R

Capital resources table for a BIPRU investment firm deducting material holdings

The capital resources calculation for an investment firm deducting material holdings		
Type of capital	Related text	Stage
Core tier one capital		(A)
<i>Permanent share capital</i>	<i>GENPRU 2.2.83R</i>	
Profit and loss account and other reserves (taking into account material interim net losses)	<i>GENPRU 2.2.85R to 2.2.90R</i>	
<i>Eligible partnership capital</i>	<i>GENPRU 2.2.93R; GENPRU 2.2.95R</i>	
<i>Eligible LLP members' capital</i>	<i>GENPRU 2.2.94R; GENPRU 2.2.95R</i>	
<i>Sole trader capital</i>	None	
<i>Share premium account</i>	<i>GENPRU 2.2.101R</i>	
Externally verified interim net profits	<i>GENPRU 2.2.102R</i>	
Perpetual non-cumulative preference shares		(B)
Perpetual non-cumulative <i>preference shares</i>	<i>GENPRU 2.2.109R</i>	
Innovative tier one capital		(C)
<i>Innovative tier one instruments</i>	<i>GENPRU 2.2.113R to GENPRU 2.2.137R</i>	
Total tier one capital before deductions = A+B+C		(D)
Deductions from tier one capital		(E)
Investments in own <i>shares</i>	None	
Intangible assets	<i>GENPRU 2.2.155R</i>	
Excess of drawings over profits for partnerships, <i>limited liability partnerships</i> and <i>sole traders</i>	<i>GENPRU 2.2.100R;</i> there is no related text for <i>sole traders</i>	

The capital resources calculation for an investment firm deducting material holdings		
Type of capital	Related text	Stage
Net losses on equities held in the available-for-sale financial asset category	<i>GENPRU 2.2.185R</i>	
(For certain limited purposes only certain additional deductions are made here)	<i>GENPRU 2.2.239R(2) to (4)</i>	
Total tier one capital after deductions = D-E		(F)
Upper tier two capital		(G)
Perpetual cumulative <i>preference shares</i>	<i>GENPRU 2.2.159R to GENPRU 2.2.181R</i>	
Perpetual subordinated debt	See previous entry	
Perpetual subordinated securities	See previous entry	
Revaluation reserves	<i>GENPRU 2.2.185R</i>	
General/collective provisions	<i>GENPRU 2.2.187R to GENPRU 2.2.189R</i>	
Surplus provisions	<i>GENPRU 2.2.190R to GENPRU 2.2.193R</i>	
Lower tier two capital		(H)
Fixed term <i>preference shares</i>	<i>GENPRU 2.2.159R to GENPRU 2.2.174R; GENPRU 2.2.194R to GENPRU 2.2.196R</i>	
Long term subordinated debt	See previous entry	
Fixed term subordinated securities	See previous entry	
Total tier two capital = G+H		(I)
Deductions from tier two capital		(J)
(For certain limited purposes only certain additional deductions are made here)	<i>GENPRU 2.2.239R(2) to (4)</i>	
Total tier two capital after deductions = I - J		(K)

The capital resources calculation for an investment firm deducting material holdings		
Type of capital	Related text	Stage
Total tier one capital plus tier two capital = F+K		(L)
Deductions from the totals of tier one and two		(M)
<i>Material holdings</i>	<i>GENPRU 2.2.208R to GENPRU 2.2.215R</i>	
<i>Expected loss amounts and other negative amounts</i>	<i>GENPRU 2.2.236R</i>	(Part 1 of stage M)
<i>Securitisation positions</i>	<i>GENPRU 2.2.237R</i>	
<i>Reciprocal cross-holdings</i>	<i>GENPRU 2.2.217R to GENPRU 2.2.220R</i>	(Part 2 of stage M)
Total tier one capital plus tier two capital after deductions = L-M		(N)
<p>In calculating whether a firm's capital resources exceed its capital resources requirement: (1) the credit risk capital component, the operational risk capital requirement (if applicable) and the counterparty risk capital component; or (2) the base capital resources requirement; as the case may be, must be deducted here.</p>		
Upper tier three		(O)
Short term subordinated debt	<i>GENPRU 2.2.241R to GENPRU 2.2.245R</i>	
Lower tier three		(P)
Net interim <i>trading book</i> profit and loss	<i>GENPRU 2.2.246R to GENPRU 2.2.249R</i>	
Total tier three capital=O+P		(Q)
Total capital before deductions = N+Q		(R)

The capital resources calculation for an investment firm deducting material holdings		
Type of capital	Related text	Stage
Deductions from total capital		(S)
<i>Free deliveries</i>	<i>BIPRU 14.4</i>	
Total capital after deductions (R – S)		(T)
<p>In calculating whether a <i>firm's capital resources</i> exceed its <i>capital resources requirement</i>, the <i>market risk capital requirement</i>, the <i>concentration risk capital component</i> and (if applicable) the <i>fixed overheads requirement</i> must be deducted here.</p>		

Note (1): Where the table refers to related text, it is necessary to refer to that text in order to understand fully what is included in the descriptions of capital items and deductions set out in the table.

Note (2): If the amount calculated at:

(a) stage N less the deductions in respect of the *capital resources requirement* made immediately following stage N; or

(b) stage T less the deductions in respect of the *capital resources requirement* made immediately following stages N and T;

is a negative number the *firm's capital resources* are less than its *capital resources requirement*.

Note (3): Stage C must be omitted except where *capital resources* are being used for a purpose for which *innovative tier one capital* may be used (see *GENPRU 2.2.27R*).

GENPRU 2Annex 5R

Capital resources table for a BIPRU investment firm deducting illiquid assets

The capital resources calculation for an investment firm that deducts illiquid assets		
Type of capital	Related text	Stage
Core tier one capital		(A)
<i>Permanent share capital</i>	<i>GENPRU 2.2.83R</i>	
Profit and loss account and other reserves (taking into account material interim net losses)	<i>GENPRU 2.2.85R to 2.2.90R</i>	
<i>Eligible partnership capital</i>	<i>GENPRU 2.2.93R; GENPRU 2.2.95R</i>	
<i>Eligible LLP members' capital</i>	<i>GENPRU 2.2.94R; GENPRU 2.2.95R</i>	
<i>Sole trader capital</i>	None	
<i>Share premium account</i>	<i>GENPRU 2.2.101R</i>	
Externally verified interim net profits	<i>GENPRU 2.2.102R</i>	
Perpetual non-cumulative preference shares		(B)
Perpetual non-cumulative <i>preference shares</i>	<i>GENPRU 2.2.109R</i>	
Innovative tier one capital		(C)
<i>Innovative tier one instruments</i>	<i>GENPRU 2.2.113R to GENPRU 2.2.137R</i>	
Total tier one capital before deductions = A+B+C		(D)
Deductions from tier one capital		(E)
Investments in own <i>shares</i>	None	
Intangible assets	<i>GENPRU 2.2.155R</i>	
Excess of drawings over profits for partnerships, <i>limited liability partnerships</i> and <i>sole traders</i>	<i>GENPRU 2.2.100R;</i> there is no related text for <i>sole traders</i>	

The capital resources calculation for an investment firm that deducts illiquid assets		
Type of capital	Related text	Stage
Net losses on equities held in the available-for-sale financial asset category	<i>GENPRU 2.2.185R</i>	
(For certain limited purposes only certain additional deductions are made here)	<i>GENPRU 2.2.239R(2) to (4)</i>	
Total tier one capital after deductions = D-E		(F)
Upper tier two capital		(G)
Perpetual cumulative <i>preference shares</i>	<i>GENPRU 2.2.159R to GENPRU 2.2.181R</i>	
Perpetual subordinated debt	See previous entry	
Perpetual subordinated securities	See previous entry	
Revaluation reserves	<i>GENPRU 2.2.185R</i>	
General/collective provisions	<i>GENPRU 2.2.187R to GENPRU 2.2.189R</i>	
Surplus provisions	<i>GENPRU 2.2.190R to GENPRU 2.2.193R</i>	
Lower tier two capital		(H)
Fixed term <i>preference shares</i>	<i>GENPRU 2.2.159R to GENPRU 2.2.174R; GENPRU 2.2.194R to GENPRU 2.2.196R</i>	
Long term subordinated debt	See previous entry	
Fixed term subordinated securities	See previous entry	
Total tier two capital = G+H		(I)
Deductions from tier two capital		(J)
(For certain limited purposes only certain additional deductions are made here)	<i>GENPRU 2.2.239R(2) to (4)</i>	
Total tier two capital after deductions = I - J		(K)

The capital resources calculation for an investment firm that deducts illiquid assets		
Type of capital	Related text	Stage
Total tier one capital plus tier two capital = F+K		(L)
Deductions from the totals of tier one and two		(M)
<i>Expected loss</i> amounts and other negative amounts	GENPRU 2.2.236R	(Part 1 of stage M)
<i>Securitisation positions</i>	GENPRU 2.2.237R	
<i>Reciprocal cross-holdings</i>	GENPRU 2.2.217R to GENPRU 2.2.220R	(Part 2 of stage M)
Total tier one capital plus tier two capital after deductions = L-M		(N)
<p>In calculating whether a firm's capital resources exceed its capital resources requirement: (1) the credit risk capital component, the operational risk capital requirement (if applicable) and the counterparty risk capital component; or (2) the base capital resources requirement; as the case may be, must be deducted here.</p>		
Upper tier three		(O)
Short term subordinated debt	GENPRU 2.2.241R to GENPRU 2.2.245R	
Lower tier three		(P)
Net interim <i>trading book</i> profit and loss	GENPRU 2.2.246R to GENPRU 2.2.249R	
Total tier three capital=O+P		(Q)
Total capital before deductions = N+Q		(R)
Deductions from total capital		(S)

The capital resources calculation for an investment firm that deducts illiquid assets		
Type of capital	Related text	Stage
<i>Illiquid assets</i>	<i>GENPRU 2.2.259R to GENPRU 2.2.260R</i>	
<i>Free deliveries</i>	<i>BIPRU 14.4</i>	
Total capital after deductions = R-S		(T)
<p>In calculating whether a <i>firm's capital resources</i> exceed its <i>capital resources requirement</i>, the <i>market risk capital requirement</i>, the <i>concentration risk capital component</i> and (if applicable) the <i>fixed overheads requirement</i> must be deducted here.</p>		

Note (1): Where the table refers to related text, it is necessary to refer to that text in order to understand fully what is included in the descriptions of capital items and deductions set out in the table.

Note (2): If the amount calculated at:
 (a) stage N less the deductions in respect of the *capital resources requirement* made immediately following stage N; or
 (b) stage T less the deductions in respect of the *capital resources requirement* made immediately following stages N and T;
 is a negative number the *firm's capital resources* are less than its *capital resources requirement*.

Note (3): Stage C must be omitted except where *capital resources* are being used for a purpose for which *innovative tier one capital* may be used (see *GENPRU 2.2.27R*).

GENPRU 2 Annex 6R

Capital resources table for a BIPRU investment firm with a waiver from consolidated supervision

Part 1 of the capital resources calculation for an investment firm with a waiver from consolidated supervision		
Type of capital	Related text	Stage
Core tier one capital		(A)
<i>Permanent share capital</i>	<i>GENPRU 2.2.83R</i>	
Profit and loss account and other reserves (taking into account material interim net losses)	<i>GENPRU 2.2.85R to 2.2.90R</i>	
<i>Eligible partnership capital</i>	<i>GENPRU 2.2.93R; GENPRU 2.2.95R</i>	
<i>Eligible LLP members' capital</i>	<i>GENPRU 2.2.94R; GENPRU 2.2.95R</i>	
<i>Sole trader capital</i>	None	
<i>Share premium account</i>	<i>GENPRU 2.2.101R</i>	
Externally verified interim net profits	<i>GENPRU 2.2.102R</i>	
Perpetual non-cumulative preference shares		(B)
Perpetual non-cumulative <i>preference shares</i>	<i>GENPRU 2.2.109R</i>	
Innovative tier one capital		(C)
<i>Innovative tier one instruments</i>	<i>GENPRU 2.2.113R to GENPRU 2.2.137R</i>	
Total tier one capital before deductions = A+B+C		(D)
Deductions from tier one capital		(E)

Part 1 of the capital resources calculation for an investment firm with a waiver from consolidated supervision		
Type of capital	Related text	Stage
Investments in own <i>shares</i>	None	(Part 1 of stage E)
Intangible assets	<i>GENPRU 2.2.155R</i>	
Excess of drawings over profits for partnerships, <i>limited liability partnerships</i> and <i>sole traders</i>	<i>GENPRU 2.2.100R</i> ; there is no related text for <i>sole traders</i>	
Net losses on equities held in the available-for-sale financial asset category	<i>GENPRU 2.2.185R</i>	(Part 1 of stage E)
(For certain limited purposes only certain additional deductions are made here. This line does not include <i>material holdings</i> .)	<i>GENPRU 2.2.239R(2) to (4)</i>	
<i>Material holdings</i> falling into Note (4)	Note (4) of Part 2 of this table; <i>GENPRU 2.2.208R to GENPRU 2.2.215R</i>	(Part 2 of stage E)
(For certain limited purposes only certain additional deductions of <i>material holdings</i> are made here)	Note (5) of Part 2 of this table; <i>GENPRU 2.2.239R(2) to (4)</i>	(Part 3 of stage E)
Total tier one capital after deductions = D-E		(F)
Upper tier two capital		(G)
Perpetual cumulative <i>preference shares</i>	<i>GENPRU 2.2.159R to GENPRU 2.2.181R</i>	
Perpetual subordinated debt	See previous entry	
Perpetual subordinated securities	See previous entry	
Revaluation reserves	<i>GENPRU 2.2.185R</i>	
General/collective provisions	<i>GENPRU 2.2.187R to GENPRU 2.2.189R</i>	

Part 1 of the capital resources calculation for an investment firm with a waiver from consolidated supervision		
Type of capital	Related text	Stage
Surplus provisions	<i>GENPRU 2.2.190R to GENPRU 2.2.193R</i>	
Lower tier two capital		(H)
Fixed term <i>preference shares</i>	<i>GENPRU 2.2.159R to GENPRU 2.2.174R; GENPRU 2.2.194R to GENPRU 2.2.196R</i>	
Long term subordinated debt	See previous entry	
Fixed term subordinated securities	See previous entry	
Total tier two capital = G+H		(I)
Deductions from tier two capital		(J)
(For certain limited purposes only certain additional deductions are made here)	Note (5) of Part 2 of this table; <i>GENPRU 2.2.239R(2) to (4)</i>	
Total tier two capital after deductions = I - J		(K)
Total tier one capital plus tier two capital = F+K		(L)
Deductions from the totals of tier one and two		(M)
<i>Material holdings</i> falling into Note (5)	Note (5) of Part 2 of this table; <i>GENPRU 2.2.208R to GENPRU 2.2.215R</i>	(Part 1 of stage M)
Contingent liabilities	Note (6) of Part 2 of this table	
<i>Expected loss</i> amounts and other negative amounts	<i>GENPRU 2.2.236R</i>	
<i>Securitisation positions</i>	<i>GENPRU 2.2.237R</i>	
<i>Reciprocal cross-holdings</i>	<i>GENPRU 2.2.217R to GENPRU 2.2.220R</i>	(Part 2 of stage M)

Part 1 of the capital resources calculation for an investment firm with a waiver from consolidated supervision		
Type of capital	Related text	Stage
Total tier one capital plus tier two capital after deductions = L-M		(N)
<p>In calculating whether a <i>firm's capital resources</i> exceed its <i>capital resources requirement</i>: (1) the <i>credit risk capital component</i>, the <i>operational risk capital requirement</i> (if applicable) and the <i>counterparty risk capital component</i>; or (2) the <i>base capital resources requirement</i>; as the case may be, must be deducted here.</p>		
Upper tier three		(O)
Short term subordinated debt	<i>GENPRU 2.2.241R to GENPRU 2.2.245R</i>	
Lower tier three		(P)
Net interim <i>trading book</i> profit and loss	<i>GENPRU 2.2.246R to GENPRU 2.2.249R</i>	
Total tier three capital=O+P		(Q)
Total capital before deductions = N+Q		(R)
Deductions from total capital		(S)
<i>Illiquid assets</i>	<i>GENPRU 2.2.259R to GENPRU 2.2.260R</i>	
<i>Free deliveries</i>	<i>BIPRU 14.4</i>	
Total capital after deductions = R-S		(T)
<p>In calculating whether a <i>firm's capital resources</i> exceed its <i>capital resources requirement</i>, the <i>market risk capital requirement</i>, the <i>concentration risk capital component</i> and (if applicable) the <i>fixed overheads requirement</i> must be deducted here.</p>		

Part 2 of the capital resources calculation for an investment firm with a waiver from consolidated supervision

Note (1): Where the table refers to related text, it is necessary to refer to that text in order to understand fully what is included in the descriptions of capital items and deductions set out in the table.

Note (2): If the amount calculated at:
 (a) stage N less the deductions in respect of the *capital resources requirement* made immediately following stage N; or
 (b) stage T less the deductions in respect of the *capital resources requirement* made immediately following stages N and T;
 is a negative number the *firm's capital resources* are less than its *capital resources requirement*.

Note (3): Stage C must be omitted except where *capital resources* are being used for a purpose for which *innovative tier one capital* may be used (see *GENPRU 2.2.27R*).

Note (4): The *material holdings* that must be deducted at part 2 of stage E are *material holdings* issued by *undertakings* which would have been members of the *firm's UK consolidation group* or *non-EEA sub-group* if the *firm* did not have an *investment firm consolidation waiver* if:

- | | | |
|-----|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| (1) | in relation to a <i>BIPRU investment firm</i> , the holding forms part of the <i>undertaking's tier one capital resources</i> ; or | |
| (2) | (subject to (3)) in relation to any other <i>undertaking</i> , the holding would form part of the <i>undertaking's tier one capital resources</i> if: | |
| | (a) | that <i>undertaking</i> were a <i>BIPRU firm</i> with a <i>Part IV permission</i> ; and |
| | (b) | it had carried on all its business in the <i>United Kingdom</i> and had obtained whatever <i>permissions</i> for doing so are required under the <i>Act</i> ; or |
| (3) | in relation to any <i>undertaking</i> not falling within (1) and for which the methodology in (2) does not give an answer, the holding would form part of its <i>tier one capital resources</i> if the <i>undertaking</i> were a <i>BIPRU firm</i> of the same category as the <i>firm</i> carrying out the calculation under this Annex. | |

Note (5): The *material holdings* that must be deducted by a *firm* at part 3 of stage E and at stage J or at Part 1 of stage M are *material holdings* issued by *undertakings* which would have been members of that *firm's UK consolidation group* or *non-EEA sub-group* if the *firm* did not have an *investment firm consolidation waiver* and which do not fall into Note (4).

Part 2 of the capital resources calculation for an investment firm with a waiver from consolidated supervision

Note (6): The contingent liabilities that must be deducted by a *firm* at Part 1 of stage M are any contingent liabilities which the *firm* has in favour of *investment firms*, *financial institutions*, *asset management companies* and *ancillary services undertakings* which would have been members of the *firm's UK consolidation group* or *non-EEA sub-group* if the *firm* did not have an *investment firm consolidation waiver*.

GENPRU 2 Annex 7R

Admissible assets in insurance

- (1) Investments that are, or amounts owed arising from the disposal of:
 - (a) *debt securities*, bonds and other money and capital market instruments;
 - (b) loans;
 - (c) *shares* and other variable yield participations;
 - (d) *units* in *UCITS schemes*, *non-UCITS retail schemes*, *recognised schemes* and any other *collective investment scheme* that invests only in *admissible assets* (including any *derivatives* or *quasi-derivatives* held by the scheme);
 - (e) land, buildings and immovable property rights;
 - (f) an *approved derivative* or *quasi-derivative* transaction that satisfies the conditions in *INSPRU 3.2.5R* or an *approved stock lending* transaction that satisfies the conditions in *INSPRU 3.2.36R*.
- (2) Debts and claims
 - (a) debts owed by *reinsurers*, including *reinsurers'* shares of *technical provisions* (but excluding amounts recoverable from an *ISPV**);
 - (b) deposits with and debts owed by *ceding undertakings*;
 - (c) debts owed by *policyholders* and *intermediaries* arising out of direct and *reinsurance* operations (except where overdue for more than 3 months and other than *commission* prepaid to agents or *intermediaries*);
 - (d) for *general insurance business* only, claims arising out of salvage and subrogation;
 - (e) for *long-term insurance business* only, advances secured on, and not exceeding the *surrender value* of, *long-term insurance contracts* issued by the *insurer*;
 - (f) tax recoveries;
 - (g) claims against *compensation funds*.
- (3) Other assets
 - (a) tangible fixed assets, other than land and buildings;
 - (b) cash at *bank* and in hand, *deposits* with *credit institutions* and any other bodies authorised to receive *deposits*;
 - (c) for *general insurance business* only, *deferred acquisition costs*;
 - (d) accrued interest and rent, other accrued income and prepayments;

(e) for *long-term insurance business* only, reversionary interests.

* A *firm* may treat amounts recoverable from an *ISPV* as an *admissible asset* if it obtains a *waiver* under section 148 of the *Act*. The conditions that will need to be met, in addition to the statutory tests under section 148(4) of the *Act*, before the *FSA* will consider granting such a *waiver* are set out in *INSPRU* 1.6.13G to *INSPRU* 1.6.18G.

G Implicit items under the Act

1	<p>The <i>capital resources table</i> does not permit <i>implicit items</i> to be included in the calculation of a <i>firm's capital resources</i>, except subject to a <i>waiver</i> under section 148 of the <i>Act</i>. Article 27(4) of the <i>Consolidated Life Directive</i> states that <i>implicit items</i> can be included in the calculation of a <i>firm's capital resources</i>, within limits, provided that the supervisory authority agrees. Certain <i>implicit items</i>, however, are not eligible for inclusion beyond 31 December 2009 (see paragraph 5). The <i>FSA</i> may be prepared to grant a <i>waiver</i> from the <i>capital resources table</i> to allow <i>implicit items</i>, in line with the purpose of the <i>Consolidated Life Directive</i>, and provided the conditions as set out in article 27(4) of the <i>Consolidated Life Directive</i> are met. Such a <i>waiver</i> would allow an <i>implicit item</i> to count towards the <i>firm's capital resources</i> available to count against its <i>capital resources requirement (CRR)</i> set out for <i>realistic basis life firms</i> in <i>GENPRU 2.1.18R</i> and for <i>regulatory basis only life firms</i> in <i>GENPRU 2.1.23R</i>. An <i>implicit item</i> may potentially count as <i>tier one capital</i> (but not <i>core tier one capital</i>) or <i>tier two capital</i>. Where a <i>waiver</i> is granted allowing an <i>implicit item</i> as <i>tier one capital</i>, the value of the <i>implicit item</i> so allowed must be included at stage B of the <i>capital resources table</i>. If the application of the value of the <i>implicit item</i> is restricted by <i>GENPRU 2.2.29R</i>, which requires that at least 50% of a <i>firm's tier one capital resources</i> must be accounted for by <i>core tier one capital</i>, the remainder may be included at stage G of the calculation in the <i>capital resources table</i>, subject to <i>GENPRU 2.2.31R</i>. An <i>implicit item</i> treated as <i>tier two capital</i> will also be included at stage G of the calculation, again subject to <i>GENPRU 2.2.81R</i>. Article 29(1) of the <i>Consolidated Life Directive</i> requires that <i>implicit items</i> be excluded from the capital eligible to cover the <i>guarantee fund</i>. Under <i>GENPRU 2.2.33R</i> a <i>firm</i> must meet the <i>guarantee fund</i> from the sum of the items listed at stages A, B, G and H of the <i>capital resources table</i> less the sum of the items listed at stage E of the <i>capital resources table</i>. The <i>FSA</i> will only grant an <i>implicit items waiver</i> if the <i>waiver</i> includes a modification to <i>GENPRU 2.2.33R</i> to ensure that the <i>implicit item</i> does not count towards meeting the <i>guarantee fund</i>.</p>
2	<p>Under section 148 of the <i>Act</i>, the <i>FSA</i> may, on the application of a <i>firm</i>, grant a <i>waiver</i> from <i>PRU</i>. There are general requirements that must be met before any <i>waiver</i> can be granted. As explained in SUP 8, the <i>FSA</i> may not give a <i>waiver</i> unless the <i>FSA</i> is satisfied that:</p>
	<p>(1) compliance by the <i>firm</i> with the <i>rules</i> will be unduly burdensome, or would not achieve the purpose for which the <i>rules</i> were made; and</p>
	<p>(2) the <i>waiver</i> would not result in undue risk to <i>persons</i> whose</p>

	interests the <i>rules</i> are intended to protect.
3	<p>The <i>FSA</i> will assess compliance with the requirements in the light of all the relevant circumstances. This will include consideration of the costs incurred by compliance with a particular <i>rule</i> or whether a <i>rule</i> is framed in a way that would make compliance difficult in view of the <i>firm's</i> circumstances. For example, the <i>firm</i> may demonstrate that if an <i>implicit item</i> were not allowed, the <i>firm</i> would either have to suffer increased (and unwarranted) costs in injecting further <i>capital resources</i> or operate with a lower equity backing ratio (see case studies in paragraph 43). Even if a <i>firm</i> can demonstrate a case for an <i>implicit item waiver</i>, it should not assume that the <i>FSA</i> will grant the <i>waiver</i> requested, or that any <i>waiver</i> will be granted for the full amount of the <i>implicit item</i> which could be granted, as set out in this annex. The <i>FSA</i> will consider each application on its own merits, and taking into account all relevant circumstances, including the financial situation and business prospects of the <i>firm</i>.</p>
4	<p><i>Implicit items</i> are economic reserves which are contained within the long-term insurance business provisions. Article 27(4) of the <i>Consolidated Life Directive</i> identifies three types of <i>implicit item</i>, in respect of: future profits, <i>zillmerisation</i> and hidden reserves. This annex is intended to amplify the <i>guidance</i> in <i>SUP 8</i> relating to the granting of <i>waivers</i> for <i>implicit items</i> and to provide <i>guidance</i> on other aspects. Whilst this <i>guidance</i> applies to applications for <i>waivers</i> for <i>implicit items</i> generally, for a <i>realistic basis life firm</i>, to the extent that an <i>implicit item</i> is allocated to a <i>with-profits fund</i>, this <i>guidance</i> relates to <i>implicit items</i> for the purposes of determining the <i>regulatory value of assets</i> (see <i>INSPRU 1.4.24R</i>).</p>
5	<p>The <i>Consolidated Life Directive</i> (reflecting the changes introduced by the <i>Solvency 1 Directive</i>) requires member states to end a <i>firm's</i> ability to take into account future profits <i>implicit items</i> by (at the latest) 31 December 2009. Until then, the maximum amount of the <i>implicit item</i> relating to future profits permitted under the <i>Consolidated Life Directive</i> is limited to 50% of the product of the estimated annual profits and the average period to run (not exceeding six years) on the <i>policies</i> in the portfolio. The <i>Consolidated Life Directive</i> further limits the maximum amount of these economic reserves that can be counted to 25% of the lesser of the available solvency margin and the required solvency margin. The changes introduced by the <i>Solvency 1 Directive</i> take effect for financial years beginning on or after 1 January 2004. However, the <i>Consolidated Life Directive</i> allows for a transitional period of five years, which runs from 20 March 2002 (the publication date of the <i>Solvency 1 Directive</i>), for <i>firms</i> to become fully compliant with these new requirements. <i>Firms</i> will need to consider the potential impact of these changes when engaging in future capital planning. When applying for an <i>implicit item waiver</i> a <i>firm</i> should provide the <i>FSA</i> with a plan showing how the <i>firm</i> intends to maintain its capital adequacy over the</p>

	period to 31 December 2009. <i>Firms</i> should also be aware that the <i>FSA</i> will typically only grant <i>waivers</i> for a maximum of 12 months.
Future Profits	
6	The future profits <i>implicit item</i> allows <i>firms</i> to take credit for margins in the <i>mathematical reserves</i> to the extent that these are expected to emerge from in force business. The future profit from in force business should be assessed, in the first instance, on prudent assumptions, to demonstrate that there is an 'economic reserve'. Having demonstrated that it exists, the amount should be limited to an amount calculated using a formula that takes into account the actual profit which has emerged over the last five years (see paragraph 28).
Zillmerisation	
7	<i>Zillmerisation</i> is an allowance for acquisition costs that are expected, under prudent assumptions, to be recoverable from future <i>premiums</i> . <i>Firms</i> can make a direct adjustment to their reserves for <i>zillmerisation</i> , subject to the <i>rules</i> on <i>mathematical reserves</i> . However, where no such adjustment has been made, the <i>FSA</i> will consider an application for a <i>waiver</i> to take into account an <i>implicit item</i> .
Hidden reserves	
8	Hidden reserves are reserves resulting from the underestimation of assets (other than <i>mathematical reserves</i>).
Process for applying for a waiver, including limits applicable when a waiver is granted	
9	This annex sets out the procedures to be followed and the form of calculations and data which should be submitted by <i>firms</i> to the <i>FSA</i> . This <i>guidance</i> should also be read in conjunction with the general requirements relating to the <i>waiver</i> process described in <i>SUP</i> 8. The <i>FSA</i> expects that applications for <i>waivers</i> in respect of future profits and <i>zillmerising</i> will not normally be considered to pass the "not result in undue risk to persons whose interests the <i>rules</i> are intended to protect" test unless the relevant criteria set out in this <i>guidance</i> have been satisfied and an application for such a <i>waiver</i> may require further criteria to be satisfied for this test to be passed. As set out below, <i>waivers</i> in respect of either <i>zillmerising</i> or hidden reserves will not normally be given except in very exceptional circumstances.
Timing	
10	A <i>long-term insurer</i> may apply to the <i>FSA</i> for a <i>waiver</i> in respect of <i>implicit items</i> . A <i>waiver</i> will not apply retrospectively (see <i>SUP</i> 8.3.6G). Consequently, applications intended for a particular accounting reference date will normally need to be made well before

	that reference date. Applications by <i>firms</i> must be made to the <i>FSA</i> in writing and include the relevant details specified under <i>SUP</i> 8.3.3D. Given the uncertainty in predicting the future, <i>waivers</i> will normally be granted for a maximum of 12 months at a time and any further applications will need to be made accordingly.
11	The information that will be required to enable an application to be considered as set out below, should normally include a demonstration of how the <i>capital resources requirement</i> is to be met, with and without the <i>waiver</i> . Clearly, up-to-date information may not be available before the <i>financial year-end</i> . In some cases information from the previous year-end's <i>return</i> may be used, as long as any known significant changes in the structure of the <i>firm</i> , or the assumptions used, have been taken into account.
12	If the application for a <i>waiver</i> is granted, when a <i>firm</i> submits its next <i>return</i> the amount of the <i>implicit item</i> shown should not exceed that supported by the <i>firm's</i> calculations as at the valuation date. In the event that the amount of the future profits item calculated by the <i>firm</i> based on these updated assumptions is less than the amount calculated at the time of the <i>firm's</i> <i>waiver</i> application, the lower figure should be used in the <i>return</i> .
13	An <i>implicit item</i> in respect of <i>zillmerising</i> or hidden reserves is related to the basis on which liabilities or assets have been valued. In the case of hidden reserves, as explained below, the granting of a <i>waiver</i> will be dependent on the overall <i>capital resources</i> of the <i>firm</i> . <i>Waivers</i> in respect of these <i>implicit items</i> will, therefore, only be made in relation to the position shown in a particular set of <i>returns</i> and it will be essential for <i>firms</i> to submit applications to the <i>FSA</i> well in advance of the latest date for the submission of the relevant <i>return</i> .
14	<i>Waivers</i> may be withdrawn by the <i>FSA</i> at any time (e.g. where the <i>FSA</i> considers the amount in respect of which a <i>waiver</i> has been given can no longer be justified). This may be as a result of changes in the <i>firm's</i> position or as a result of queries arising on scrutiny of the <i>returns</i> .
Information to be submitted	
15	An application for a <i>waiver</i> (which includes an application for an extension to or other variation of a <i>waiver</i>) should be prepared using the standard application form for a <i>waiver</i> (see <i>SUP</i> 8 Annex 2D). In addition, the application should be accompanied by full supporting information to enable the <i>FSA</i> to arrive at a decision on the merits of the case. In particular, the application should state clearly the nature and the amounts of the <i>implicit items</i> that a <i>firm</i> wishes to count against its <i>capital resources requirement</i> and whether it proposes to treat the <i>implicit item</i> as <i>tier one capital</i> or <i>tier two capital</i> . In order to assess an application, the <i>FSA</i> needs information as to the make-up of

	<p>the <i>firm's capital resources</i>, the quality of the capital items which have been categorised into each tier of capital and a breakdown of capital both within and outside the <i>firm's long-term insurance fund</i> or <i>funds</i> and between the <i>firm's with-profits funds</i> and <i>non-profit funds</i>. An explanation as to the appropriateness of the proposed treatment of the <i>implicit item</i> under the <i>capital resources table</i> should also be provided, including a demonstration that, in allowing for <i>implicit items</i>, there has been no double counting of future margins and that the basis for valuing such margins is prudent.</p>
16	<p>The <i>FSA</i> recognises that the assessment of the insurance <i>technical provisions</i> reflects the contractual obligations of the <i>firm</i>. <i>Implicit items</i> are therefore margins over and above an economic assessment in these <i>technical provisions</i> only. Non-contractual "constructive" obligations arising from a <i>firm's</i> regulatory duty to treat <i>customers</i> fairly e.g. regarding future terminal bonuses, are not fully captured by the <i>technical provisions</i>. A <i>firm</i> must instead be satisfied that it has sufficient <i>capital resources</i> at all times to meet its obligations under <i>Principle 6</i>. The granting of a <i>waiver</i> for an <i>implicit item</i> does not in any way detract from this requirement and a <i>firm</i> will need to be satisfied that this condition is still met.</p>
17	<p>As a minimum, applications for a future profits <i>implicit item</i> should be supported by the information contained in Forms 13, 14, 18, 19, 40, 41, 42, 48, 49, the answers to questions 1 to 12 of the abstract of the valuation report, Appendix 9.4 of <i>IPRU(INS)</i>, the abstract of the valuation report for the realistic valuation, Appendix 9.4A of <i>IPRU(INS)</i> and Forms 51, 52, 53, 54 and 58. For a <i>zillmerisation</i> <i>implicit item</i>, only those items noted above forming part of the abstract valuation report will normally be needed. Applications for a <i>waiver</i> in respect of a hidden reserves <i>implicit item</i> will normally be considered only if accompanied by the information which is contained in the annual regulatory <i>returns</i>. In particular, the balance sheet forms, <i>long-term insurance business</i> revenue accounts, and abstract of the valuation report as set out in Appendices 9.1, 9.3 and 9.4 of <i>IPRU(INS)</i> should be provided. This is not to say that a full regulatory <i>return</i> must be provided in the specified format, simply that the information contained in these forms should be provided. Where appropriate, the information may be summarised.</p>
18	<p>The following supporting information relating to the calculation of the amounts claimed should be supplied for each type of <i>implicit item</i> in respect of which a <i>waiver</i> is sought:</p> <p>Future profits: in addition to information related to the prospective calculation and retrospective calculation described below, the profits reported in each of the last five <i>financial years</i> up to the date of the most recent available valuation under <i>rule 9.4</i> of <i>IPRU(INS)</i> which has been submitted to the <i>FSA</i> prior to, or together with, the application, and the amounts and nature of any exceptional items left out of account; the method used for calculating the average period to</p>

	<p>run and the results for each of the main categories of business, both before and after allowing for premature termination (where the calculation has been made in two stages); and the basis on which this allowance has been made.</p> <p><i>Zillmerising</i>: the categories of contracts for which an item has been calculated and the percentages of the <i>relevant capital sum</i> in respect of which an adjustment has been made.</p> <p>Hidden reserves: particulars, with supporting evidence, of the undervaluation of assets for which recognition is sought.</p>
Continuous monitoring by firms	
19	<p><i>Firms</i> should take into account any material changes in financial conditions or other relevant circumstances that may have an impact on the level of future profits that can prudently be taken into account.</p> <p><i>Firms</i> should also re-evaluate whether an application to vary an <i>implicit item waiver</i> should be made whenever circumstances have changed. In the event that circumstances have changed such that an amendment is appropriate, the <i>firm</i> must contact the <i>FSA</i> as quickly as possible in accordance with <i>Principle 11</i>. (See <i>SUP 8.5.1R</i>). In this context, the <i>FSA</i> would expect notice of any matter that materially impacts on the <i>firm's</i> financial condition, or any <i>waivers</i> granted.</p>
Future profits - factors to take into account when submitting calculations to support waiver applications	
20	<p>Where an application is made in respect of a <i>firm</i> which has separate <i>with-profits funds</i> and <i>non-profit funds</i>, the <i>firm</i> should ensure that the <i>capital resources requirement</i> in respect of the <i>non-profit fund</i> is not covered by future profits attributable to <i>policyholders</i> arising in the <i>with-profits fund</i>. Furthermore, for a <i>realistic basis life firm</i> the amount of the <i>implicit item</i> allocated to each <i>with-profits fund</i> should be calculated separately, as the amount allocated to each <i>with-profits fund</i> will be taken into consideration in the calculation of the <i>with-profits insurance capital component</i> (see <i>INSPRU 1.4.24R</i>).</p>
21	<p><i>Firms</i> need to assess prospective future profit (i.e. how much can reasonably be expected to arise) and compare this to maximum limits (in article 27(4) of the <i>Consolidated Life Directive</i>), which relate to past profits.</p>
Future profits - prospective calculation	
22	<p>The application for a <i>waiver</i> should be supported by details of a prospective calculation of future profits arising from in-force business. The information supplied to the <i>FSA</i> should include a description of the method used in the calculation and of the assumptions made, together with the results arising. From 31 December 2009 at the latest, future profits <i>implicit items</i> will no longer be permitted under the <i>Consolidated Life Directive</i>. Where a <i>firm</i> first applies for an <i>implicit items waiver</i> after <i>GENPRU 2.2</i> comes into effect, under the</p>

prospective calculation a *firm* should only take into consideration future profits that are expected to emerge in the period up to 31 December 2009. *Implicit item waivers* granted before *GENPRU 2.2* comes into effect will continue to operate under the terms of those *waivers*, but an application to vary the terms of such a *waiver*, for example to extend the effective period, is an application for a new *waiver* for which a *firm* should usually only take into consideration future profits that are expected to emerge in the period up to 31 December 2009.

Assumptions

23 The assumptions made should be prudent, rather than best estimate, assumptions of future experience (that is, the prudent assumptions should allow for the fair market price for assuming that risk including associated expenses). In particular, it would not normally be considered appropriate for the projected return on any asset to be taken to be higher than the risk-free yield (that is, assessed by reference to the yield arrived at using a model of future risk free yields properly calibrated from the forward gilts market). It may also be appropriate to bring future withdrawals into account on a suitably prudent basis. For *with-profits business*, the assumptions for future investment returns should not capitalise future bonus loadings except where the *with-profits policyholders* share in risks other than the investment performance of the fund. Furthermore, the rate at which future profits are discounted should include an appropriate margin over a risk free rate of return. Calculations should also be carried out to demonstrate that the prospective calculation of the future profits arising from the in-force business supporting the application for the *implicit item* would be sufficient to support the amount of the *implicit item* under each scenario described for use in determining the *resilience capital requirement* - where the *waiver* relates to an *implicit item* allocated to more than one fund, this should be demonstrated separately for that element of the *implicit item* allocated to each fund. For an *implicit item* allocated to a *with-profits fund*, proper allowance should be made for any shareholder transfers to ensure that the *implicit item* is not supported by future profits which will be required to support those transfers. To the extent, if any, that future profits are dependent on the levying of explicit expense related charges (for example as in the case of unit-linked business) the documentation submitted should include a demonstration of the prudence of the assumptions made as to the level at which future charges will be levied and expenses incurred.

Other limitations on the extent to which waivers for implicit items will be granted to a realistic basis life firm

24 Where a *waiver* in respect of an *implicit item* is granted to a *realistic basis life firm* additional limits may apply by reference to a comparison of *realistic excess capital* and *regulatory excess capital*

	including allowance for the effect of the <i>waiver</i> . Where the <i>waiver</i> relates to an <i>implicit item</i> allocated partly or entirely to a <i>with-profits fund</i> , the <i>waiver</i> will contain a limitation to the effect that the <i>regulatory excess capital</i> for that <i>with-profits fund</i> , allowing for the effect of the <i>waiver</i> , may not exceed that fund's <i>realistic excess capital</i> . This limitation will apply on an ongoing basis so that, for example, in the case of an <i>implicit item</i> allocated to a <i>with-profits fund</i> , the amount of the <i>implicit item</i> would be limited to zero whenever the <i>regulatory excess capital</i> exceeded the <i>realistic excess capital</i> of that fund.
Other charges to future profits	
25	To avoid double counting, no account should be taken of any future surplus arising from assets corresponding to explicit items which have been counted towards the <i>capital resources requirement</i> such as shareholders funds, surplus carried forward or investment reserves. Deductions should be made in the calculation of future surpluses for the impact of any other arrangements which give rise to a charge over future surplus emerging (e.g. financial <i>reinsurance</i> arrangements, subordinated loan capital or contingent loan agreements). Deductions should also be made to the extent that any credit has been taken for the purposes of <i>INSPRU 1.4.45R(2)(c)</i> for the present value of future profits relating to non-profit business written in a <i>non-profit fund</i> . The information supplied to the <i>FSA</i> should identify the amount and reason for any adjustments made to the calculation of the prospective amount of future profits.
26	The <i>firm</i> should confirm to the <i>FSA</i> that the calculations have been properly carried out and that there are no other factors that should be taken into account.
Future profits - retrospective calculation	
Overriding limit	
27	The maximum amount of the <i>implicit item</i> relating to future profits permitted under the <i>Consolidated Life Directive</i> is 50% of the product of the estimated annual profit and the average period to run (not exceeding six years (ten years during the transitional period referred to in paragraph 5)) on the <i>policies</i> in the portfolio. Article 27(4) of the <i>Consolidated Life Directive</i> also imposes a further limit on the amount of the <i>implicit item</i> equal to 25% of the lower of:
	(1) the <i>firm's capital resources</i> ; and
	(2) the higher of its <i>base capital resources requirement</i> for <i>long-term insurance business</i> and its <i>long-term insurance capital requirement</i> .

	Once the transitional period set out in article 71(1) of the <i>Consolidated Life Directive</i> has expired in 2007 (see paragraph 5), the <i>FSA</i> will not allow a <i>waiver</i> for more than the amount permitted by article 27(4) of the Directive.
Definition of profits	
28	The estimated annual profit should be taken as the average annual surplus arising in the <i>long-term insurance fund</i> over the last five <i>financial years</i> up to the date of the most recent available valuation which has been submitted to the <i>FSA</i> prior to, or together with, the application. For this purpose, deficiencies arising should be treated as negative surpluses. Where a <i>firm's financial year</i> has altered, the surplus arising in a period falling partly outside the relevant five year period should be assumed to accrue uniformly over the period in question for the purpose of estimating the profits arising within the five year period. When there has been a transfer of a block of business into the <i>firm</i> (or out of the <i>firm</i>) during the period, surplus arising from the transferred block should be included (or excluded) for the full five year period. Where a portion of a block of business is transferred, the surplus included (or excluded) should be a reasonable estimate of the surplus arising from the portion transferred.
29	Where a <i>firm</i> has been carrying on <i>long-term insurance business</i> for less than 5 years, the total profits made during the past five years should be taken to be the aggregate of any surpluses that have arisen during the period in which <i>long-term insurance business</i> has been carried on less any deficiencies that may have arisen during that period. The resulting total should still be divided by five to obtain the estimated annual profit.
Exceptional items	
30	Substantial items of an exceptional nature should be excluded from the calculation of the estimated annual profit. Such items include profits arising from an exceptional change in the value at which assets are brought into account, where this is not reflected in a similar change in the amount of the liabilities, and profits arising from a change in the overall valuation approach between one year and another. An exceptional loss (i.e. a reduction of an exceptional nature in the surplus arising) may be excluded from the calculation only to the extent that it can be set against a profit or profits up to the amount of the loss and arising from a similar cause. It is not intended, however, that any adjustment should be made for the effect on surplus of a net strengthening of reserves for costs associated with an expansion of the business or for special capital expenditure, such as the purchase of computer systems.
Double counting	

31	<p>The inclusion of investment income arising from the assets representing the explicit components of <i>capital resources</i> (as part of the estimated annual profit for the purpose of determining the future profits <i>implicit item</i>) would result in double-counting. If those assets were required to meet the effects of adverse developments, this would automatically result in the cessation of the contribution to profits from the associated investment income. It would clearly not be appropriate for the <i>FSA</i> to grant a <i>waiver</i> which would enable a <i>firm</i> to meet the <i>capital resources requirement</i> on the basis of counting both the capital values of the assets and the value of the income flow which they can be expected to generate.</p>
32	<p>The definition of the estimated annual profit as the surplus arising in the <i>long-term insurance fund</i> ensures that any contribution to surplus arising from transfers from the profit and loss account, including investment income on shareholders' assets, is not included in the estimated annual profit. Thus double-counting should not arise in respect of shareholders' assets. Double-counting may arise, however, in respect of the investment income from the assets representing the explicit components of <i>capital resources</i> carried within the <i>long-term insurance fund</i> (e.g. surplus carried forward or investment reserves), but the amount of such investment income is not separately identified in the <i>return</i>.</p>
33	<p>Where there is reason to suspect that the elimination of any such double-counting would reduce a <i>firm's capital resources</i> to close to or below the required level, or would otherwise be significant, the <i>FSA</i> will request this information with a view to taking account of this factor in determining the amount of the <i>implicit item</i>. Additional information concerning investment income should be furnished with an application for a <i>waiver</i>, if a <i>firm</i> believes that any double-counting would fall into one of the categories mentioned above.</p>
Average period to run	
34	<p>The average number of years remaining to run on <i>policies</i> should be calculated on the basis of the weighted average of the periods for individual <i>contracts of insurance</i>, using as weights the actuarial present value of the benefits payable under the contracts. A separate weighted average should be calculated for each of the various categories of contract and the results combined to obtain the weighted average for the portfolio as a whole. Approximate methods of calculation, which the <i>firm</i> considers will give results similar to the full calculation, will be accepted. In particular, the <i>FSA</i> will normally accept the calculation of an average period to run for a specific category of contract on the basis of the average valuation factor for future benefits derived from data contained in the abstract of the valuation report in the regulatory <i>returns</i>. A <i>firm</i> will be asked to demonstrate the validity of the method adopted only where an abnormal distribution of the business in force gives grounds for doubt</p>

	about its accuracy.
35	Calculations will normally be requested only for the main categories of <i>insurance business</i> , accounting for not less than 90% of the <i>mathematical reserves</i> , except where there are grounds for expecting that the exclusion of certain categories of <i>policies</i> under this provision might have a significant effect on the resulting average period to run. Detailed calculations will not be required where a <i>waiver</i> is sought in respect of a low multiple of the annual profits, well within the average period to run for the <i>firm</i> .
36	Where, for a particular category of business, a method of valuation is used which does not involve the calculation of the value of future benefits and which is significant for the <i>firm</i> in question, the calculation of the average period to run should be based on estimates of the value of future benefits.
Premature termination of contracts	
37	Allowance should be made for the premature termination of <i>contracts of insurance</i> , based on the actual experience of the <i>firm</i> over the last five years, or other appropriate period, and taking into account specific features of contracts such as options which can be expected to lead to premature termination (e.g. guaranteed surrender values on income bonds written as <i>long-term insurance contracts</i> and option dates on flexible whole-life contracts). The adjustment should be made separately for each of the main categories of business. The use of industry-wide rates of termination will be acceptable where a <i>firm</i> is satisfied that this will result in sufficient allowance being made having regard to the <i>firm's</i> own experience. Methods of calculation that involve a degree of approximation will be permitted.
38	For certain types of contract, where the period left to run is most naturally defined as the term to a fixed maturity or expiry date, the allowance for premature termination should also take into account terminations resulting from death.
Overall limit	
39	The overall average period left to run calculated as described above should be limited to a maximum of six years under article 27(4) of the <i>Consolidated Life Directive</i> (or a maximum of ten years during the transitional period referred to in paragraph 5) before applying it to the estimated annual profit in order to determine the maximum value of the future profits <i>implicit item</i> .
Definition of period to run	
40	The definition of the period to run and the basis of the allowance for early termination should clearly be considered together. For certain types of contracts (e.g. pension contracts with a range of retirement

	ages or other options), there is inherent uncertainty about the likely term to run. In such circumstances any estimate for determining the amount of the future profits <i>implicit item</i> for which a <i>waiver</i> is sought should be based on prudent assumptions tending, if anything, to underestimate the average period to run.
Zillmerising	
41	The <i>FSA</i> does not normally expect to grant <i>waivers</i> permitting <i>implicit items</i> due to <i>zillmerisation</i> except in very exceptional circumstances. <i>Zillmerisation</i> is an allowance for acquisition costs that are expected, under prudent assumptions, to be recoverable from future <i>premiums</i> . <i>Firms</i> can make a direct adjustment to their reserves for <i>zillmerisation</i> , subject to the requirements on <i>mathematical reserves</i> set out in <i>INSPRU</i> 1.3.43R, and this is the usual approach. However, where no such adjustment has been made, or where the maximum adjustment has not been made in the <i>mathematical reserves</i> , the <i>FSA</i> will consider an application for an <i>implicit item</i> , if the amount is consistent with the amount that would have been allowed as an adjustment to <i>mathematical reserves</i> under <i>INSPRU</i> 1.3.43R.
Hidden reserves	
42	The <i>FSA</i> will grant <i>waivers</i> permitting <i>implicit items</i> due to hidden reserves only in very exceptional circumstances. These items relate to hidden reserves resulting from the underestimation of assets. The <i>rules</i> for the valuation of assets and liabilities (see <i>GENPRU</i> 1.3) which apply to assets and liabilities other than <i>mathematical reserves</i> are based on the valuation used by the <i>firm</i> for the purposes of its external accounts, with adjustments for regulatory prudence such as concentration limits for large holdings, and would not normally be expected to contain hidden reserves.
Case studies on "unduly burdensome"	
43	Some examples of situations where the existing <i>rules</i> might be considered to be unduly burdensome are given below:
	<ul style="list-style-type: none"> • A <i>firm</i> writes <i>with-profits business</i>. The <i>firm's</i> investment policy is affected by its published financial position. Application of the <i>rules</i> without an <i>implicit item</i> would result in the <i>firm</i> adopting a lower equity backing ratio. It may be possible to demonstrate that, in the circumstances, it would be unduly burdensome to require the <i>firm</i> to incur costs (which might prejudice <i>policyholders</i>) resulting from the lower equity backing ratio, rather than take allowance for an <i>implicit item</i>.
	<ul style="list-style-type: none"> • A <i>firm</i> has purchased a block of in-force business, on which the future profits may be reasonably estimated. However, this asset is given no value under the <i>rules</i>. It may be possible to demonstrate that it is unduly burdensome for the <i>firm</i> to recognise the cost of acquiring the

	assets whilst giving no value to the asset acquired.
•	A <i>firm</i> has a block of in-force business, on which the future profits may be reasonably estimated. Application of the <i>rules</i> without an <i>implicit item</i> would result in a need to obtain additional capital. It may be possible to demonstrate that it is unduly burdensome, having regard to the particular circumstances of the <i>firm</i> , to require it to incur the costs involved in the injection of further capital rather than take allowance for an <i>implicit item</i> .
•	A <i>firm</i> has purchased matching assets for guaranteed annuity liabilities. The operation of the asset and liability valuation <i>rules</i> leads to statutory losses in certain circumstances in spite of good matching of assets and liabilities on a realistic basis of assessment. It may be possible to demonstrate that it is unduly burdensome to require the <i>firm</i> to incur the costs involved in the injection of further capital rather than take allowance for an <i>implicit item</i> .
Conditions which will typically be applied to implicit items waivers	
Limits	
44	Where <i>implicit items waivers</i> are granted, the value cannot exceed (and will normally be less than) the monetary limits described in paragraph 27, except that during the transitional period the pre-Solvency I limits will apply. In addition, time limits will apply and <i>wavers</i> will normally only last for 12 months.
Publicity	
45	The <i>FSA</i> will publish the <i>waiver</i> (see <i>SUP</i> 8.6 and <i>SUP</i> 8.7). Public disclosure is standard practice unless the <i>FSA</i> is satisfied that publication is inappropriate or unnecessary (see section 148 of the <i>Act</i>). Any request that a direction not be published should be made to the <i>FSA</i> in writing with grounds in support, as set out in <i>SUP</i> 8.6. Disclosure of a <i>waiver</i> will normally be required in the <i>firm's</i> annual <i>returns</i> .

Annex C

Chapter 3 of GENPRU

In this Annex the text shown is redesignated text. Where changes are to be made to the redesignated text, new text is underlined and text that is deleted is shown as struck-through.

3.1 ~~8.4~~ Cross sector groups

Application

- ~~8.4.13.1.1~~ R (1) *GENPRU 8.43.1* applies to every *firm* that is a member of a *financial conglomerate* other than:
- (a) an *incoming EEA firm*;
 - (b) an *incoming Treaty firm*;
 - (c) a *UCITS qualifier*; and
 - (d) an *ICVC*.
- (2) *GENPRU 3.18.4* does not apply to a *firm* with respect to a *financial conglomerate* of which it is a member if the interest of the *financial conglomerate* in that *firm* is no more than a *participation*.
- (3) *GENPRU 3.18.4.25* (Capital adequacy requirements: high level requirement), *GENPRU 3.18.4.26R* (Capital adequacy requirements: application of Method 4 from Annex I of the Financial Groups Directive), *GENPRU 3.18.4.29R* (Capital adequacy requirements: application of Methods 1, 2 or 3 from Annex I of the Financial Groups Directive) and *GENPRU 3.18.4.35R* (Risk concentration and intra group transactions: the main rule) do not apply with respect to a *third-country financial conglomerate*.

Purpose

3.1.28.4.2 G GENPRU 3.18.4 implements the *Financial Groups Directive*. However, material on the following topics is to be found elsewhere in the *Handbook* as follows:

- (1) further material on *third-country financial conglomerates* can be found in GENPRU 3.28.5;
- (2) *SUP 15.9* contains notification *rules* for members of *financial conglomerates*;
- (3) material on reporting obligations can be found in *SUP 16.7.7382R* and *SUP 16.7.7483R*; and
- (4) material on systems and controls in *financial conglomerates* can be found in PRU 8.1SYSC 12.

Introduction: identifying a financial conglomerate

3.1.3
8.4.3

- G
- (1) In general the process in (2) to (8) applies for identifying *financial conglomerates*.
 - (2) *Competent authorities* that have authorised *regulated entities* should try to identify any *consolidation group* that is a *financial conglomerate*. If a *competent authority* is of the opinion that a *regulated entity* authorised by that *competent authority* is a member of a *consolidation group* which may be a *financial conglomerate* it should communicate its view to the other *competent authorities* concerned.
 - (3) A *competent authority* may start (as described in (2)) the process of deciding whether a group is a *financial conglomerate* even if it would not be the *coordinator*.
 - (4) A member of a group may also start that process by notifying one of the *competent authorities* that have authorised group members that its group may be a *financial conglomerate*, for example by notification under *SUP 15.9*.
 - (5) If a group member gives a notification in accordance with (4), that does not automatically mean that the group should be treated as a *financial conglomerate*. The process described in (6) to (9) still applies.
 - (6) The *competent authority* that would be *coordinator* will take the lead in establishing whether a group is a *financial conglomerate* once the process has been started as described in (2) and (3).
 - (7) The process of establishing whether a group is a *financial conglomerate* will normally involve discussions between the *financial conglomerate* and the *competent authorities* concerned.

- (8) A *financial conglomerate* should be notified by its *coordinator* that it has been identified as a *financial conglomerate* and of the appointment of the *coordinator*. The notification should be given to the *parent undertaking* at the head of the group or, in the absence of a *parent undertaking*, the *regulated entity* with the largest balance sheet total in the *most important financial sector*. That notification does not of itself make a group into a *financial conglomerate*; whether or not a group is a *financial conglomerate* is governed by the definition of *financial conglomerate* as set out in GENPRU 3.1 8.4.
- (9) GENPRU 3 8 Ann 3 4G is a questionnaire (together with its explanatory notes) that the *FSA* asks groups that may be *financial conglomerates* to fill out in order to decide whether or not they are.

Introduction: The role of other competent authorities

- 3.1.4
8.4.4 G A lead supervisor (called the *coordinator*) is appointed for each *financial conglomerate*. Article 10 of the *Financial Groups Directive* describes the criteria for deciding which *competent authority* is appointed as *coordinator*. Article 11 of the *Financial Groups Directive* sets out the tasks of the *coordinator*.

Definition of financial conglomerate: basic definition

- 3.1.5
8.4.5 R A *financial conglomerate* means a *consolidation group* that is identified as a *financial conglomerate* in accordance with the decision tree in GENPRU 3 8 Ann 43R.

Definition of financial conglomerate: sub-groups

- 3.1.6
8.4.6 R A *consolidation group* is not prevented from being a *financial conglomerate* because it is part of a wider:
- (1) *consolidation group*; or
 - (2) *financial conglomerate*; or
 - (3) group of persons linked in some other way.

Definition of financial conglomerate: the financial sectors: general

- 3.1.7
8.4.7 R For the purpose of the definition of *financial conglomerate*, there are two *financial sectors* as follows:
- (1) the *banking sector* and the *investment services sector*, taken together; and
 - (2) the *insurance sector*.

- 3.1.8
8.4.8 R (1) This *rule* applies for the purpose of the definition of *financial conglomerate* and the *financial conglomerate definition decision tree*.
- (2) Any *mixed financial holding company* is considered to be outside the *overall financial sector* for the purpose of the tests set out in the boxes titled

Threshold Test 1, Threshold Test 2 and Threshold Test 3 in the *financial conglomerate definition decision tree*.

- (3) Determining whether the tests set out in the boxes titled Threshold Test 2 and Threshold Test 3 in the *financial conglomerate definition decision tree* are passed is based on considering the consolidated and/or aggregated activities of the members of the *consolidation group* within the *insurance sector* and the consolidated and/or aggregated activities of the members of the *consolidation group* within the *banking sector* and the *investment services sector*.

Definition of financial conglomerate: adjustment of the percentages

3.1.9
8.4.9

R Once a *financial conglomerate* has become a *financial conglomerate* and subject to supervision in accordance with the *Financial Groups Directive*, the figures in the *financial conglomerate definition decision tree* are altered as follows:

- (1) the figure of 40% in the box titled Threshold Test 1 is replaced by 35%;
- (2) the figure of 10% in the box titled Threshold Test 2 is replaced by 8%; and
- (3) the figure of six billion Euro in the box titled Threshold Test 3 is replaced by five billion Euro.

3.1.10
8.4.10

R The alteration in GENPRU 3.1.98.4.9R only applies to a *financial conglomerate* during the period that:

- (1) begins when the *financial conglomerate* would otherwise have stopped being a *financial conglomerate* because it does not meet one of the unaltered thresholds referred to in GENPRU 3.1.98.4.9R; and
- (2) covers the three years following that date.

Definition of financial conglomerate: balance sheet totals

3.1.11
8.4.11

R The calculations referred to in the *financial conglomerate definition decision tree* regarding the balance sheet must be made on the basis of the aggregated balance sheet total of the members of the *consolidation group*, according to their annual accounts. For the purposes of this calculation, *undertakings* in which a *participation* is held must be taken into account as regards the amount of their balance sheet total corresponding to the aggregated proportional share held by the *consolidation group*. However, where consolidated accounts are available, they must be used instead of aggregated accounts.

Definition of financial conglomerate: solvency requirement

3.1.12
8.4.12

R The solvency and capital adequacy requirements referred to in the *financial conglomerate definition decision tree* must be calculated in accordance with the provisions of the relevant *sectoral rules*.

Definition of financial conglomerate: discretionary changes to the definition

3.1.13
8.4.13

G Articles 3(3) to 3(6), Article 5(4) and Article 6(5) of the *Financial Groups Directive* allow *competent authorities*, on a case by case basis, to:

- (1) change the definition of *financial conglomerate* and the obligations applying with respect to a *financial conglomerate*;
- (2) apply the scheme in the *Financial Groups Directive* to *EEA regulated entities* in specified kinds of group structures that do not come within the definition of *financial conglomerate*; and
- (3) exclude a particular entity in the scope of capital adequacy requirements that apply with respect to a *financial conglomerate*.

Capital adequacy requirements: introduction

3.1.14
8.4.14

G The capital adequacy provisions of GENPRU 3.1.18.4 are designed to be applied to *EEA-based financial conglomerates*.

3.1.15
8.4.15

G GENPRU 3.1.25.4.25R is a high level capital adequacy *rule*. It applies whether or not the *FSA* is the *coordinator* of the *financial conglomerate* concerned.

3.1.16
8.4.16

G GENPRU 3.1.26.4.26R to GENPRU 3.1.31.4.31R and GENPRU 38 Ann 1R implement the detailed capital adequacy requirements of the *Financial Groups Directive*. They only deal with a *financial conglomerate* for which the *FSA* is the *coordinator*. If another *competent authority* is *coordinator* of a *financial conglomerate*, those *rules* do not apply with respect to that *financial conglomerate* and instead that *coordinator* will be responsible for implementing those detailed requirements.

3.1.17
8.4.17

G Annex I of the *Financial Groups Directive* lays down four methods for calculating capital adequacy at the level of a *financial conglomerate*. Those four methods are implemented as follows:

- (1) Method 1 calculates capital adequacy using accounting consolidation. It is implemented by GENPRU 3.1.29.4.29R to GENPRU 3.1.31.4.31R and Part 1 of GENPRU 38 Ann 1R.
- (2) Method 2 calculates capital adequacy using a deduction and aggregation approach. It is implemented by GENPRU 3.1.29.4.29R to GENPRU 3.1.31.4.31R and Part 2 of GENPRU 38 Ann 1R.
- (3) Method 3 calculates capital adequacy using book values and the deduction of capital requirements. It is implemented by GENPRU 3.1.29.4.29R to GENPRU 3.1.31.4.31R and Part 3 of GENPRU 38 Ann 1R.

- (4) Method 4 consists of a combination of Methods 1, 2 and 3 from Annex I of the *Financial Groups Directive*, or a combination of two of those Methods. It is implemented by ~~GENPRU 3.1.268.4.26R~~ to ~~GENPRU 3.1.288.4.28R~~, ~~GENPRU 3.1.308.4.30R~~ and Part 4 of GENPRU 38 Ann 1R.

3.1.18
8.4.18

- G Part 4 of GENPRU 38 Ann 1R (Use of Method 4 from Annex I of the *Financial Conglomerates Directive*) applies the *FSA's sectoral rules* with respect to the *financial conglomerate* as a whole, with some adjustments. Where Part 4 of GENPRU 38 Ann 1R applies the *FSA's sectoral rules* for:

- (1) the *insurance sector*, that involves a combination of Methods 2 and 3; and
- (2) the *banking sector* and the *investment services sector*, that involves a combination of Methods 1 and 3.

3.1.19
8.4.19

- G Paragraph 5.75 of GENPRU 38 Ann 1R (Capital adequacy calculations for financial conglomerates) deals with a case in which there are no capital ties between entities in a *financial conglomerate*. In particular, the *FSA*, after consultation with the other *relevant competent authorities* and in accordance with Annex I of the *Financial Groups Directive*, will determine which proportional share of a solvency deficit in such an entity will have to be taken into account, bearing in mind the liability to which the existing relationship gives rise.

3.1.20
8.4.20

- G (1) In the following cases, the *FSA* (acting as *coordinator*) may choose which of the four methods for calculating capital adequacy laid down in Annex I of the *Financial Groups Directive* should apply:
- (a) where a *financial conglomerate* is headed by a *regulated entity* that has been authorised by the *FSA*; or
 - (b) the only *relevant competent authority* for the *financial conglomerate* is the *FSA*.
- (2) ~~GENPRU 3.1.288.4.28R~~ automatically applies Method 4 from Annex I of the *Financial Groups Directive* in these circumstances except in the cases set out in ~~GENPRU 3.1.288.4.28R(1)(e)~~ and ~~GENPRU 3.1.288.4.28R(1)(f)~~. The process in ~~GENPRU 3.1.228.4.22G~~ does not apply.

3.1.21
8.4.21

- G Where ~~GENPRU 3.1.208.4.20G~~ does not apply, the Annex I method to be applied is decided by the *coordinator* after consultation with the *relevant competent authorities* and the *financial conglomerate* itself.

- 3.1.22
8.4.22 G The method of calculating capital adequacy chosen in respect of a *financial conglomerate* as described in GENPRU 3.1.218.4.21G will be applied with respect to that *financial conglomerate* by varying the *Part IV permission* of a *firm* in that *financial conglomerate* to include a *requirement*. That *requirement* will have the effect of obliging the *firm* to ensure that the *financial conglomerate* has capital resources of the type and amount needed to comply with whichever of the methods in GENPRU 38 Ann 1R is to be applied with respect to that *financial conglomerate*. The powers in the *Act* relating to *waivers* and varying a *firm's Part IV permission* can be used to implement one of the methods from Annex I of the *Financial Groups Directive* in a way that is different from that set out in GENPRU 3.18.4 and GENPRU 38 Ann 1R if that is necessary to reflect the consultations referred to in GENPRU 3.1.218.4.21G.
- 3.1.23
8.4.23 G If there is more than one *firm* in a *financial conglomerate* with a *Part IV permission*, the *FSA* would not normally expect to apply the *requirement* described in GENPRU 3.1.228.4.22G to all of them. Normally it will only be necessary to apply it to one.
- 3.1.24
8.4.24 G The *FSA* expects that in all or most cases falling into GENPRU 3.1.218.4.21G, the *rules* in Part 4 of GENPRU 38 Ann 1R will be applied.
- Capital adequacy requirements: high level requirement
- 3.1.25
8.4.25 R (1) A *firm* that is a member of a *financial conglomerate* must at all times have capital resources of such an amount and type that results in the capital resources of the *financial conglomerate* taken as a whole being adequate.
- (2) This *rule* does not apply with respect to any *financial conglomerate* until notification has been made that it has been identified as a *financial conglomerate* as contemplated by Article 4(2) of the *Financial Groups Directive*.
- Capital adequacy requirements: application of Method 4 from Annex I of the *Financial Groups Directive*
- 3.1.26
8.4.26 R If this *rule* applies under GENPRU 3.1.278.4.27R to a *firm* with respect to a *financial conglomerate* of which it is a member, the *firm* must at all times have capital resources of an amount and type:
- (1) that ensure that the *financial conglomerate* has capital resources of an amount and type that comply with the *rules* applicable with respect to that *financial conglomerate* under Part 4 of GENPRU 38 Ann 1R (as modified by that annex); and
- (2) that as a result ensure that the *firm* complies with those *rules* (as so modified) with respect to that *financial conglomerate*.
- 3.1.27
8.4.27 R GENPRU 3.1.268.4.26R applies to a *firm* with respect to a *financial conglomerate* of which it is a member if one of the following conditions is satisfied:
- (1) the condition in GENPRU 3.1.288.4.28R is satisfied; or

- (2) this *rule* is applied to the *firm* with respect to that *financial conglomerate* as described in GENPRU 3.1.308.4.30R.

Capital adequacy requirements: compulsory application of Method 4 from Annex I of the Financial Groups Directive

3.1.28
8.4.28

- R (1) The condition in this *rule* is satisfied for the purpose of GENPRU 3.1.278.4.27R(1) with respect to a *firm* and a *financial conglomerate* of which it is a member (with the result that GENPRU 3.1.268.4.26R automatically applies to that *firm*) if:
- (a) notification has been made in accordance with regulation 2 of the *Financial Groups Directive Regulations* that the *financial conglomerate* is a *financial conglomerate* and that the *FSA* is *coordinator* of that *financial conglomerate*;
 - (b) the *financial conglomerate* is not part of a wider *FSA regulated EEA financial conglomerate*;
 - (c) the *financial conglomerate* is not an *FSA regulated EEA financial conglomerate* under another *rule* or under paragraph (b) of the definition of *FSA regulated EEA financial conglomerate* (application of supplementary supervision through a *firm's Part IV permission*);
 - (d) one of the following conditions is satisfied:
 - (i) the *financial conglomerate* is headed by a *regulated entity* that is a *UK domestic firm*; or
 - (ii) the only *relevant competent authority* for that *financial conglomerate* is the *FSA*;
 - (e) this *rule* is not disapplied under paragraph 5.75 of GENPRU 38 Ann 1R (No capital ties); and
 - (f) the *financial conglomerate* meets the condition set out in the box titled Threshold Test 2 (10% average of balance sheet and solvency requirements) in the *financial conglomerate definition decision tree*.
- (2) Once GENPRU 3.1.268.4.26R applies to a *firm* with respect to a *financial conglomerate* of which it is a member under GENPRU 3.1.278.4.27R(1), (1)(f) ceases to apply with respect to that *financial conglomerate*. Therefore the fact that the *financial conglomerate* subsequently ceases to meet the condition in (1)(f) does not mean that the condition in this *rule* is not satisfied.

Capital adequacy requirements: application of Methods 1, 2 or 3 from Annex I of the Financial Groups Directive

3.1.29
8.4.29 R If with respect to a *firm* and a *financial conglomerate* of which it is a member, this *rule* is applied to the *firm* with respect to that *financial conglomerate* as described in GENPRU 3.1.308.4.30R, the *firm* must at all times have capital resources of an amount and type that ensures that the *conglomerate capital resources* of that *financial conglomerate* at all times equal or exceed its *conglomerate capital resources requirement*.

Capital adequacy requirements: use of Part IV permission to apply Annex I of the Financial Groups Directive

3.1.30
8.4.30 R With respect to a *firm* and a *financial conglomerate* of which it is a member:

(1) GENPRU 3.1.268.4.26R (Method 4 from Annex I of the *Financial Groups Directive*) is applied to the *firm* with respect to that *financial conglomerate* for the purposes of GENPRU 3.1.278.4.27R(2); or

(2) GENPRU 3.1.298.4.29R (Methods 1 to 3 from Annex I of the *Financial Groups Directive*) is applied to the *firm* with respect to that *financial conglomerate*;

if the *firm's Part IV permission* contains a *requirement* obliging the *firm* to comply with GENPRU 3.1.268.4.26R or, as the case may be, GENPRU 3.1.298.4.29R.

3.1.31
8.4.31 R If GENPRU 3.1.298.4.29R (Methods 1-3 from Annex I of the *Financial Groups Directive*) applies to a *firm* with respect to a *financial conglomerate* of which it is a member, the definitions of *conglomerate capital resources* and *conglomerate capital resources requirement* that apply for the purposes of that *rule* are the ones from whichever of Part 1, Part 2 or Part 3 of GENPRU 38 Ann 1R is specified in the *requirement* referred to in GENPRU 3.1.308.4.30R.

Risk concentration and intra-group transactions: introduction

3.1.32
8.4.32 G GENPRU 3.1.358.4.35R implements Article 7(4) and Article 8(4) of the *Financial Groups Directive*, which provide that where a *financial conglomerate* is headed by a *mixed financial holding company*, the *sectoral rules* regarding *risk concentration* and *intra-group transactions* of the *most important financial sector* in the *financial conglomerate*, if any, shall apply to that sector as a whole, including the *mixed financial holding company*.

3.1.33
8.4.33 G Articles 7(3) (Risk concentration) and 8(3) (Intra-group transactions) and Annex II (Technical application of the provisions on intra-group transactions and risk concentration) of the *Financial Groups Directive* say that Member States may apply at the level of the *financial conglomerate* the provisions of the *sectoral rules* on *risk concentrations* and *intra-group transactions*. GENPRU 3.18.4 does not take up that option, although the *FSA* may impose such obligations on a case by case basis.

Risk concentration and intra-group transactions: application

- 3.1.34
8.4.34 R GENPRU 3.1.358.4.35R applies to a *firm* with respect to a *financial conglomerate* of which it is a member if:
- (1) the condition in Articles 7(4) and 8(4) of the *Financial Groups Directive* is satisfied (the *financial conglomerate* is headed by a *mixed financial holding company*); and
 - (2) that *financial conglomerate* is an *FSA regulated EEA financial conglomerate*.

Risk concentration and intra group transactions: the main rule

- 3.1.35
8.4.35 R A *firm* must ensure that the *sectoral rules* regarding *risk concentration* and *intra-group transactions* of the *most important financial sector* in the *financial conglomerate* referred to in GENPRU 3.1.348.4.34R are complied with with respect to that *financial sector* as a whole, including the *mixed financial holding company*. The *FSA's sectoral rules* for these purposes are those identified in the table in GENPRU 3.1.368.4.36R.

Risk concentration and intra-group transactions: Table of applicable sectoral rules

- 3.1.36
8.4.36 R Table: application of sectoral rules
This table belongs to GENPRU 3.1.358.4.35R

The most important financial sector	Applicable sectoral rules	
	Risk concentration	Intra-group transactions
<u>Banking and investment services sector</u>	Rules 3.3.13, 3.3.19 and 3.3.21 of chapter GN of IPRU(BANK) (as they apply to large exposures on a consolidated basis) <u>BIPRU 8.9 (Consolidated concentration risk requirements) including BIPRU TP as it applies to a UK consolidation group.</u>	Rules 3.3.13, 3.3.19 and 3.3.21 of chapter GN of IPRU(BANK) (as they apply to large exposures on a solo basis) <u>BIPRU 10 (Concentration Risk) including BIPRU TP as it applies on a solo basis and relates to BIPRU 10.</u>
<u>Insurance sector</u>	None	<u>Rule 9.39 of IPRU(INS)</u>
<u>Investment services sector</u>	Rule 14.3.2 in Chapter 14 of IPRU(INV)	Rule 10-190 in Chapter 10 of IPRU(INV) as it applies on a solo basis
Note:	The <i>rules</i> as applied in column three apply without any concession or exemption for exposures to other group members.	

The most important financial sector	Applicable sectoral rules	
	Risk concentration	Intra-group transactions
Note	The decision tree in paragraph 4.5 of <u>GENPRU 38 Ann 1R</u> applies for the purpose of identifying the <i>most important financial sector</i> .	
Note	<u>Any waiver granted to a member of the financial conglomerate, on a solo or consolidated basis, shall not apply in respect of the financial conglomerate for the purposes of GENPRU 3.1.36R.</u>	

- 3.1.37 R (1) Where the rules for the banking and investment services sector are being applied, a mixed financial holding company must be treated as being a financial holding company.
- (2) Where the rules for the insurance sector are being applied, a mixed financial holding company must be treated as being an insurance holding company.
- 3.1.38 R (1) This rule applies for the purposes of the definitions of:
- (a) a concentration risk group counterparty; and
- (b) a consolidation concentration risk group counterparty;
- as they apply for the purposes of the rules for the banking and investment services sector as applied by GENPRU 3.1.36R.
- (2) For the purposes of BIPRU 3.2.27R(1)(a) and (b) (as they apply to the definition in GENPRU 3.1.38R(1)(a)), the conditions are also satisfied if the counterparty and the firm are included within the scope of consolidated supervision on a full basis with respect to the same financial conglomerate under GENPRU 3.1 or the relevant implementation measures in another EEA State for the Financial Groups Directive.
- (3) Subject to (4), for the purposes of BIPRU 8.9.11R(3) (as it applies to the definition in GENPRU 3.1.38R(1)(b)), the conditions are also satisfied if the counterparty and the firm are included within the scope of consolidated supervision on a full basis with respect to the same financial conglomerate under GENPRU 3.1 or the relevant implementation measures in another EEA State for the Financial Groups Directive.
- (4) BIPRU 8.9.11R(3)(a) does not apply.
- 8.4.37 G The material in IPRU(BANK) that has particular application to the rules in IPRU(BANK) referred to in the table in PRU 8.4.36R is:
- (1) (in the case of column 2) Chapter LE as it applies on a consolidated basis;
- (2) (in the case of column 3) Chapter LE as it applies on a solo basis.

8.4.38 G ~~The table in PRU 8.4.36R does not refer to the rules for building societies as a building society cannot have a mixed financial holding company as a parent.~~

The financial sectors: asset management companies

- ~~3.1.39~~
~~8.4.39~~ R (1) In accordance with Article 30 of the *Financial Groups Directive* (Asset management companies), this *rule* deals with the inclusion of an *asset management company* that is a member of a *financial conglomerate* in the scope of regulation of *financial conglomerates*. This *rule* does not apply to the definition of *financial conglomerate*.
- (2) An *asset management company* is in the *overall financial sector* and is a *regulated entity* for the purpose of:
- (a) ~~GENPRU 3.1.26R~~~~8.4.26R~~ to ~~GENPRU 3.1.36R~~~~8.4.36R~~;
- (b) ~~GENPRU 3~~ Ann 1R (Capital adequacy calculations for financial conglomerates) and ~~GENPRU 3~~ Ann 2R (Prudential rules for third country groups); and
- (c) any other provision of the *Handbook* relating to the supervision of *financial conglomerates*.
- (3) In the case of a *financial conglomerate* for which the *FSA* is the *coordinator*, all *asset management companies* must be allocated to one *financial sector* for the purposes in (2), being either the *investment services sector* or the *insurance sector*. But if that choice has not been made in accordance with (4) and notified to the *FSA* in accordance with (4)(d), an *asset management company* must be allocated to the *investment services sector*.
- (4) The choice in (3):
- (a) must be made by the *undertaking* in the *financial conglomerate* holding the position referred to in Article 4(2) of the *Financial Groups Directive* (group member to whom notice must be given that the group has been found to be a *financial conglomerate*);
- (b) applies to all *asset management companies* that are members of the *financial conglomerate* from time to time;
- (c) cannot be changed; and
- (d) must be notified to the *FSA* as soon as reasonably practicable after the notification in (4)(a).
- (5) This rule applies even if:
- (a) a UCITS management company is a BIPRU investment firm; or
- (b) an asset management company is an investment firm.

3.28.5 Third-country groups

Application

3.2.1
8.5.1 R *GENPRU 3.28.5* applies to every *firm* that is a member of a *third-country group*.
But it does not apply to:

- (1) an *incoming EEA firm*; or
- (2) an *incoming Treaty firm*; or
- (3) a *UCITS qualifier*; or
- (4) an *ICVC*.

Purpose

3.2.2
8.5.2 G *GENPRU 3.28.5* implements in part Article 18 of the *Financial Groups Directive* and Article ~~143~~^{56a} of the *Banking Consolidation Directive*.

Equivalence

3.2.3
8.5.3 G The first question that must be asked about a *third-country financial group* is whether the *EEA regulated entities* in that *third-country group* are subject to supervision by a *third-country competent authority*, which is equivalent to that provided for by the *Financial Groups Directive* (in the case of a *financial conglomerate*) or the *EEA prudential sectoral legislation* for the *banking sector* or the *investment services sector* (in the case of a *banking and investment group*). Article 18(1) of the *Financial Groups Directive* sets out the process for establishing equivalence with respect to *third-country financial conglomerates* and ~~the first three paragraphs of Article 143 (1) and (2)~~^{56a} of the *Banking Consolidation Directive* does so with respect to *third-country banking and investment groups*.

Other methods: General

3.2.4
8.5.4 G If the supervision of a *third-country group* by a *third-country competent authority* does not meet the equivalence test referred to in *GENPRU 3.2.38.5.3G*, *competent authorities* may apply other methods that ensure appropriate supervision of the *EEA regulated entities* in that *third-country group* in accordance with the aims of supplementary supervision under the *Financial Groups Directive* or consolidated supervision under the applicable *EEA prudential sectoral legislation*.

Supervision by analogy: introduction

- 3.2.5
8.5.5 G If the supervision of a *third-country group* by a *third-country competent authority* does not meet the equivalence test referred to in *GENPRU 3.2.38.5.3G*, a *competent authority* may, rather than take the measures described in *GENPRU 3.2.48.5.4G*, apply, by analogy, the provisions concerning supplementary supervision under the *Financial Groups Directive* or, as applicable, consolidated supervision under the applicable *EEA prudential sectoral legislation*, to the *EEA regulated entities* in the *banking sector*, *investment services sector* and (in the case of a *financial conglomerate*) *insurance sector*.
- 3.2.6
8.5.6 G The *FSA* believes that it will only be right to adopt the option in *GENPRU 3.2.58.5.5G* in response to very unusual group structures.
- 3.2.7
8.5.7 G *GENPRU 3.2.88.5.8R* and *GENPRU 3.2.98.5.9R* and *GENPRU 38 Ann 2* set out *rules* to deal with the situation covered in *GENPRU 3.2.58.5.5G*. Those *rules* do not apply automatically. Instead, they can only be applied with respect to a particular *third-country group* through the *Part IV permission* of a *firm* in that *third-country group*. Broadly speaking the procedure described in *GENPRU 3.1.228.4.22G* also applies to this process.

Supervision by analogy: rules for third-country conglomerates

- 3.2.8
8.5.8 R If the *Part IV permission* of a *firm* contains a *requirement* obliging it to comply with this *rule* with respect to a *third-country financial conglomerate* of which it is a member, it must comply, with respect to that *third-country financial conglomerate*, with the *rules* in Part 1 of *GENPRU 38 Ann 2R*, as adjusted by Part 3 of that annex.

Supervision by analogy: rules for third-country banking and investment groups

- 3.2.9
8.5.9 R If the *Part IV permission* of a *firm* contains a *requirement* obliging it to comply with this *rule* with respect to a *third-country banking and investment group* of which it is a member, it must comply, with respect to that *third-country banking and investment group*, with the *rules* in Part 2 of *GENPRU 38 Ann 2R*, as adjusted by Part 3 of that annex.

GENPRU 38 Ann 1R

Capital adequacy calculations for financial conglomerates (GENPRU 3.1.268-4.26R and GENPRU 3.1.298-4.29R)

1 Table: PART 1: Method of Annex I of the Financial Groups Directive (Accounting Consolidation Method)

Capital resources	1.1	The <i>conglomerate capital resources</i> of a <i>financial conglomerate</i> calculated in accordance with this Part are the capital of that <i>financial conglomerate</i> , calculated on an accounting consolidation basis, that qualifies under paragraph 1.2.	
	1.2	The elements of capital that qualify for the purposes of paragraph 1.1 are those that qualify in accordance with the <i>applicable sectoral rules</i> , in accordance with the following:	
		(1)	the <i>conglomerate capital resources requirement</i> is divided up in accordance with the contribution of each <i>financial sector</i> to it; and
		(2)	the portion of the <i>conglomerate capital resources requirement</i> attributable to a particular <i>financial sector</i> must be met by capital resources that are eligible in accordance with the <i>applicable sectoral rules</i> for that <i>financial sector</i> .
Capital resources requirement	1.3	The <i>conglomerate capital resources requirement</i> of a <i>financial conglomerate</i> calculated in accordance with this Part is equal to the sum of the capital adequacy and solvency requirements for each <i>financial sector</i> calculated in accordance with the <i>applicable sectoral rules</i> for that <i>financial sector</i> .	
Consolidation	1.4	The information required for the purpose of establishing whether or not a <i>firm</i> is complying with <u>GENPRU 3.1.298-4.29R</u> (insofar as the definitions in this Part are applied for the purpose of that <i>rule</i>) must be based on the consolidated accounts of the <i>financial conglomerate</i> , together with such other sources of information as appropriate.	
	1.5	The <i>applicable sectoral rules</i> that are applied under this Part are the <i>applicable sectoral consolidation rules</i> . Other <i>applicable sectoral rules</i> must be applied if required.	

2 Table: PART 2: Method 2 of Annex I of the Financial Groups Directive (Deduction and aggregation Method)

Capital resources	2.1	<p>The <i>conglomerate capital resources</i> of a <i>financial conglomerate</i> calculated in accordance with this Part are equal to the sum of the following amounts (so far as they qualify under paragraph 2.3) for each member of the <i>overall financial sector</i>:</p> <p>(1) (for the <i>person</i> at the head of the <i>financial conglomerate</i>) its <i>solo capital resources</i>;</p> <p>(2) (for any other member):</p> <p>(a) its <i>solo capital resources</i>; less</p> <p>(b) the book value of the <i>financial conglomerate's</i> investment in that member.</p>
	2.2	<p>The deduction in paragraph 2.1(2) must be carried out separately for each type of capital represented by the <i>financial conglomerate's</i> investment in the member concerned.</p>
	2.3	<p>The elements of capital that qualify for the purposes of paragraph 2.1 are those that qualify in accordance with the <i>applicable sectoral rules</i>. In particular, the portion of the <i>conglomerate capital resources requirement</i> attributable to a particular member of a <i>financial sector</i> must be met by capital resources that would be eligible under the <i>sectoral rules</i> that apply to the calculation of its <i>solo capital resources</i>.</p>
Capital resources requirement	2.4	<p>The <i>conglomerate capital resources requirement</i> of a <i>financial conglomerate</i> calculated in accordance with this Part is equal to the sum of the <i>solo capital resources requirement</i> for each member of the <i>financial conglomerate</i> that is in the <i>overall financial sector</i>.</p>
Partial inclusion	2.5	<p>The capital resources and capital resources requirements of a member of the <i>financial conglomerate</i> in the <i>overall financial sector</i> must be included proportionally. If however the member is a <i>subsidiary undertaking</i> and it has a <i>solvency deficit</i>, they must be included in full.</p>
Accounts	2.6	<p>The information required for the purpose of establishing whether or not a <i>firm</i> is complying with <u>GENPRU 3.1.298.4.29R</u> (insofar as the definitions in this Part are applied for the purpose of that <i>rule</i>) must be based on the individual accounts of members of the <i>financial conglomerate</i>, together with such other sources of information as appropriate.</p>

3. Table: PART 3: Method 3 of Annex I of the Financial Groups Directive
(Book value/Requirement Method)

Capital resources	3.1	The <i>conglomerate capital resources</i> of a <i>financial conglomerate</i> calculated in accordance with this Part are equal to the capital resources of the <i>person</i> at the head of the <i>financial conglomerate</i> that qualify under paragraph 3.2.
	3.2	The elements of capital that qualify for the purposes of paragraph 3.1 are those that qualify in accordance with the <i>applicable sectoral rules</i> . In particular, the portion of the <i>conglomerate capital resources requirement</i> attributable to a particular member of a <i>financial sector</i> must be met by capital resources that would be eligible under the <i>sectoral rules</i> that apply to the calculation of its <i>solo capital resources</i> .
Capital resources requirement	3.3	The <i>conglomerate capital resources requirement</i> of a <i>financial conglomerate</i> calculated in accordance with this Part is equal to the sum of the following amounts for each member of the <i>overall financial sector</i> :
	(1)	(in the case of the <i>person</i> at the head of the <i>financial conglomerate</i>) its <i>solo capital resources requirement</i> ;
	(2)	(in the case of any other member) the higher of the following two amounts:
	(a)	its <i>solo capital resources requirement</i> ; and
	(b)	the book value of the interest of the <i>person</i> at the head of the <i>financial conglomerate</i> in that member.
	3.4	A <i>participation</i> may be valued using the equity method of accounting.
Partial inclusion	3.5	The capital resources requirement of a member of the <i>financial conglomerate</i> in the <i>overall financial sector</i> must be included proportionally. If however the member has a <i>solvency deficit</i> and is a <i>subsidiary undertaking</i> , it must be included in full.
Accounts	3.6	The information required for the purpose of establishing whether or not a <i>firm</i> is complying with <u>GENPRU 3.1.298.4.29R</u> (insofar as the definitions in this Part are applied for the purpose of that <i>rule</i>) must be based on the individual accounts of members of the <i>financial conglomerate</i> , together with such other sources of information as appropriate.

- 4 Table: PART 4: Method 4 of Annex I of the Financial Groups Directive (Combination of Methods 1, 2 and 3)

Applicable sectoral rules	4.1	The <i>rules</i> that apply with respect to a particular <i>financial conglomerate</i> under GENPRU 3.1.268.4.26R are those relating to capital adequacy and solvency set out in the table in paragraph 4.2.
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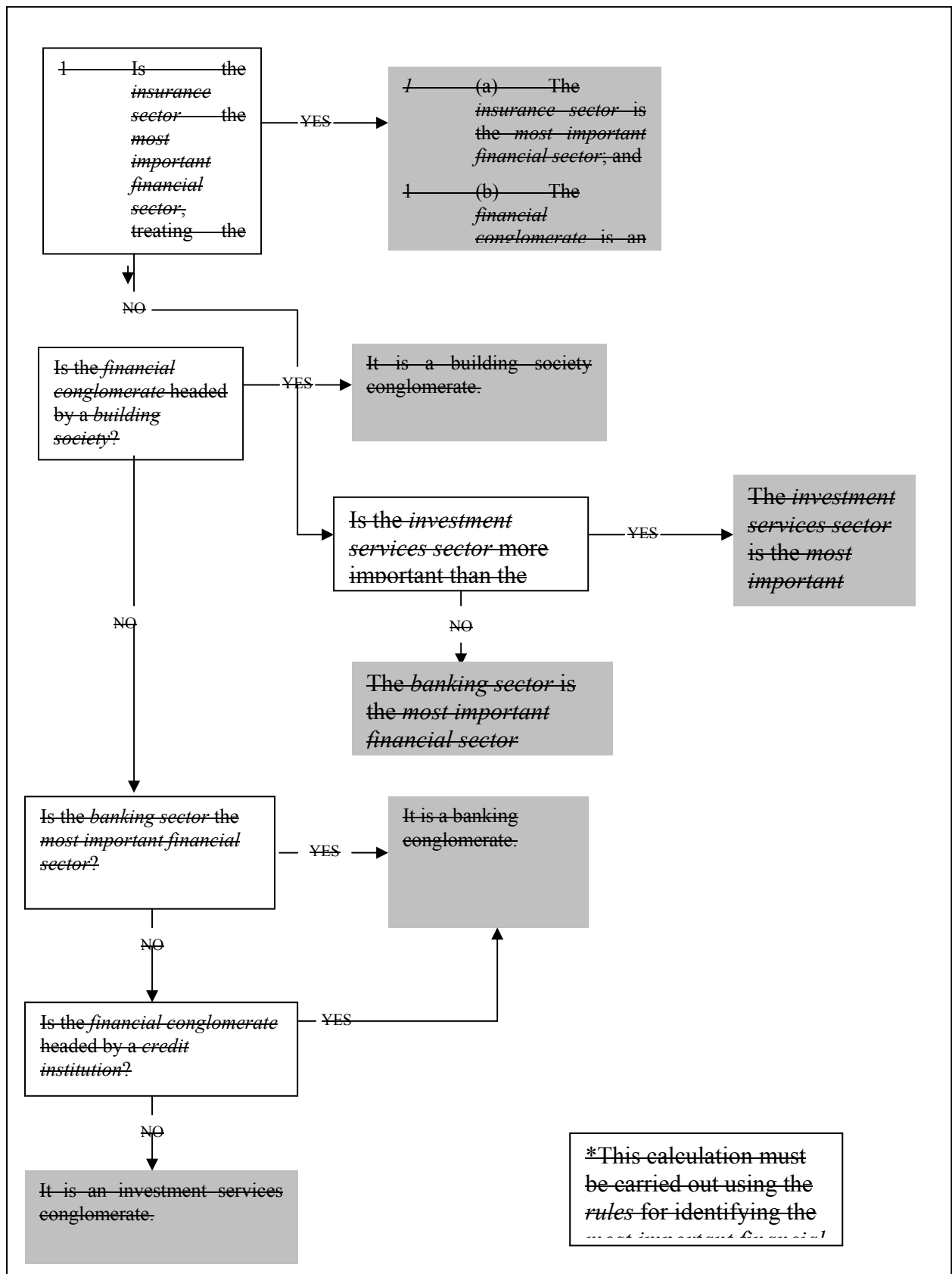
- 5 Table: Paragraph 4.2: Application of sectoral consolidation rules

Type of financial conglomerate	Applicable sectoral consolidation rules
<i>Banking and investment services conglomerate</i>	BIPRU 8 and BIPRU TP, subject to paragraph 4.5 IPRU(BANK) Chapter GN rule 3.3.13 (as it applies on a consolidated basis), subject to paragraph 4.7.
<i>Insurance conglomerate</i>	INSPRU 6.1 PRU 8.3 amended in accordance with Part 5.
<i>Building society conglomerate</i>	IPRU(BSOC) (Volume 1) Chapter 1, rule 1.2.1 (as it applies on a consolidated basis).
<i>Investment services conglomerate</i>	Chapter 14 of IPRU(INV).

Types of financial conglomerate	4.3	<p>(1) <u>This paragraph sets out how to determine the category of <i>financial conglomerate</i> for the purposes of paragraphs 4.1 and 4.2.</u></p> <p>(2) <u>If there is an <i>EEA regulated entity</i> at the head of the <i>financial conglomerate</i>, then:</u></p> <p>(a) <u>if that entity is in the <i>banking sector</i> or the <i>investment services sector</i>, the <i>financial conglomerate</i> is a <i>banking and investment services conglomerate</i>; or</u></p> <p>(b) <u>if that entity is in the <i>insurance sector</i>, the <i>financial conglomerate</i> is an <i>insurance conglomerate</i>.</u></p> <p>(3) <u>If (2) does not apply and the <i>most important financial sector</i> is the <i>banking and investment services sector</i>, it is a <i>banking and investment services conglomerate</i>.</u></p> <p>(4) <u>If (2) and (3) does not apply, it is an <i>insurance conglomerate</i>.</u></p>
How to apply chapter 14 of IPRU(INV)	4.3	<p>Where chapter 14 of <i>IPRU(INV)</i> applies:</p> <p>(1) the <i>main investment services undertaking</i> is treated as being the main firm for the purpose of rule 14.4.2 of chapter 14 of <i>IPRU(INV)</i>;</p> <p>(2) if the <i>main investment services undertaking</i> is not subject to any of the <i>FSA's sectoral rules</i> applied by chapter 14 of <i>IPRU(INV)</i>, then the <i>FSA's sectoral rules</i> that are applied are those that would do so if:</p> <p>(a) it were a <i>UK domestic firm</i>; and</p> <p>(b) it had a <i>permission</i> that includes all the <i>regulated activities</i> that it would need to have in its <i>Part IV permission</i> if it carried on all its activities in the <i>United Kingdom</i>.</p>
The different types of financial conglomerate	4.4	<p>(1) The decision tree in paragraph 4.5:</p> <p>(a) decides into which of the categories listed in the table in paragraph 4.2 a <i>financial conglomerate</i> falls; and</p> <p>(b) modifies the definition of the <i>most important financial sector</i> for the purposes of <i>PRU 8 Ann 1R</i> and for the purposes of any other provision in <i>PRU 8 (Group risk)</i> that applies that decision tree.</p>

(2) Paragraph 6.1(2) (*financial institution allocated to the banking sector*) and paragraph 6.1(3) (*allocation of asset management companies*) apply for the purpose of 4.4 and the table in paragraph 4.5.

7 Table: Paragraph 4.5: Types of financial conglomerate and definition of most important financial sector



8 Table

A mixed financial holding company	4.46	<p>A <i>mixed financial holding company</i> must be treated in the same way as:</p> <ol style="list-style-type: none"> (1) a <i>financial holding company</i> (if the rules in <u>BIPRU 8 IPRU(BANK)</u> or <u>IPRU(INV)</u> are applied; or (2) an <i>insurance holding company</i> (if the rules in <u>INSPRU 6.1 PRU 8.3</u> are applied).
E-money	4.57	<p>If there are no <i>full credit institutions</i> or <i>investment firms</i> in a <i>banking and investment services conglomerate</i> but there are one or more <i>e-money issuers</i>, the <i>sectoral rules</i> in <u>BIPRU 8 IPRU(BANK)</u> are amended as follows :</p> <ol style="list-style-type: none"> (1) the rules in <i>ELM</i> that apply on a solo basis must be used to establish the capital requirement for the <i>e- money issuers</i>; and (2) for the purpose of (1), those rules in <i>ELM</i> shall be amended by calculating the amount of the deductions in respect of <i>ownership shares</i> and capital falling into <i>ELM 2.4.17R(6)</i> in accordance with paragraph 3.3(2).

9 Table: PART 5: Principles applicable to all methods

Transferability of capital	5.1	<p>Capital may not be included in:</p> <ol style="list-style-type: none"> (1) a <i>firm's conglomerate capital resources</i> under <u>GENPRU 3.1.298-4.29R</u>; or (2) in the capital resources of the <i>financial conglomerate</i> for the purposes of <u>GENPRU 3.1.268-4.26R</u>; <p>if the effectiveness of the transferability and availability of the capital across the different members of the <i>financial conglomerate</i> is insufficient, given the objectives (as referred to in the third unnumbered sub-paragraph of paragraph 2(ii) of Annex I of the <i>Financial Groups Directive</i> (Technical principles)) of the capital adequacy rules for <i>financial conglomerates</i>.</p>
Double counting	5.2	<p>Capital must not be included in:</p>

<p>Cross sectoral capital</p>	<p>(1) a <i>firm's conglomerate capital resources</i> under <u>GENPRU 3.1.298.4.29R</u>; or</p> <p>(2) the capital resources of the <i>financial conglomerate</i> for the purposes of <u>GENPRU 3.1.268.4.26R</u>;</p> <p>if:</p> <p>(3) it would involve double counting or multiple use of the same capital; or</p> <p>(4) it results from any inappropriate intra-group creation of capital.</p> <p>5.3 In accordance with the second sub-paragraph of paragraph 2(ii) of Section I of Annex I of the <i>Financial Groups Directive</i> (Other technical principles and insofar as not already required in Parts 1-3):</p> <p>(1) the solvency requirements for each different <i>financial sector</i> represented in a <i>financial conglomerate</i> required by <u>GENPRU 3.1.268.4.26R</u> or, as the case may be, <u>GENPRU 3.1.298.4.29R</u> must be covered by own funds elements in accordance with the corresponding <i>applicable sectoral rules</i>; and</p> <p>(2) if there is a deficit of own funds at the <i>financial conglomerate</i> level, only cross sectoral capital (as referred to in that sub-paragraph) shall qualify for verification of compliance with the additional solvency requirement required by <u>GENPRU 3.1.268.4.26R</u> or, as the case may be, <u>GENPRU 3.1.298.4.29R</u>.</p>
<p>Application of sectoral rules; <u>General</u></p>	<p>5.4 The following adjustments apply to the <i>applicable sectoral rules</i> as they are applied by the <i>rules</i> in this annex.</p> <p>(1) The scope of those <i>rules</i> will be extended to cover any <i>mixed financial holding company</i> and each other member of the <i>overall financial sector</i>.</p> <p>(2) If any of those <i>rules</i> would otherwise not apply to a situation in which they are applied by <u>GENPRU 38 Ann 1R</u>, those <i>rules</i> nevertheless still apply (and in particular, any of those <i>rules</i> that would otherwise have the effect of disapplying consolidated supervision (or, in the case of the <i>insurance sector</i>, supplementary supervision) do not apply).</p> <p>(3) (If it would not otherwise have been included) an <i>ancillary investment services undertaking</i> is included in the <i>investment services sector</i>.</p>

Application
of sectoral
rules:
Insurance
sector

5.5

- (3) (If it would not otherwise have been included) an *ancillary insurance services undertaking* is included in the *insurance sector*.
- 4) ~~(In relation to the *insurance sector*) to the extent that:~~
- (a) ~~those *rules* merely require a report on whether or not a specified level of solvency is met (a soft limit); or~~
- (b) ~~the requirements in those *rules* concern having certain net assets of an amount at or above certain levels;~~
- ~~those requirements are restated so as to include an obligation at all times actually to have capital at or above that level (a hard limit), thereby turning a soft limit drafted by reference to assets and liabilities into a hard limit requiring capital to be held at or above specified levels. If those *rules* apply both a hard and a soft limit, and the level of the soft limit is higher, that soft limit is applied under this annex, but translated into a hard limit in accordance with the earlier provisions of (5).~~
- (46) The scope of ~~the~~ those *rules* is amended so as to remove restrictions relating to where members of the *financial conglomerate* are incorporated or have their head office, so that the scope covers every member of the *financial conglomerate* that would have been included in the scope of those *rules* if those members had their head offices in an *EEA State*.
- (57) (For the purposes of Parts 1 to 3) those *rules* must be adjusted, if necessary, when calculating the capital resources, capital resources requirements or solvency requirements for a particular *financial sector* to exclude those for a member of another *financial sector*.
- (6) Any waiver granted to a member of the *financial conglomerate* under those *rules* does not apply for the purposes of this annex.
- (1) This *rule* applies an adjustment to the *applicable sectoral rules for the insurance sector* as they are applied by the *rules* in this annex.
- (2) To the extent that:
- (a) those *rules* merely require a report on whether or not a specified level of solvency is met (a soft limit); or
- (b) the requirements in those *rules* concern having certain

		<p style="text-align: center;"><u>net assets of an amount at or above certain levels;</u></p> <p><u>those requirements are restated so as to include an obligation at all times actually to have capital at or above that level (a hard limit), thereby turning a soft limit into a hard limit and turning a limit drafted by reference to assets and liabilities into a requirement that the level of capital be maintained at or above a specified level. If those rules apply both a hard and a soft limit, and the level of the soft limit is higher, that soft limit is applied under this annex, but translated into a hard limit in accordance with the earlier provisions of this rule.</u></p>
<p><u>Application of sectoral rules:</u> <u>Banking sector and investment services sector</u></p>	<p>5.6</p>	<p><u>The following adjustments apply to the applicable sectoral rules for the banking sector and the investment services sector as they are applied by the rules in this annex.</u></p> <ol style="list-style-type: none"> (1) <u>References in those rules to non-EEA sub-groups do not apply.</u> (2) <u>(For the purposes of Parts 1 to 3), where those rules require a group to be treated as if it were a single undertaking, those rules apply to the banking sector and investment services sector taken together.</u> (3) <u>Any investment firm consolidation waivers granted to members of the financial conglomerate do not apply.</u> (4) <u>(For the purposes of Parts 1 to 4), without prejudice to the application of requirements in BIPRU 8 preventing the use of an advanced prudential calculation approach on a consolidated basis, any advanced prudential calculation approach permission that applies for the purpose of BIPRU 8 does not apply.</u> (5) <u>(For the purposes of Parts 1 to 4), BIPRU 8.5.9R and BIPRU 8.5.10R do not apply.</u> (6) <u>(For the purposes of Parts 1 to 4), where the financial conglomerate does not include a credit institution, the method in GENPRU 2 Annex 4R must be used for calculating the capital resources and BIPRU 8.6.8R does not apply.</u>
<p>No capital ties</p>	<p>5.7 5</p>	<p>(1) This rule deals with a financial conglomerate in which some of the members are not linked by capital ties at the time of the notification referred to in <u>GENPRU 3.1.288-4.28R(1)</u> (Capital adequacy requirements: Compulsory application of Method 4</p>

from Annex I of the Financial Groups Directive).

(2) If:

- (a) GENPRU 3.1.268.4.26R (Capital adequacy requirements: Application of Method 4 from Annex I of the Financial Groups Directive) would otherwise apply with respect to a *financial conglomerate* under GENPRU 3.1.288.4.28R; and
- (b) all members of that *financial conglomerate* are linked directly or indirectly with each other by capital ties except for members that collectively are of negligible interest with respect to the objectives of supplementary supervision of *regulated entities* in a *financial conglomerate* (the "peripheral members");

GENPRU 3.1.288.4.28R continues to apply. Otherwise GENPRU 3.1.288.4.28R does not apply with respect to a *financial conglomerate* falling into (1).

(3) If GENPRU 3.1.288.4.28R applies with respect to a *financial conglomerate* in accordance with (2) the peripheral members must be excluded from the calculations under GENPRU 3.1.268.4.26R.

(4) If:

- (a) GENPRU 3.1.268.4.26R applies with respect to a *financial conglomerate* falling into (1) under GENPRU 3.1.278.4.27R(2) (Use of *Part IV permission* to apply Annex I of the *Financial Groups Directive*); or
- (b) GENPRU 3.1.298.4.49R (Capital adequacy requirements: Application of Methods 1, 2 or 3 from Annex I of the Financial Groups Directive) applies with respect to a *financial conglomerate* falling into (1);

then:

- (c) the treatment of the links in (1) (including the treatment of any *solvency deficit*) is as provided for in the *requirement* referred to in GENPRU 3.1.308.4.30R; and
- (d) GENPRU 3.1.268.4.26R or GENPRU 3.1.298.4.29R, as the case may be, apply even if the *applicable sectoral rules* do not deal with how *undertakings* not linked by capital ties are to be dealt with for the purposes of consolidated supervision (or, in the case of the *insurance sector*, supplementary supervision).

- (5) Once GENPRU 3.1.268.4.26R applies to a *firm* with respect to a *financial conglomerate* of which it is a member under GENPRU 3.1.278.4.27R(1) (automatic application of Method 4 from Annex I of the *Financial Groups Directive* on satisfaction of the condition in GENPRU 3.1.288.4.28R), the disapplication of GENPRU 3.1.288.4.28R under (2) ceases to apply with respect to that *financial conglomerate*.

<p>Defining the financial sectors</p>	<p>6.1</p>	<p>For the purposes of Parts 1 to 3 of this annex (but, unless specified otherwise in paragraph 4.4, not for the purposes of the definition of <i>most important financial sector</i>):</p> <p>(1) the banking sector and the investment services sector are considered separately;</p> <p>(2) if a financial institution could otherwise fall into both the banking sector and the investment services sector, it must be allocated to the banking sector;</p> <p>(13) an asset management company is allocated in accordance with GENPRU 3.1.398.4.39R; and</p> <p>(24) a mixed financial holding company must be treated as being a member of the most important financial sector.</p>
<p><u>Solo capital resources requirement: Banking sector and investment service sector</u></p>	<p>6.2</p>	<p>(1) <u>The solo capital resources requirement of an undertaking in the banking sector or the investment services sector must be calculated in accordance with this rule, subject to paragraphs 6.5 and 6.6.</u></p> <p>(2) <u>The solo capital resources requirement of a building society is its CRR.</u></p> <p>(3) <u>The solo capital resources requirement of an e-money issuer is:</u></p> <p>(a) <u>(in the case of ELMI) the capital resources requirement that applies to it under ELM; or</u></p> <p>(b) <u>(in any other case) the capital resources requirement that would apply to it under ELM if it were an ELMI incorporated in the United Kingdom.</u></p> <p>(4) <u>If there is a credit institution in the financial conglomerate, the solo capital resources requirement for any undertaking in the banking sector or the investment services sector is, subject to (2) and (3), calculated in accordance with the rules for calculating the CRR of a bank that is a BIPRU firm.</u></p> <p>(5) <u>If:</u></p>

- (a) the financial conglomerate does not include a credit institution;
- (b) there is at least one CAD investment firm in the financial conglomerate; and
- (c) all the CAD investment firms in the financial conglomerate are limited licence firms or limited activity firms;

the solo capital resources requirement for any undertaking in the banking sector or the investment services sector is calculated in accordance with the rules for calculating the CRR of:

- (d) (if there is a limited activity firm in the financial conglomerate), a BIPRU limited activity firm; or
- (e) (in any other case), a BIPRU limited licence firm.

(6) If:

- (a) the financial conglomerate does not include a credit institution; and
- (b) (5) does not apply;

the solo capital resources requirement for any undertaking in the banking sector or the investment services sector is calculated in accordance with the rules for calculating the CRR of a full scope BIPRU investment firm.

(7) Any CRR calculated under a BIPRU TP may be used for the purposes of the solo capital resources requirement in this rule in the same way that the CRR can be used under BIPRU 8.

Solo capital resources requirement: application of rules

6.3 Any exemption that would otherwise apply under any rules applied by paragraph 6.2 do not apply for the purposes of this Annex.

Solo capital resources requirement: Insurance sector

6.4 (1) The solo capital resources requirement of an undertaking in the insurance sector must be calculated in accordance with this rule.

(2) Subject to (3), the solo capital resources requirement of an undertaking in the insurance sector is the capital resources

<p><u>Solo capital resources requirement: EEA firms in the banking sector or investment services sector</u></p>		<p>requirement identified in <i>INSPRU</i> 6.1.34R (1) to (8) as applying to that <i>undertaking</i>.</p> <p>(3) <u><i>INSPRU</i> 6.1.34R (1)(b) does not apply for the purposes of this annex.</u></p>
	<p>6.5</p>	<p><u>The solo capital resources requirement for an EEA regulated entity (other than a BIPRU firm, an insurer or an EEA insurer) that is subject to the solo capital adequacy sectoral rules for its financial sector of the competent authority that authorised it is equal to the amount of capital it is obliged to hold under those sectoral rules provided that the following conditions are satisfied:</u></p> <p>(1) <u>(for the purposes of the banking sector and the investment services sector) those sectoral rules must correspond to the FSA's sectoral rules identified in paragraph 6.2 as applying to that financial sector;</u></p> <p>(2) <u>the entity must be subject to those sectoral rules in (1); and</u></p> <p>(3) <u>paragraph 6.3 applies to the entity and those sectoral rules.</u></p>
<p><u>Solo capital resources requirement: non-EEA firms subject to equivalent regimes in the banking sector or investment services sector</u></p>	<p>6.6</p>	<p><u>The solo capital resources requirement for a recognised third country credit institution or a recognised third country investment firm is the amount of capital resources that it is obliged to hold under the sectoral rules for its financial sector that apply to it in the state or territory in which it has its head office provided that:</u></p> <p>(1) <u>there is no reason for the firm applying the rules in this annex to believe that the use of those sectoral rules would produce a lower figure than would be produced under paragraph 6.2; and</u></p> <p>(2) <u>paragraph 6.3 applies to the entity and those sectoral rules.</u></p>
<p>Solo capital resources requirement: mixed financial holding</p>	<p>6.7 4</p>	<p>The solo capital resources requirement of a mixed financial holding company is a notional capital requirement. It is the capital adequacy requirement that applies to regulated entities in the most important financial sector under the table in paragraph 6.108.</p>

company		
Solo-capital resources requirement: UK-domestic firms	6.2	The solo-capital resources requirement for a <i>regulated entity</i> that is a <i>UK domestic firm</i> is its solo-regulatory capital requirement under the <i>FSA's sectoral rules</i> for its <i>financial sector</i> applicable to it.
Solo-capital resources requirement: EEA firms	6.3	The solo-capital resources requirement for an <i>EEA regulated entity</i> that is subject to the solo-capital adequacy <i>sectoral rules</i> for its <i>financial sector</i> of the competent authority that authorised it is equal to the amount of capital resources it is obliged to hold under those <i>sectoral rules</i> .
Solo-capital resources requirement: non-EEA firms subject to equivalent regimes	6.5	<p>The solo-capital resources requirement for a <i>regulated entity</i> that:</p> <ul style="list-style-type: none"> (1) does not fall into paragraphs 6.2 to 6.4; (2) is subject to any of the <i>sectoral rules</i> referred to in paragraph 6.6 applicable to its <i>financial sector</i>; and (3) is incorporated in and has its head-office in: <ul style="list-style-type: none"> (a) (where the <i>sectoral rules</i> in (2) are for the <i>banking sector</i> or the <i>investment services sector</i>) the same state or territory as the regulator for those <i>sectoral rules</i>, as referred to in paragraph 6.6(1) or 6.6(2)); or (b) (where the <i>sectoral rules</i> in (2) are for the <i>insurance sector</i>) the designated state or territory in question, as referred to in 6.6(3); <p>is equal to the amount of capital resources it is obliged to hold under those <i>sectoral rules</i>. However, where 3(b) would otherwise apply, paragraph 6.7 may be applied instead.</p>
	6.6	<p>The sectoral rules referred to in paragraph 6.5 are:</p> <ul style="list-style-type: none"> (1) (for the <i>banking sector</i>) the sectoral rules of or administered by one of the regulators listed in Appendix D of chapter CS of <i>IPRU(BANK)</i>; (2) (for the <i>investment services sector</i>) the sectoral rules of or administered by one of the regulators listed in Appendix 59 of chapter 10 of <i>IPRU(INV)</i>; and (3) (for the <i>insurance sector</i>) the sectoral rules of the states or territories referred to in the definition of designated states or territories in chapter 11 of <i>IPRU(INS)</i> (Definitions), but

<p>Solo capital resources: other members</p>	<p style="text-align: center;">excluding EEA States.</p> <p>6.7 The solo capital resources requirement for:</p> <p>(1) any of the following:</p> <ul style="list-style-type: none"> (a) a UK domestic firm; (b) an EEA regulated entity; or (c) a regulated entity that is incorporated in and has its head office in one of the states or territories referred to in paragraphs 6.5; <p>that is not subject to the solo capital adequacy sectoral rules referred to in paragraph 6.2, 6.3, or 6.6 (including in a case in which this paragraph applies under (i) of the definition of sectoral rules); and</p> <p>(2) any member of a financial conglomerate in the overall financial sector otherwise not treated under paragraphs 6.2 to 6.6;</p> <p>is a notional capital requirement. It is the capital resources requirement that would apply to it under the following rules:</p> <ul style="list-style-type: none"> (3) (in the case of an asset management company) the rules in Chapter 7 of IPRU(INV); and (4) (in any other case), the rules applicable to its financial sector under the table in paragraph 6.8.
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11 Table: Paragraph 6.8: The FSA's sectoral rules for the solo capital resources requirement

Financial sector	FSA's sectoral rules
<i>Banking sector</i>	The <i>FSA's sectoral rules for banks</i> , except that <i>e-money issuers</i> are subject to <i>ELM</i> .
<i>Insurance sector</i>	The <i>FSA's sectoral rules for insurance undertakings</i> .
<i>Investment services sector</i>	(1) The <i>rules in IPRU(INV)</i> that would apply on the assumptions in paragraph 4.3(2). (2) (If (1) does not result in the application of any <i>rules in IPRU(INV)</i>) the <i>rules in IPRU(INV)</i> that would be applied to it under <i>rule 14.5.2 of Chapter 14 of IPRU(INV)</i> (<i>Group financial resources requirement</i>).

12 Table

Solo capital resources requirement: the insurance sector	6.8 ⁹	References to capital requirements in the provisions of <i>GENPRU 38 Ann 1R</i> defining <i>solo capital resources requirement</i> must be interpreted in accordance with paragraph 5.4 (5) .
Applicable sectoral consolidation rules	6.9 ¹⁰	The <i>applicable sectoral consolidation rules</i> for a <i>financial sector</i> are the <i>FSA's sectoral rules</i> about capital adequacy and solvency on a consolidated basis that are applied in the table in paragraph 6.10 4 .

13 Table: Paragraph 6.104: Application of sectoral consolidation rules

Financial sector	Type of financial conglomerate	FSA's sectoral rules
<i>Banking sector</i>	<i>Building society conglomerate</i>	The rules for building societies.
	Any other type	The rules for banks - <u>BIPRU 8 and BIPRU TP</u> , as adjusted under paragraph 4.5
<i>Insurance sector</i>	N/A	The rules for insurance undertakings -INSRU 6.1.
<i>Investment services sector</i>	N/A	The rules for investment firms <u>BIPRU 8 and BIPRU TP</u>
Note 1: Paragraph 4.6 applies for the purposes of those <i>rules</i> .		

14 Table:

Applicable sectoral consolidation rules (contd.) <u>Part 5</u>	6.12 <u>1</u>	<p>The <i>rules</i> referred to in the third column of the table in paragraph 6.11 are as follows: <u>This Part 6 is subject to Part 5 of this Annex.</u></p> <p>(1) the rules for building societies are the ones for <i>building society conglomerates</i> listed in the table in paragraph 4.2;</p> <p>(2) the rules for banks are the ones for <i>banking conglomerates</i> listed in the table in paragraph 4.2 as adjusted under paragraph 4.7;</p> <p>(3) the rules for insurance undertakings are whichever of the ones for <i>insurance conglomerates</i> that are applied by the table in paragraph 4.2; and</p> <p>(4) the rules for investment firms are the ones for <i>investment services conglomerates</i> listed in the table in paragraph 4.2 as applied under paragraph 4.3 (How to apply chapter 14 of IPRU(INV)).</p>
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GENPRU 38 Ann 2R

Prudential rules for third country groups (GENPRU 3.2.88.5.8R to GENPRU 3.2.98.5.9R)

1 Table: PART 1: Third-country financial conglomerates

1.1	This Part of this annex sets out the <i>rules</i> with which a <i>firm</i> must comply under <u>GENPRU 3.2.88.5.8R</u> with respect to a <i>financial conglomerate</i> of which it is a member.
1.2	A <i>firm</i> must comply, with respect to the <i>financial conglomerate</i> referred to in paragraph 1.1, with whichever of <u>GENPRU 3.1.268.4.26R</u> and <u>GENPRU 3.1.298.4.29R</u> is applied under paragraph 1.3.
1.3	For the purposes of paragraph 1.2: <ol style="list-style-type: none">(1) the <i>rule</i> in <u>GENPRU 3.18.4</u> that applies as referred to in paragraph 1.2 is the one that is specified by the <i>requirement</i> referred to in <u>GENPRU 3.2.88.5.8R</u>;(2) (where <u>GENPRU 3.1.298.4.29R</u> is applied) the definitions of <i>conglomerate capital resources</i> and <i>conglomerate capital resources requirement</i> that apply for the purposes of that <i>rule</i> are the ones from whichever of Part 1, Part 2 or Part 3 of <u>GENPRU 38 Ann 1R</u> is specified in that <i>requirement</i>; and(3) the <i>rules</i> so applied (including those in <u>GENPRU 38 Ann 1R</u>) are adjusted in accordance with paragraph 3.1.
1.4	If the condition in Articles 7(4) and 8(4) of the <i>Financial Groups Directive</i> is satisfied (the <i>financial conglomerate</i> is headed by a <i>mixed financial holding company</i>) with respect to the <i>financial conglomerate</i> referred to in paragraph 1.1 the <i>firm</i> must also comply with <u>GENPRU 3.1.358.4.35R</u> (as adjusted in accordance with paragraph 3.1) with respect to that <i>financial conglomerate</i> .
1.5	A <i>firm</i> must comply with the following with respect to the <i>financial conglomerate</i> referred to in paragraph 1.1: <ol style="list-style-type: none">(1) <u>SYSC 12 PRU 8.1</u> (as it applies to <i>financial conglomerates</i> and as adjusted under paragraph 3.1); and(2) <u>GENPRU 3.1.258.4.25R</u>.

2 Table: PART 2: Third-country banking and investment groups

2.1	This Part of this annex sets out the <i>rules</i> with which a <i>firm</i> must comply under <u>GENPRU 3.2.98.5.9R</u> with respect to a <i>third-country banking and investment group</i> of which it is a member.
2.2	A <i>firm</i> must comply with one of the sets of <i>rules</i> specified in paragraph 2.3 as adjusted under paragraph 3.1 with respect to the <i>third-country banking and investment group</i> referred to in paragraph 2.1.
2.3	The <i>rules</i> referred to in paragraph 2.2 are as follows: <ul style="list-style-type: none"> (1) the <i>applicable sectoral consolidation rules</i> in <u>BIPRU 8IPRU(BANK)</u>; or (2) the applicable sectoral consolidation rules for the investment services sector; or (23) the <i>rules</i> in <u>ELM 7</u>.
2.4	The set of <i>rules</i> from paragraph 2.3 that apply with respect to a particular <i>third-country banking and investment group</i> (as referred to in paragraph 2.1) are those that would apply if they were adjusted in accordance with paragraph 3.1.
2.5	The <i>sectoral rules</i> applied by Part 2 of this annex cover all prudential <i>rules</i> applying on a consolidated basis including those relating to large exposures.
2.6	A <i>firm</i> must comply with <u>SYSC 12PRU 8.1</u> (as it applies to <i>banking and investment groups</i> and as adjusted under paragraph 3.1) with respect to the <i>third-country banking and investment group</i> referred to in paragraph 2.1.

3 Table: PART 3: Adjustment of scope

3.1	The adjustments that must be carried out under this paragraph are that the scope of the <i>rules</i> referred in Part 1 or Part 2 of this annex, as the case may be, are amended: <ul style="list-style-type: none"> (1) so as to remove any provisions disapplying those <i>rules</i> for <i>third-country groups</i>; (2) so as to remove all limitations relating to where a member of the <i>third-country group</i> is incorporated or has its head office; and (3) so that the scope covers every member of the <i>third-country group</i> that would have been included in the scope of those <i>rules</i> if those members had their head offices in, and were incorporated in, an <i>EEA State</i>.
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GENPRU 38 Ann 3G: CLASSIFICATION OF GROUPS (GENPRU 3.1.38.4.3G)

(form ref)

Part 1 : General Information

A	Name of Group:	
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B	Name of FSA supervisor:	
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C	Name of entity at head of the group:	
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D	Type of entity at head of the group:	D1	EU regulated entity country of authorisation	
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(select one of D1, D2, D3 and D4)

(a)	Credit institution	<input type="checkbox"/>
(b)	Investment firm	<input type="checkbox"/>
(c)	Insurance firm	<input type="checkbox"/>

(tick one)

D2	EU non-regulated entity country of location	
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D3	Non-EU regulated entity country of authorisation	
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D4	Non- EU non-regulated entity country of location	
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E	Year-end for group consolidation purposes	
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Part 2 : Threshold Information

F1	Is at least one of the entities in the group within the insurance sector and at least one in the banking/investment sector?	<input type="checkbox"/> Yes	<input type="checkbox"/> No (go to part 3)
F2	For D2 & D4 groups only: enter the ratio of the balance sheet total of the financial sectors in the group to the balance sheet total of the group as a whole. <i>Enter percentage in box*.</i>	<input type="text"/>	%
F3	What is the smallest financial sector?	<input type="checkbox"/>	Insurance
		<input type="checkbox"/>	Banking/Investment
F4	Ratio of balance sheet total of smallest financial sector to the balance sheet total of the financial sector entities in the group. <i>Enter percentage in box*.</i>	<input type="text"/>	%
F5	Ratio of the solvency requirement of the smallest financial sector to the solvency requirements of the total financial sector entities in the group. <i>Enter percentage in box*.</i>	<input type="text"/>	%
F6	What is the balance sheet total of the smallest financial sector in the group (identified in F3)*?	<input type="text"/>	(€'m)

*see guidance notes on a recommended method of calculation

Part 3: Conclusion on reason for becoming a financial conglomerate

G Select **ONE** of the following based on the answers in section 1 & 2.

If answer to F1 is NO or if none of the following are met then select type Z:

Z		Not a conglomerate.
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If the group is category D1 or D3 and the average of F4 and F5 is greater than 10% then select type i.

i		Conglomerate headed by a regulated institution with significant cross sector activities. [article 3(2)]
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If the group is category D1 or D3 and the average of F4 and F5 is less than 10% but F6 is greater than €6bn then select ii.

ii		Possible conglomerate headed by a regulated institution with presumed significant cross sector activities. [article 3(3)]
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If the group is category D2 or D4 and the answer to F2 is greater than 40% AND the average of F4 and F5 is greater than 10% then select type iii.

iii		Conglomerate headed by non-regulated entity with significant cross sector activities. [article 3(1) & 3(2)]
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If the group is category D2 or D4 and the answer to F2 is greater than 40% AND the average of F4 and F5 is less than 10% but F6 is greater than €6bn then select type iv.

iv		Possible conglomerate headed by non-regulated entity with presumed significant cross sector activities. [article 3(1) & 3(3)]
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Part 4: Other relevant information

H1	<p>Who do you think are the relevant competent authorities for your group (i.e. supervisors in EEA States in which the group has significant regulated activity)?</p> <p>See article 2 (17)(a) for definition of relevant competent authorities.</p>	
H2	<p>Who do you think should be the likely coordinator for the group (i.e. EEA supervisor of the group's most important regulated activity in the EU)?</p> <p>See article 10(1) and 10(2).</p>	
H3	<p>Do you consider that balance sheet value and solvency requirements were an appropriate criterion to determine whether a group is financial and whether cross sector activities exist? If not, do you consider there are other parameters (as referred to in article 3(5)) that would be more appropriate?</p>	
H4	<p>Do you have any other relevant comments?</p> <p>(use continuation sheet if necessary)</p>	

GENPRU 38 Ann 3G: Guidance Notes for Classification of Groups

Purpose and scope

The form is designed to identify groups and sub-groups that are likely to be financial conglomerates under the Financial Groups Directive. A group may be a financial conglomerate if it contains both insurance and banking/investment businesses and meets certain threshold tests. The FSA needs to identify conglomerates with their head offices in the EEA and those with their head offices outside the EEA, although this does not necessarily mean that the latter will be subject to EEA conglomerate supervision.

This form's purpose is to enable the FSA to obtain sufficient information so as to be able to determine how likely a group/sub-group is to be a financial conglomerate. In certain cases this can only be determined after consultation with the other EU relevant competent authorities. A second purpose of the form is therefore to identify any groups and sub-groups that may need such consultation so that this can be made as soon as possible. This should allow firms time to prepare to comply.

The third purpose of the form is to gain information from firms on the most efficient way to implement the threshold calculations in detail (consistently with the directive). We have, therefore, asked for some additional information in part 4 of the form.

A copy of this form will can be found on the FSA's Financial Groups Website with current contact details.

Please include workings showing the method employed to determine the percentages in part 2 (for the threshold conditions) and giving details of all important assumptions / approximations made in doing the calculations.

The definition of financial conglomerate includes not only conventional groups made up of parent-subsidiary relationships but groups linked by control and "consolidation Article 12(1) relationships". If this is the case for your group, please submit along with this form a statement that this is the case. Please include in that statement an explanation of how you have included group members not linked by capital ties in the questionnaire calculations.

A consolidation Article 12(1) relationship arises between undertakings in the circumstances set out in Article 12(1) of the Seventh Company Law Directive. These are set out in the Handbook Glossary (in the definition of consolidation Article 12(1) relationship). Broadly speaking, undertakings come within this definition if they do not form a conventional group but:

- (a) are managed on a unified basis; or
- (b) have common management.

General guidance

We would like this to be completed based on the most senior parent in the group, and, if applicable, for the company heading the most senior conglomerate group in the EEA. If appropriate, please also attach a list of all other likely conglomerate sub-groups.

Please use the most recent accounts for the top level company in the group together with the corresponding accounts for all subsidiaries and participations that are included in the consolidated accounts. Please indicate the names of any significant subsidiaries with a different year-end from the group's year-end.

Please note the following:

- (a) Branches should be included as part of the parent entity.
- (b) Include in the calculations overseas entities owned by the relevant group or sub-group.
- (c) There are only two sectors for this purpose: banking/investment and insurance.
- (d) You will need to assign non-regulated financial entities to one of these sectors:
 - **banking/investment** activities are listed in – Annex 1 to the Banking Consolidation Directive IPRU Banks CS 10 Appendix A
 - **insurance** activities are listed in - IPRU Insurers Annex 11.1 and 11.2 p 163-168.
 - Any **operator of a UCITS scheme, insurance intermediary, mortgage broker and mixed financial holding company** does not fall into the directive definitions of either financial sector or insurance sector and should be treated for these purposes as being outside the financial sector. They should therefore be ignored for the purposes of these calculations.

Threshold tests

For the purpose of completing section 2 of the form relating to the threshold tests, the following guidance should be used. However, if you consider that for your group there is a more appropriate calculation then you may use this calculation so long as the method of computation is submitted with the form.

Calculating balance sheet totals

Generally, use total (gross) assets for the balance sheet total of a group/entity. However, investments in other entities that are part of the group will need to be deducted from the sector that has made the investment and the balance sheet total of the entity is added to the sector in which it operates.

Our expectation of how this may be achieved efficiently is as follows:

- (i) Off-balance-sheet items should be excluded.
- (ii) Where off-balance sheet treatment of **funds under management** and on-balance sheet treatment of **policy holders' funds** may distort the threshold calculation, groups should consult the FSA on the appropriateness of using other measures under article 3.5 of the Financial Groups Directive.
- (iii) If consolidated accounts exist for a sub-group consisting of financial entities from only one of the two sectors, these consolidated accounts should be used to measure the balance-sheet total of the sub-group (i.e. total assets less investments in entities in the other sector). If consolidated accounts do not exist, intra-group balances should be netted out when calculating the balance sheet total of a single sector (but cross-sector intra-group balances should not be netted out).
- (iv) Where consolidated accounts are used, minority interests should be excluded and goodwill should be included.
- (v) Where accounting standards differ between entities, groups should consult the FSA if they believe this is likely materially to affect the threshold calculation.
- (vi) Where there is a subsidiary or participation in the opposite sector from its parent (i.e. insurance sector for a banking/investment firm parent and vice versa), the balance sheet amount of the subsidiary or participation should be allocated to its sector using its individual accounts.
- (vii) The balance-sheet total of the parent entity/sub-group is measured as total assets of the parent/sub-group less the book value of its subsidiaries or participations in the other sector (i.e. the value of the subsidiary or participation in the parent's consolidated accounts is deducted from the parent's consolidated assets).
- (viii) The cross-sector subsidiaries or participations referred to above, valued according to their own accounts, are allocated pro-rata, according to the aggregated share owned by the parent/sub-group, to their own sector.
- (ix) If the cross-sector entities above themselves own group entities in the first sector (i.e. that of the top parent/sub-group) these should (in accordance with the methods above) be excluded from the second sector and added to the first sector using individual accounts.

Solvency (capital adequacy) requirements

Generally, the solvency requirements should be according to sectoral rules of the FSA that would apply to the type of entity ~~(that is EEA prudential sectoral legislation—see Glossary)~~. However, you can use EEA rules or local rules in the circumstances set out in Part 6 of GENPRU 3 Ann 1R. ~~for convenience, you may choose to use either EEA rules, FSA rules or local rules.~~ But if this choice makes a significant difference, either with respect to whether the group is a financial conglomerate or with respect to which sector is the biggest, you should consult with the FSA. Non-regulated financial entities should have proxy requirements calculated on the basis of the most appropriate sector. If sub-groups submit single sector consolidated returns then the solvency requirement may be taken from those returns.

Our expectation of how this may be achieved efficiently is as follows:

- (i) If you complete a solvency return for a sub-group consisting of financial entities from only one of the two sectors, the total solvency requirement for the sub-group should be used.
- (ii) Solvency requirements taken must include any deductions from available capital so as to allow the appropriate aggregation of requirements.
- (iii) Where there is a regulated subsidiary or participation in the opposite sector from its parent/sub-group, the solvency requirement of the subsidiary or participation should be from its individual regulatory return. If there is an identifiable contribution to the parent's solvency requirement in respect of the cross-sector subsidiary or participation, the parent's solvency requirement may be adjusted to exclude this.
- (iv) Where there is an unregulated financial undertaking in the opposite sector from its parent/sub-group, the solvency requirement of the subsidiary or participation should be one of the following:
 - (a) as if the entity were regulated by the FSA under the appropriate sectoral rules;
 - (b) using EU minimum requirements for the appropriate sector; or
 - (c) using non-EU local requirements* for the appropriate sector.

Please note on the form which of these options you have used, according to the country and sector, and whether this is the same treatment as in your latest overall group solvency calculation.

- (v) For banking/investment requirements, use the total amount of capital required.

(vi) For insurance requirements, use the total amount of capital required. ~~Required Minimum Margin:~~

~~(a) UK firms, Form 9: for general insurance business = capital resources requirement [line 29]; for long term insurance business = capital resources requirement (higher of Minimum Capital Requirement and Enhanced Capital Resources Requirement) [line 52].~~

~~(b) Overseas firms, either:~~

- ~~• the local requirement*;~~
- ~~• the EU minimum; or~~
- ~~• the FSA requirement.~~

~~* N.B. local requirements may only be used if they are at least equivalent to the EU minimum (designated states or territories). However, local requirements of a non-designated state or territory may be used if the resulting ratio in F5 is significantly below the 10% threshold (for this purpose "significantly below" may be taken to mean <5%).~~

Market share measures

These are not defined by the directive. The aim is to identify any standard industry approaches to measuring market share in individual EU countries by sector, or any data sources which are commonly used as a proxy.

Article I.

Article II. Threshold tests

Test F2

B/S of banking/investment + insurance sector = result %

B/S total

Test F3/F4/F5

B/S of insurance sector

B/S of banking/investment sector + insurance sector = A%

B/S of banking/investment sector

B/S of banking/investment sector + insurance sector = B%

Solvency requirement of insurance sector

Solvency requirement of banking/investment sector + insurance sector = C%

Solvency requirement of banking/investment sector

Solvency requirement of banking/investment sector + insurance sector = D%

The relevant percentage for the insurance sector is:

$$(A\% + C\%)/2 = I\%$$

The relevant percentage for the banking/investment sector is:

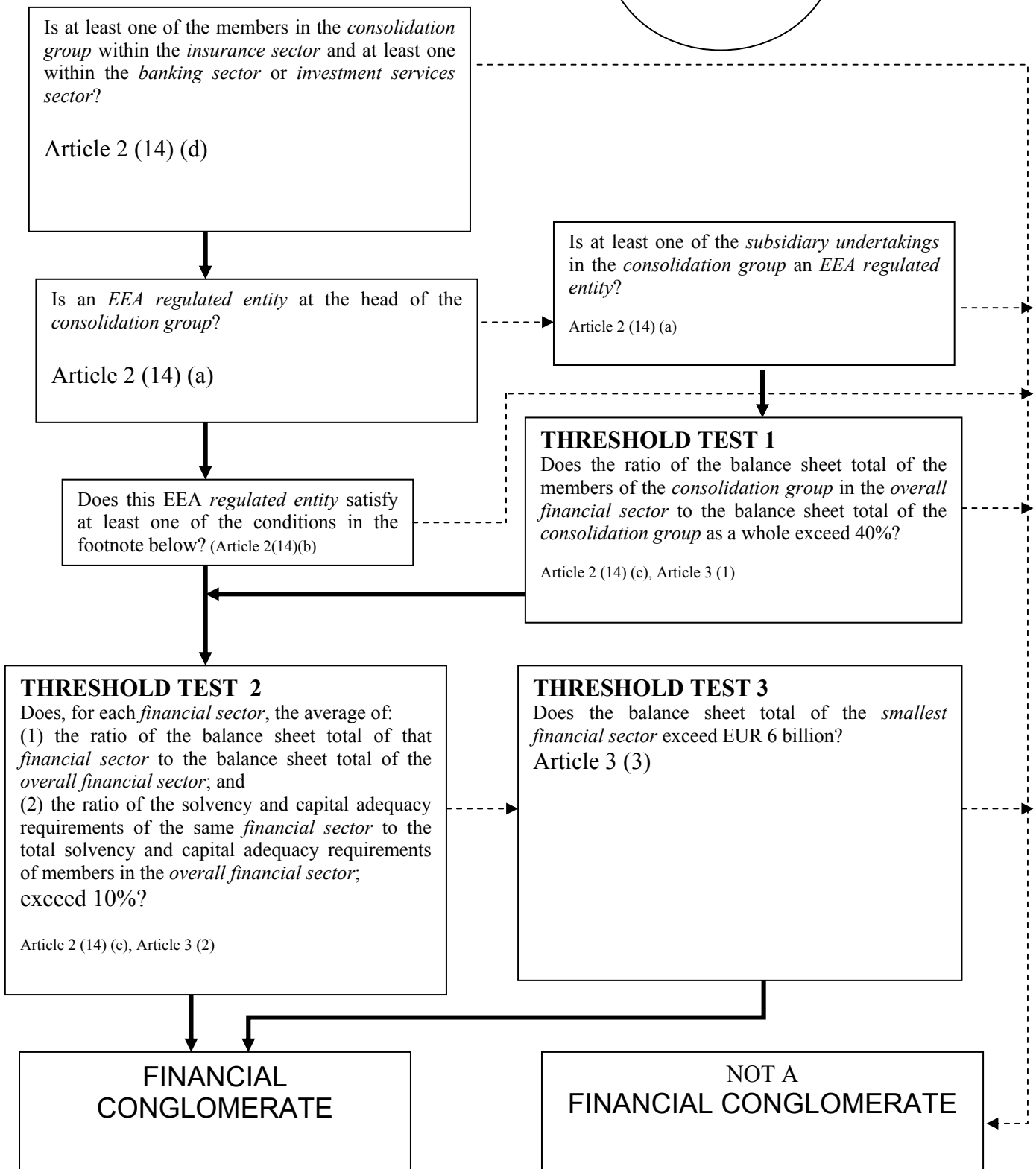
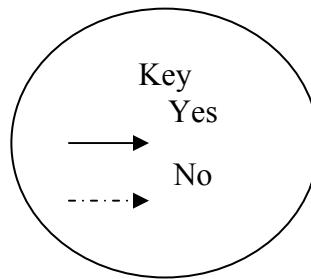
$$(B\% + D\%)/2 = BI\%$$

The smallest sector is the sector with the smallest relevant percentage.

Article III. If $I\% < BI\%$ then F3 is insurance, F4 = A%, and F5 = C%

Article IV. If $BI\% < I\%$ then F3 is banking/investment, F4 = B% and F5 = D%

GENPRU 38 Ann 4R (see GENPRU 3.18.4.5R)



Footnote: The conditions are that the *EEA regulated entity* at the head of the *consolidation group*:

(1) is a *parent undertaking* of a member of the *consolidation group* in the *overall financial sector*;

- (2) has a *participation* in a member of the *consolidation group* that is in the *overall financial sector*; or
- (3) has a *consolidation Article 12(1) relationship* with a member of the *consolidation group* that is in the *overall financial sector*.

**THE PRUDENTIAL SOURCEBOOK FOR BANKS, BUILDING SOCIETIES
AND INVESTMENT FIRMS INSTRUMENT 2006**

Powers exercised

- A. The Financial Services Authority makes this instrument in the exercise of the following powers and related provisions:
- (1) the following sections of the Financial Services and Markets Act 2000 (“the Act”):
 - (a) section 138 (General rule-making power);
 - (b) section 148(3) (Modification or waiver of rules);
 - (c) section 149 (Evidential provisions);
 - (d) section 150(2) (Actions for damages);
 - (e) section 156 (General supplementary powers); and
 - (f) section 157 (Guidance); and
 - (2) regulation 2(3) of the Capital Requirements Regulations 2006 (Application for permission).
- B. The rule-making powers listed above are specified for the purpose of section 153(2) (Rule-making instruments) of the Act.

Commencement

- C. (1) This instrument comes into force on 1 January 2007 except (subject to (2)) as follows:
- (a) the provisions providing for the advanced measurement approaches to operational risk do not apply until 1 January 2008 including in particular BIPRU 6.2.7R, BIPRU 6.2.9R and BIPRU 6.5; and
 - (b) the provisions providing for the advanced internal ratings based approach (the advanced IRB approach) do not apply until 1 January 2008 including in particular BIPRU 4.2.24R, BIPRU 4.4.40R to BIPRU 4.4.55R, BIPRU 4.8.22R(3) and BIPRU 4.8.26R.
- (2) The provisions providing for applications to use the advanced measurement approaches to operational risk and the advanced IRB approach come into force on 1 January 2007, including in particular BIPRU 1.3.7D to BIPRU 1.3.9D and BIPRU 1.3.14D.

Amendments to the Handbook

- D. The Annex to this instrument inserts into the Handbook the Prudential Sourcebook For Banks, Building Societies and Investment Firms to form a new module within the Prudential Standards block.

Citation

- E. This instrument may be cited as the Prudential Sourcebook For Banks, Building Societies and Investment Firms Instrument 2006.

By order of the Board
25 October 2006

Annex

Text of BIPRU

In this Annex, all text is new and is not underlined.

Insert the following new sourcebook, the Prudential Sourcebook For Banks, Building Societies and Investment Firms (BIPRU).

- 1.1 Application
- Application
- 1.1.1 G There is no overall application statement for *BIPRU*. Each chapter or section has its own application statement. Broadly speaking however, *BIPRU* applies to:
- (1) a *bank*;
 - (2) a *building society*;
 - (3) a *BIPRU investment firm*; and
 - (4) groups containing such *firms*.
- 1.1.2 R *BIPRU* applies to a *firm* in relation to the whole of its business, except where a particular provision provides for a narrower scope.
- 1.1.3 G In the main *BIPRU* only applies to a *UCITS investment firm* in respect of *designated investment business* (excluding *scheme management activity*). However *BIPRU* 2.2 (Internal capital adequacy standards), *BIPRU* 2.3 (Interest rate risk in the non-trading book), *BIPRU* 8 (Group risk - consolidation) and *BIPRU* 11 (Disclosure) apply to the whole of its business.
- Purpose
- 1.1.4 G *BIPRU* 1.1 implements in part Articles 3(1)(b), 5, 9, 10 and 20 of the *Capital Adequacy Directive*. However it amends those definitions so as to base the classification of *investment firms* on the *ISD* rather than the *MiFID*. *BIPRU* 1.1 will be amended so as to base that classification on the *MiFID* when the *MiFID* is applied to *firms* by the *FSA*.
- Guidance on the categorisation of *BIPRU investment firms*
- 1.1.5 G *Guidance* on the categorisation of *investment firms* for the purposes of *BIPRU* and *GENPRU* from 1 November 2007 will be included in *PERG* 13 (Guidance on the scope of the Markets in Financial Instruments Directive and the recast Capital Adequacy Directive).
- The definition of a *BIPRU firm*
- 1.1.6 R Subject to *BIPRU* 1.1.7R, a *BIPRU firm* means a *firm* that is:
- (1) a *building society*; or
 - (2) a *bank*; or
 - (3) a *full scope BIPRU investment firm*; or

- (4) a *BIPRU limited licence firm*; or
 - (5) a *BIPRU limited activity firm*.
- 1.1.7 R None of the following is a *BIPRU firm* and each of the following is excluded from each of the categories of *BIPRU investment firm* listed in *BIPRU* 1.1.6R(3) to (5) and *BIPRU* 1.1.18R(2) to (4):
- (1) an *incoming EEA firm*;
 - (2) an *incoming Treaty firm*;
 - (3) any other *overseas firm*;
 - (4) an *ELMI*;
 - (5) an *insurer*; and
 - (6) an *ICVC*.
- 1.1.8 R A *firm* falling within *BIPRU* 1.1.6R(3) to (5) is a *BIPRU investment firm*. A *BIPRU investment firm* includes a *UCITS investment firm* that is not excluded under *BIPRU* 1.1.7R.
- 1.1.9 G *EEA firms* are subject to the prudential standards of their home state regulator. But the *Banking Consolidation Directive* permits a host state *competent authority* to require a *BCD credit institution* to meet certain standards relating to its liquidity. The *FSA's* approach to liquidity for such *firms* is set out in *IPRU(BANK)* and *SYSC* 11 (Liquidity risk systems and controls).
- 1.1.10 G
- (1) This paragraph applies to an *undertaking* that would be a *third country BIPRU firm* if it were *authorised* under the *Act*.
 - (2) Except in exceptional circumstances, it is the *FSA's* policy that it will not give an overseas applicant a *Part IV permission* unless the *FSA* is satisfied that the applicant will be subject to prudential regulation by its home state *regulatory body* that is broadly equivalent to that provided for in the *Handbook* and the applicable *EEA prudential sectoral legislation*. The *FSA* will take into account not only the requirements to which the *firm* is subject but how they are enforced. The *FSA* will also take into account the laws, regulations and administrative provisions to which it is subject in its home state. The reasons for that policy include:
 - (a) it is unlikely that a *firm* that is not subject to equivalent supervision will be able to satisfy the *threshold conditions* (and in particular *threshold condition 5* (Suitability)) and it is unlikely that it will be possible to establish that the *firm* does satisfy them;

- (b) such a *firm* is likely to pose a threat to the interests of *consumers* and potential *consumers*, particularly as effective supervision of an *overseas firm* depends on cooperation between the *FSA* and the *regulatory body* that authorises the *firm* in its home country and on the *FSA* being able to place appropriate reliance on the supervision carried out by such *regulatory body*; and
 - (c) under Article 38(1) of the *Banking Consolidation Directive* the *FSA* should not apply to *branches* of *credit institutions* having their head office outside the *EEA*, when commencing or carrying on their business, provisions which result in more favourable treatment than that accorded to *branches* of *credit institutions* having their head office in the *EEA*.
- (3) If an *undertaking* is not subject to equivalent supervision in its home state and it wishes to carry on in the *United Kingdom regulated activities* coming within the scope of the activities that define a *BIPRU firm* it should establish a *subsidiary undertaking* in the *United Kingdom*. Such a *subsidiary undertaking* should be able to show, amongst other things, how it would comply with the *threshold conditions* (and in particular *threshold conditions* 3 (Close links) and 5 (Suitability)).
- (4) If in exceptional circumstances the *FSA* does grant a *Part IV permission* to an *undertaking* that is not subject to equivalent prudential regulation the *FSA* is likely to take measures under the *regulatory system* to compensate for the lack of equivalent supervision. These may include applying the prudential requirements for *BIPRU firms* to the *firm*.
- (5) An *overseas firm* that is subject to equivalent supervision is subject to the *threshold conditions* and the *Principles*. *BIPRU* and *GENPRU* do not generally apply. However *GENPRU* 1.2 (Adequacy of financial resources) applies to a *credit institution* with respect to liquidity risk in relation to its *United Kingdom branch*.

Types of investment firm: Limited activity firms

1.1.11 R A *limited activity firm* means (as specified by Article 20(3) of the *Capital Adequacy Directive* (Exemptions from operational risk)) a *CAD investment firm* that satisfies the following conditions:

- (1) it meets the criteria in (a) or the criteria in (b):
 - (a) it *deals on own account* only:
 - (i) for the purpose of fulfilling or executing a client order; or

- (ii) for the purpose of gaining entrance to a clearing and settlement system or a *recognised investment exchange* or *designated investment exchange* when acting in an agency capacity or executing a client order; or
- (b) it satisfies the following conditions:
- (i) it does not hold client money or securities in relation to *investment services* that it provides and is not authorised to do so;
 - (ii) the only *core investment service* it undertakes is *dealing on own account*;
 - (iii) it has no external customers in relation to *investment services* it provides; and
 - (iv) the execution and settlement of its transactions in relation to *investment services* it provides takes place under the responsibility of a clearing institution and are guaranteed by that clearing institution;
- (2) (in the case of a *CAD investment firm* that is a *BIPRU investment firm*) its *base capital resources requirement* is €730,000;
- (3) (in the case of a *CAD investment firm* that is an *EEA firm*) it is subject to the *CRD implementation measures* of its *Home State* for Article 9 of the *Capital Adequacy Directive* (Initial capital requirement of €730,000); and
- (4) (in the case of any other *CAD investment firm*) its *base capital resources requirement* would be €730,000 if it had been a *BIPRU investment firm* on the basis of the assumptions in *BIPRU* 1.1.14R(3)(a) and (b).

Types of investment firm: Limited licence firms

1.1.12 R A *limited licence firm* means (as specified by Article 20(2) of the *Capital Adequacy Directive* (Exemptions from operational risk)) a *CAD investment firm* that is not authorised to:

- (1) *deal on own account*; or
- (2) provide the investment services of underwriting or placing *financial instruments* (as referred to in point 4 of Section A of Annex I of the *ISD*) on a firm commitment basis.

Types of investment firm: CAD full scope firm

1.1.13 R A *CAD full scope firm* means a *CAD investment firm* that is not a *limited activity firm* or a *limited licence firm*.

Types of investment firm: CAD investment firm

1.1.14 R (1) In accordance with Article 3(1)(b) of the *Capital Adequacy Directive*, a person is a *CAD investment firm* if it falls into (2) or (3).

(2) A person whose head office is in an *EEA State* is a *CAD investment firm* if it is an *investment firm* that is subject to the requirements imposed by the *ISD* but excludes the following:

(a) a *bank*, a *building society* or an *ELMI*;

(b) a *credit institution*;

(c) a *local*; and

(d) an *exempt CAD firm*.

(3) An *investment firm* whose head office is not in an *EEA State* is a *CAD investment firm* if it would have fallen into (2) if:

(a) its head office had been in an *EEA State*; and

(b) it had carried on all its business in the *EEA* and had obtained whatever authorisations for doing so are required under the *ISD*.

1.1.15 G An *investment firm* with the benefit of an exemption pursuant to Article 2(2) of the *ISD* is excluded from the definition of a *CAD investment firm* and hence from the definition of *BIPRU investment firm*.

Types of investment firm: Exempt CAD firm

1.1.16 R In accordance with Article 3(1)(b)(iii) of the *Capital Adequacy Directive* (Definitions), an *exempt CAD firm* means an *investment firm* that satisfies the following conditions:

(1) it would have been a *CAD investment firm* if *exempt CAD firms* were not excluded from the definition; and

(2) the only *core investment service* for which it is authorised is receiving and transmitting orders from investors (as referred to in Section A of Annex I of the *ISD*) without holding money or securities belonging to its clients in relation to *investment services* it provides and for that reason it may not at any time place itself in debt with those clients.

Types of BIPRU investment firm

- 1.1.17 R (1) A *BIPRU limited licence firm* means a *limited licence firm* that falls into (4).
- (2) A *BIPRU limited activity firm* means a *limited activity firm* that falls into (4).
- (3) A *full scope BIPRU investment firm* means a *CAD full scope firm* that falls into (4).
- (4) A *limited licence firm, limited activity firm* or *CAD full scope firm* falls into (4) if:
- (a) it is a *firm*; and
 - (b) its head office is in the *United Kingdom* and it is not otherwise excluded from the definition of *BIPRU firm* under *BIPRU 1.1.7R*.

Alternative classification of BIPRU investment firms

- 1.1.18 R *BIPRU investment firms* are divided into the following classes for the purposes of the calculation of the *base capital resources requirement* and for the purpose of any other provision of the *Handbook* that applies this classification:
- (1) a *UCITS investment firm*;
 - (2) a *BIPRU 50K firm*;
 - (3) a *BIPRU 125K firm*; and
 - (4) a *BIPRU 730K firm*.

Types of investment firm: BIPRU 125K firm

- 1.1.19 R A *BIPRU 125K firm* means a *BIPRU investment firm* that satisfies the following conditions:
- (1) it does not:
 - (a) *deal on own account*; or
 - (b) underwrite issues of *financial instruments* (as referred in Section A of Annex I of the *ISD*) on a firm commitment basis;
 - (2) it holds clients' money or securities in relation to *investment services* it provides or is authorised to do so;

- (3) it offers one or more of the following services (all as referred to in Section A of Annex I of the *ISD*):
 - (a) reception and transmission of investors' orders for *financial instruments*; or
 - (b) the execution of investors' orders for *financial instruments*; or
 - (c) the management of individual portfolios of investments in *financial instruments*; and
- (4) it is not a *UCITS investment firm*.

Types of investment firm: BIPRU 50K firm

1.1.20 R A *BIPRU 50K firm* means a *BIPRU investment firm* that satisfies the following conditions:

- (1) it satisfies the conditions in *BIPRU 1.1.19R(1)* and (3);
- (2) it does not hold clients' money or securities in relation to *investment services* it provides and it is not authorised to do so; and
- (3) it is not a *UCITS investment firm*.

Types of investment firm: 730K firm

1.1.21 R A *BIPRU investment firm* that is not a *UCITS investment firm*, a *BIPRU 50K firm* or a *BIPRU 125K firm* is a *BIPRU 730K firm*.

Types of investment firm: Part IV permission

1.1.22 R A *firm* also falls into one of the categories of *BIPRU investment firm* listed in *BIPRU 1.1.6R(3)* to (5) or *BIPRU 1.1.18R* if its *Part IV permission* contains a *requirement* that it comply with the *rules* in *GENPRU* and *BIPRU* applicable to that category of *firm*. If a *firm* is subject to such a *requirement* and it would otherwise also fall into another category of *BIPRU investment firm* it does not fall into that other category.

Meaning of dealing on own account

- 1.1.23 R (1) *Dealing on own account* means (for the purpose of *GENPRU* and *BIPRU*) the service of dealing in any *financial instruments* for own account as referred to in point 2 of Section A of the Annex to the *ISD*, subject to (2) and (3).
- (2) In accordance with Article 5(2) of the *Capital Adequacy Directive* (Definition of dealing on own account), a *CAD investment firm* that executes investors' orders for *financial instruments* and holds such *financial instruments* for its own account does not for that reason *deal on own account* if the following conditions are met:

- (a) such *positions* only arise as a result of the *CAD investment firm's* failure to match investors' orders precisely;
 - (b) the total market value of all such *positions* is no higher than 15% of the *CAD investment firm's initial capital*;
 - (c) (in the case of a *BIPRU investment firm*) it complies with the *main BIPRU firm Pillar 1 rules* and *BIPRU 10* (Concentration risk);
 - (d) (in the case of a *CAD investment firm* that is an *EEA firm*) it complies with the *CRD implementation measures* of its *Home State* for Articles 18 and 20 (Minimum capital requirements) and 28 (Large exposures) of the *Capital Adequacy Directive*;
 - (e) (in the case of any other *CAD investment firm*) it would comply with the *rules* in (2)(c) if it had been a *BIPRU investment firm* on the basis of the assumptions in *BIPRU 1.1.14R(3)(a)* and (b); and
 - (f) such *positions* are incidental and provisional in nature and strictly limited to the time required to carry out the transaction in question.
- (3) In accordance with Article 5(2) of the *Capital Adequacy Directive*, the holding of *non-trading book positions* in *financial instruments* in order to invest *capital resources* is not *dealing on own account* for the purposes referred to in *BIPRU 1.1.18R*.

Interpretation of the definition of types of firm and undertaking

- 1.1.24 R For the purposes of the definitions in *BIPRU 1.1*, a *person* does any of the activities referred to in *BIPRU 1.1* if:
- (1) it does that activity anywhere in the world; or
 - (2) if its *permission* includes that activity; or
 - (3) (in the case of an *EEA firm*) it is authorised by its *Home State regulator* to do that activity; or
 - (4) (if the carrying on of that activity is prohibited in a state or territory without an authorisation in that state or territory) that *firm* has such an authorisation.
- 1.1.25 R For the purposes of the definitions in *BIPRU 1.1*, a *person* offers any of the services referred to in *BIPRU 1.1.19R(3)* if:
- (1) it offers that service anywhere in the world; or
 - (2) any of *BIPRU 1.1.24R(1)* to (4) apply.

- 1.1.26 R For the purposes of the definitions in *BIPRU* 1.1, a *person* has an authorisation to do any of the activities referred to in *BIPRU* 1.1 if any of *BIPRU* 1.1.24R(2) to (4) apply.

1.2 Definition of the trading book

Application

1.2.1 R This section applies to a *BIPRU firm*.

Purpose

1.2.2 G This section implements certain provisions of the *Capital Adequacy Directive* and the *Banking Consolidation Directive* relating to the *trading book*. The precise provisions being implemented are listed as a note after each *rule*.

Definition of the trading book: General

1.2.3 R The *trading book* of a *firm* consists of all *positions* in *CRD financial instruments* and *commodities* held either with trading intent or in order to hedge other elements of the *trading book* and which are either free of any restrictive covenants on their tradability or able to be hedged.

[Note: *CAD* Article 11(1)]

Definition of the trading book: Positions

1.2.4 R The term *positions* includes proprietary positions and positions arising from client servicing and market making.

[Note: *CAD* Article 11(2) second sentence]

1.2.5 G *Positions* arising from client servicing include those arising out of contracts where a *firm* acts as principal (even in the context of activity described as ‘broking’ or ‘customer business’). Such *positions* should be allocated to a *firm's trading book* if the intent is trading (see *BIPRU* 1.2.10R). This applies even if the nature of the business means that generally the only risks incurred by the *firm* are counterparty risks (i.e. no market risk charges apply). If the nature of the business means that generally the only risks incurred by the *firm* are counterparty risks, the *position* will generally still meet the trading intent requirement in *BIPRU* 1.2.10R if the *position* would meet the trading intent requirement if *position* risk did arise. The *FSA* understands that business carried out under International Uniform Brokerage Execution (“Give-Up”) Agreements involve back to back trades as principal. Thus *positions* arising out of business carried out under such agreements should be allocated to a *firm's trading book*.

Definition of the trading book: Repos

- 1.2.6 R Term trading-related repo-style transactions that a *firm* accounts for in its *non-trading book* may be included in the *trading book* for capital requirement purposes so long as all such repo-style transactions are included. For this purpose, trading-related repo-style transactions are defined as those that meet the requirements of *BIPRU 1.2.4R*, *BIPRU 1.2.10R* and *BIPRU 1.2.12R*, and both legs are in the form of either cash or securities includable in the *trading book*. Regardless of where they are booked, all repo-style transactions are subject to a *non-trading book* counterparty credit risk charge.

[Note: *CAD* Annex VII Part D point 4]

CRD financial instruments

- 1.2.7 R A *CRD financial instrument* means any contract that gives rise to both a financial asset of one party and a financial liability or equity instrument of another party.

[Note: *CAD* Article 3(1)(e)]

- 1.2.8 R *CRD financial instruments* include both primary *CRD financial instruments* or cash instruments, and derivative *CRD financial instruments* the value of which is derived from the price of an underlying *CRD financial instrument*, a rate, an index or the price of another underlying item and include as a minimum the instruments specified in Section C of Annex I to the *MIFID*.

[Note: *CAD* Article 3(1) last paragraph]

- 1.2.9 G Generally, for the purpose of the definition of *CRD financial instrument*:
- (1) a financial asset means cash, the right to receive cash or another financial asset, the contractual right to exchange financial assets on potentially favourable terms or an equity instrument; and
 - (2) a financial liability means the contractual obligation to deliver cash or another financial asset or to exchange financial liabilities under conditions that are potentially unfavourable.

Trading intent

- 1.2.10 R *Positions* held with trading intent for the purpose of the definition of the *trading book* are those held intentionally for short-term resale and/or with the intention of benefiting from actual or expected short-term price differences between buying and selling prices, or from other price or interest rate variations.

[Note: *CAD* Article 11(2) first sentence]

1.2.11 R Trading intent must be evidenced on the basis of the strategies, policies and procedures set up by the *firm* to manage the *position* or portfolio in accordance with *BIPRU* 1.2.12R.

[**Note:** *CAD* Article 11(3)]

1.2.12 R *Positions*/portfolios held with trading intent must comply with the following requirements:

- (1) there must be a clearly documented trading strategy for the *position*/instrument or portfolios, approved by senior management, which must include the expected holding horizon;
- (2) there must be clearly defined policies and procedures to monitor the *position* against the *firm's* trading strategy including the monitoring of turnover and stale *positions* in the *firm's trading book*; and
- (3) there must be clearly defined policies and procedures for the active management of the *position*, which must include the following:
 - (a) *positions* entered into on a trading desk;
 - (b) *position* limits are set and monitored for appropriateness;
 - (c) dealers have the autonomy to enter into/manage the *position* within agreed limits and according to the approved strategy;
 - (d) *positions* are reported to senior management as an integral part of the *firm's* risk management process; and
 - (e) *positions* are actively monitored with reference to market information sources and an assessment made of the marketability or hedge-ability of the *position* or its component risks, including the assessment of, the quality and availability of market inputs to the valuation process, level of market turnover, sizes of *positions* traded in the market.

[**Note:** *CAD* Annex VII Part A]

Internal hedges

1.2.13 R Internal hedges may be included in the *trading book*, in which case *BIPRU* 1.2.14R to *BIPRU* 1.2.16R apply.

[**Note:** *CAD* Article 11(5)]

- 1.2.14 R (1) An internal hedge is a *position* that materially or completely offsets the component risk element of a *non-trading book position* or a set of *positions*. *Positions* arising from internal hedges are eligible for *trading book* capital treatment, provided that they are held with trading intent and that the general criteria on trading intent and prudent valuation specified in *BIPRU 1.2.12R* and the *trading book systems and controls rules*. In particular:
- (a) internal hedges must not be primarily intended to avoid or reduce capital requirements;
 - (b) internal hedges must be properly documented and subject to particular internal approval and audit procedures;
 - (c) the internal transaction must be dealt with at market conditions;
 - (d) the bulk of the market risk that is generated by the internal hedge must be dynamically managed in the *trading book* within the authorised limits; and
 - (e) internal transactions must be carefully monitored.
- (2) Monitoring must be ensured by adequate procedures.

[Note: *CAD Annex VII Part C point 1*]

- 1.2.15 R The treatment referred to in *BIPRU 1.2.14R* applies without prejudice to the capital requirements applicable to the “*non-trading book leg*” of the internal hedge.

[Note: *CAD Annex VII Part C point 2*]

- 1.2.16 R Notwithstanding *BIPRU 1.2.14R* to *BIPRU 1.2.15R*, when a *firm* hedges a *non-trading book* credit risk exposure using a credit derivative booked in its *trading book* (using an internal hedge), the *non-trading book* exposure is not deemed to be hedged for the purposes of calculating capital requirements unless the *firm* purchases from an eligible third party protection provider a credit derivative meeting the requirements set out in *BIPRU 5.7.13R* (Additional requirements for credit derivatives) with regard to the *non-trading book* exposure. Where such third party protection is purchased and is recognised as a hedge of a *non-trading book* exposure for the purposes of calculating capital requirements, neither the internal nor external credit derivative hedge may be included in the *trading book* for the purposes of calculating capital requirements.

[Note: *CAD Annex VII Part C point 3*]

Size thresholds

- 1.2.17 R (1) Subject to (3), a *firm* may calculate its capital requirements for its *trading book* business in accordance with the *standardised approach* to credit risk (or, if it has an *IRB permission*, the *IRB approach*) as it applies to the *non-trading book* where the size of the *trading book* business meets the following requirements:
- (a) the *trading book* business of the *firm* does not normally exceed 5% of its total business;
 - (b) its total *trading book positions* do not normally exceed €15 million; and
 - (c) the *trading book* business of the *firm* never exceeds 6% of its total business and its total *trading book positions* never exceed €20 million.
- (2) Subject to (3), if (1) applies, the following are disapplied:
- (a) the *rules* relating to the *interest rate PRR*, the *equity PRR*, the *CIU PRR* and the *PRR* calculated under *BIPRU 7.11* (Credit derivatives in the trading book);
 - (b) the *rules* relating to the *option PRR* (but only in relation to *positions* which under *BIPRU 7.6.5R* (Table: Appropriate calculation for an option or warrant) may be subject to one of the other *PRR charges* listed in (2)(a) or which would be subject to such a *PRR charge* if *BIPRU 7.6.5R* did not require an *option PRR* to be calculated);
 - (c) *BIPRU 7.10* (Use of a Value at Risk Model) so far as *BIPRU 7.10* relates to the risks covered by the requirements in (a) and (b); and
 - (d) *BIPRU 14* (Capital requirements for settlement and counterparty risk).
- (3) If (1) applies, the following continue to apply:
- (a) the *rules* relating to the *commodity PRR* and the *foreign currency PRR*;
 - (b) the *rules* relating to the *option PRR* (so far as not disapplied under (2)(b));
 - (c) *BIPRU 7.10* (so far as not disapplied under (2)(c));
 - (d) *BIPRU 14.2.3R* to *BIPRU 14.2.8R* (Credit derivatives); and

- (e) *BIPRU 14.2.15R to BIPRU 14.2.16R* (Collateral for *repurchase transactions* and other products).

[Note: *CAD Article 18(2)*]

- 1.2.18 R In order to calculate the proportion that *trading-book* business bears to total business for the purpose of *BIPRU 1.2.17R(1)(a) to (c)* the *firm* must refer to the size of the combined on- and off-balance-sheet business. For this purpose, debt instruments must be valued at their market prices or their principal values, equities at their market prices and derivatives according to the nominal or market values of the instruments underlying them. Long *positions* and short *positions* must be summed regardless of their signs.

[Note: *CAD Article 18(3)*]

- 1.2.19 R If a *firm* should happen for more than a short period to exceed either or both of the limits imposed in *BIPRU 1.2.17R(1)(a) and (b)* or either or both of the limits imposed in *BIPRU 1.2.17R(1)(c)*:

(1) *BIPRU 1.2.17R* ceases to apply; and

(2) the *firm* must notify the *FSA*.

[Note: *CAD Article 18(4)*]

- 1.2.20 G As required by *BIPRU 8.7.21R* (Special rules for the consolidated market risk requirement), a *firm* should consider whether it meets the threshold conditions in *BIPRU 1.2.17R* on both an unconsolidated (or solo) basis and a consolidated basis. If a *firm's* trading activities on both an unconsolidated (or solo) basis and a consolidated basis are below the threshold size, it may be appropriate for the *firm* not to adopt the *trading book* treatment. However, even if the *firm* does not apply the *trading book* treatment it should still adopt a *trading book policy statement*. That statement may be restricted to identifying the activities the *firm* normally considers to be trading and that would constitute part of its *trading book*. The *firm* should use this policy statement to help it to decide whether or not adopting the *trading book* treatment is appropriate.

Systems and controls for the trading book

- 1.2.21 R A *firm* must implement policies and processes for the measurement and management of all material sources and effects of market risks.

[Note: *BCD Annex V, Part 7 point 10*]

- 1.2.22 R A *firm* must establish and maintain systems and controls to manage its *trading book*, in accordance with the *trading book systems and controls rules, BIPRU 1.2.6R* (Definition of the trading book: Repos) and the *overall financial adequacy rule to BIPRU 1.2.27R* (Trading book policy statements).

[Note: CAD Article 11(4)]

1.1.23 R A *firm* must establish and maintain systems and controls sufficient to provide prudent and reliable valuation estimates.

[Note: CAD Annex VII Part B point 1]

1.2.24 R Systems and controls must include at least the following elements:

- (1) documented policies and procedures for the process of valuation (including clearly defined responsibilities of the various areas involved in the determination of the valuation, sources of market information and review of their appropriateness, frequency of independent valuation, timing of closing prices, procedures for adjusting valuations, month end and ad-hoc verification procedures); and
- (2) reporting lines for the department accountable for the valuation process that are clear and independent of the front office.

[Note: CAD Annex VII Part B point 2]

1.2.25 R The reporting line in relation to the matters covered by *BIPRU* 1.2.21R to *BIPRU* 1.2.24R must ultimately be to an executive *director* on the *firm's* governing body.

[Note: CAD Annex VII Part B point 2 (last sentence)]

Trading book policy statements

1.2.26 R A *firm* must have clearly defined policies and procedures for determining which *positions* to include in the *trading book* for the purposes of calculating its capital requirements, consistent with the criteria set out in *BIPRU* 1.2.3R to *BIPRU* 1.2.4R, *BIPRU* 1.2.10R to *BIPRU* 1.2.11R, *BIPRU* 1.2.13R and *BIPRU* 1.2.22R and taking into account the *firm's* risk management capabilities and practices. Compliance with these policies and procedures must be fully documented and subject to periodic internal audit.

[Note: CAD Annex VII Part D point 1]

1.2.27 R A *firm* must have clearly defined policies and procedures for overall management of the *trading book*. At a minimum these policies and procedures must address:

- (1) the activities the *firm* considers to be trading and as constituting part of the *trading book* for capital requirement purposes;
- (2) the extent to which a *position* can be marked-to-market daily by reference to an active, liquid two-way market;

- (3) for *positions* that are marked-to-model, the extent to which the *firm* can:
 - (a) identify all material risks of the *position*;
 - (b) hedge all material risks of the *position* with instruments for which an active, liquid two-way market exists; and
 - (c) derive reliable estimates for the key assumptions and parameters used in the model;
- (4) the extent to which the *firm* can, and is required to, generate valuations for the *position* that can be validated externally in a consistent manner;
- (5) the extent to which legal restrictions or other operational requirements would impede the *firm's* ability to effect a liquidation or hedge of the *position* in the short term;
- (6) the extent to which the *firm* can, and is required to, actively risk manage the *position* within its trading operation; and
- (7) the extent to which the *firm* may transfer risk or *positions* between the *non-trading book* and *trading book* and the criteria for such transfers.

[Note: CAD Annex VII Part D point 2]

- 1.2.28 G The policies and procedures referred to in *BIPRU* 1.2.27R(1) should cover:
- (1) the *CRD financial instruments* and *commodities* that the *firm* proposes to trade in, including the currencies, maturities, issuers and quality of issues; and
 - (2) any instruments to be excluded from its *trading book*.
- 1.2.29 R (1) The policies and procedures referred to in the *overall financial adequacy rule* and *BIPRU* 1.2.27R must be recorded in a single written document. A *firm* may record those policies and procedures in more than one written document if the *firm* has a single written document that identifies:
- (a) all those other documents; and
 - (b) the parts of those documents that record those policies and procedures.
- (2) A *trading book policy statement* means the single document referred to in this *rule*.

- 1.2.30 R (1) A *firm* must notify the *FSA* as soon as is reasonably practicable when it adopts a *trading book policy statement*.
- (2) A *firm* must notify the *FSA* as soon as is reasonably practicable if the *trading book policy statement* is subject to significant changes.
- 1.2.31 G A significant change for the purpose of the *overall Pillar 2 rule* includes new types of customers or business requiring different funding or provisioning.
- 1.2.32 G There is likely to be an overlap between what the *trading book policy statement* should contain and other documents such as dealing or treasury manuals. A cross reference to the latter in the *trading book policy statement* is adequate and material in other documents need not be set out again in the *trading book policy statement*. However where this is the case the matters required to be included in the *trading book policy statement* should be readily identifiable.
- 1.2.33 G The *trading book policy statement* may be prepared on either a consolidated or a solo (or solo-consolidated) basis. It should be prepared on a consolidated basis when a group either manages its trading risk centrally or employs the same risk management techniques in each group member. A *trading book policy statement* prepared on a consolidated basis should set out how it applies to each *firm* in the group and should be approved by each such *firm's governing body*.
- Treatments common to the trading book and the non-trading book
- 1.2.34 G Capital requirements for *foreign currency* risk and *commodity position* risk are the same whether the risk arises in the *trading book* or the *non-trading book*. The calculation of capital requirements for *foreign currency* risk is set out in *BIPRU 7.5*. The calculation of capital requirements for *commodity position* risk is set out in *BIPRU 7.4*.
- Trading book treatments
- 1.2.35 G All *positions* that are in a *firm's trading book* require capital to cover *position* risk and may require capital to cover counterparty credit risk and to cover large exposures. Counterparty credit risk in the *trading book* is dealt with by *BIPRU 14* and capital for *large exposures* is covered by *BIPRU 10*.
- Non-trading book treatments
- 1.2.36 G All *positions* that are not in a *firm's trading book* are included in its *non-trading book* and subject capital requirements for the *non-trading book* unless they are deducted from *capital resources* under *GENPRU 2.2* (Capital resources).

1.3 Applications for advanced approaches

Application

- 1.3.1 R This section of the *Handbook* applies to every *BIPRU firm* that wishes to apply for a permission to use any of the approaches set out in *BIPRU* 1.3.2G.

Purpose

- 1.3.2 G (1) A *firm* may apply for an *Article 129 permission* or a *waiver* in respect of:
- (a) the *IRB approach*;
 - (b) the *advanced measurement approach*;
 - (c) the *CCR internal model method*; and
 - (d) the *VaR model approach*.
- (2) A *firm* should apply for a *waiver* if it wants to:
- (a) apply the *CAD 1 model approach*;
 - (b) apply the *master netting agreement internal models approach*;
 - (c) disapply consolidated supervision under *BIPRU* 8 for its *UK consolidation group* or *non-EEA sub-group*;
 - (d) apply the treatment in *BIPRU* 2.1 (Solo-consolidation waiver); or
 - (e) apply the treatment in *BIPRU* 10.8 (Exemption from limits in *BIPRU* 10.5 for concentration risk counterparty).

Article 129

- 1.3.3 G An *EEA parent institution* and its *subsidiary undertakings* or the *subsidiary undertakings* of its *EEA parent financial holding company* that wish to use any of the approaches listed in *BIPRU* 1.3.2G(1) in respect of its group,

including members of its group that are *BIPRU firms*, may apply for an *Article 129 permission*.

- 1.3.4 G The *Article 129 procedure* allows an *EEA parent institution* and its *subsidiary undertakings* or the *subsidiary undertakings* of its *EEA parent financial holding company* to apply for permission to use the approaches in *BIPRU 1.3.2G(1)* without making separate applications to the *competent authority* of each *EEA State* where members of a *firm's* group are authorised.
- 1.3.5 G The *Capital Requirements Regulations 2006* set out the *Article 129 procedure*.
- 1.3.6 G Where a *firm* or its group has been granted an *Article 129 permission*, each *competent authority*, including the lead *competent authority*, will need to take action to apply that *Article 129 permission* to the *institutions* that they authorise. Part 3 of the *Capital Requirements Regulations 2006* governs how the *FSA* will take that action, whether or not the *FSA* is the lead *competent authority*.

Article 129 permissions and waivers – specific conditions

- 1.3.7 D When an *advanced measurement approach* is intended to be used by an *EEA parent institution* and its *subsidiary undertakings* or the *subsidiary undertakings* of an *EEA parent financial holding company*, the application of a *firm* in accordance with *BIPRU 1.3.14D* must include the elements listed in *BIPRU 6.5.5R* (Minimum standards for the advanced measurement approach).

[**Note:** *BCD Article 105(2)*]

- 1.3.8 D When an *advanced measurement approach* is intended to be used by an *EEA parent institution* and its *subsidiary undertakings* or the *subsidiary undertakings* of an *EEA parent financial holding company*, the application of a *firm* must include a description of the methodology used for allocating *operational risk* capital between the different entities of the group.

[**Note:** *BCD Annex X Part 3 point 30*]

- 1.3.9 D For the purposes of *BIPRU 1.3.8D*, the application of a *firm* must indicate whether and how diversification effects are intended to be factored in the risk measurement system.

[**Note:** *BCD Annex X Part 3 point 31*]

Waiver – general

- 1.3.10 G As explained in *SUP* 8, under section 148 of the *Act*, the *FSA* may not grant a *waiver* to a *firm* unless it is satisfied that:
- (1) compliance by the *firm* with the *rules*, or with the *rules* as modified, would be unduly burdensome or would not achieve the purpose for which the *rules* were made; and
 - (2) the *waiver* would not result in undue risk to *persons* whose interests the *rules* are intended to protect.
- 1.3.11 G The conditions relating to the use of an approach listed in *BIPRU* 1.3.2G referred to in the relevant chapter of *BIPRU* are minimum standards. Satisfaction of those conditions does not automatically mean the *FSA* will grant a *waiver* referred to in those paragraphs. The *FSA* will in addition also apply the tests in section 148 of the *Act*.
- 1.3.12 G In the *FSA's* view, if the minimum standards referred to in *BIPRU* 1.3.11G are satisfied, the conditions referred to in *BIPRU* 1.3.10G(1) will generally be met.

Forms and method of application

- 1.3.13 D Subject to *BIPRU* 1.3.14D to *BIPRU* 1.3.21D, if a *firm* wishes to apply for a *waiver* to apply an approach set out in *BIPRU* 1.3.2G, it must comply with *SUP* 8.3.3D.
- 1.3.14 D If a *firm* wishes to apply for a *waiver* or an *Article 129 permission* to use the *advanced measurement approach*, it must complete and submit the form in *BIPRU* 1 Ann 1D.
- 1.3.15 D If a *firm* wishes to apply for a *waiver* or an *Article 129 permission* to use the *IRB approach*, it must complete and submit the form in *BIPRU* 1 Ann 2D.
- 1.3.16 D If a *firm* wishes to apply for a *waiver* or an *Article 129 permission* to use the *CCR internal model method*, it must complete and submit the form in *BIPRU* 1 Ann 3D.
- 1.3.17 D Where a *firm* makes an application in accordance with *BIPRU* 1.3.14D, *BIPRU* 1.3.15D or *BIPRU* 1.3.16D, the *firm* must state on the application whether it is making an application for a *waiver* or an *Article 129 permission*.
- 1.3.18 D Where a *firm* applies for a *VaR model permission*, the *firm* must state whether it is making an application for a *waiver* or an *Article 129 permission*.

- 1.3.19 G In respect of the application for *waivers* to apply the approaches set out in *BIPRU 1.3.2G(1)*, the *FSA* will aim to give decisions on applications as soon as practicable. However, the *FSA* expects that it will take a significant period to determine and give a decision due to the complexity of the issues raised by the applications. Details of timelines for applications for waivers to use advanced approaches and under the *Article 129 procedure* are set out on the *FSA* website.
- 1.3.20 D Where a *firm* applies for a *solo consolidation waiver*, it must demonstrate how each of the conditions set out in *BIPRU 2.1.20R* to *BIPRU 2.1.24R* are met and address the criteria set out in the *guidance* in *BIPRU 2.1.25G* as part of its application in accordance with *BIPRU 1.3.13D*.
- 1.3.21 G Before sending in an application for a *waiver* or *Article 129 permission*, a *firm* may find it helpful to discuss the application with its usual supervisory contact at the *FSA*. However, the *firm* should still ensure that all relevant information is included in the application.

BIPRU 1 Annex 1D

Application form to apply the advanced measurement approach

[link to be added]

BIPRU 1 Annex 2D

Application form to apply the IRB approach

[link to be added]

BIPRU 1 Annex 3D

Application form to apply the CCR internal model method approach

[link to be added]

BIPRU 1.4: Actions for damages

1.4 Actions for damages

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

2.1 Solo consolidation

Application

2.1.1 R This section applies to a *BIPRU firm* that has a *solo consolidation waiver*.

Purpose

2.1.2 G The purpose of this section is to implement Articles 70 and 118 of the *Banking Consolidation Directive*. It also implements Articles 2 and 28 of the *Capital Adequacy Directive* so far as they apply those provisions of the *Banking Consolidation Directive* to *CAD investment firms*.

2.1.3 G The *rules* in *GENPRU* and *BIPRU* do not allow a *firm* that is a *parent undertaking* to incorporate the capital and requirements of a *subsidiary undertaking* in the calculation of that *firm's capital resources* and *capital resources requirement*. A *firm* that wishes to incorporate a *subsidiary undertaking* for this purpose should therefore apply for a *solo consolidation waiver*.

Applying for a solo consolidation waiver

2.1.4 G *BIPRU* 1.3 (Applications for advanced approaches) explains how to apply for a *solo consolidation waiver*.

General

2.1.5 G The *FSA* will not grant a *firm* a *solo consolidation waiver* with respect to a *subsidiary undertaking* unless the *firm* and the *subsidiary undertaking* meet the standards in *BIPRU* 2.1.19R to *BIPRU* 2.1.24R.

2.1.6 G A *solo consolidation waiver* will modify the relevant parts of *GENPRU*, *BIPRU* and *SYSC* referred to in *BIPRU* 2.1.7R to *BIPRU* 2.1.8R to apply *BIPRU* 2.1 to a *firm*.

The basic rules for solo consolidation

2.1.7 R A *firm* that has a *solo consolidation waiver* must incorporate in the calculation of its requirements under the *main BIPRU firm Pillar 1 rules* and *BIPRU* 10 (Concentration risk requirement) each *subsidiary undertaking* to which the *solo consolidation waiver* applies. This does not apply to the *base capital resources requirement*.

2.1.8 R (1) A *firm* that has a *solo consolidation waiver* must meet the obligations in *SYSC* 12.1.13R (Application of certain systems and controls *rules* on a consolidated basis) on a consolidated basis with respect to the *firm* and each *subsidiary undertaking* to which the *firm's solo consolidation waiver* applies.

- (2) If (1) applies, *SYSC* 12.1.13R applies to the group made up of the *firm* and its *subsidiary undertakings* referred to in (1) in the same way as it applies to a *UK consolidation group* or *non-EEA sub-group*.
- (3) If (1) applies, the provisions of *SYSC* and *BIPRU* listed in *SYSC* 12.1.13R do not apply to the *firm* on a solo basis.

Solo consolidation and capital and concentration risk requirements

- 2.1.9 R *BIPRU* 2.1.10R to *BIPRU* 2.1.18R apply for the purposes of *BIPRU* 2.1.7R.
- 2.1.10 R A *firm* must treat itself and each *subsidiary undertaking* referred to in *BIPRU* 2.1.7R as a single *undertaking* and must apply, on that basis, *BIPRU* 8 (Group risk – consolidation) to the group made up of the *firm* and such *subsidiary undertakings* in the same way as *BIPRU* 8 applies to a *UK consolidation group* or *non-EEA sub-group*.
- 2.1.11 R Subject to *BIPRU* 2.1.13R, a *firm* must calculate its *capital resources* in accordance with *BIPRU* 8.6 (Consolidated capital resources).
- 2.1.12 R A *firm* must calculate its *capital resources requirement* in accordance with *BIPRU* 8.7.13R(3) (Treating group members as a single undertaking for consolidation purposes).
- 2.1.13 R Where *GENPRU* applies a different method of calculating *capital resources* or *capital resources requirements* depending on the category into which the *firm* in question falls, the method that applies is the one that would apply to the *firm* on a solo basis.
- 2.1.14 G For example, the effect of *BIPRU* 2.1.13R is that if a *firm* that is applying *BIPRU* 2.1 is a *limited licence firm* it should continue to apply the *capital resources* and *capital resources requirement* applicable to a *limited licence firm*.
- 2.1.15 R A *firm* must continue to calculate its *base capital resources requirement* and the requirement in *GENPRU* 2.1.42R (Calculation of capital resources requirement on authorisation) on a solo basis.
- 2.1.16 R A *firm* must apply *BIPRU* 10 (Concentration risk requirement) in accordance with *BIPRU* 8.9 (Consolidated concentration risk requirements). Accordingly the *firm* must apply *BIPRU* 8.9 to the group made up of the *firm* and the *subsidiary undertakings* referred to in *BIPRU* 2.1.7R in the same way as *BIPRU* 8.9 applies to a *UK consolidation group* or *non-EEA sub-group*.
- 2.1.17 G One effect of *BIPRU* 2.1.16R is that *BIPRU* 10.8 (UK integrated groups) and *BIPRU* 10.9 (Wider integrated groups) do not apply. The corresponding provisions of *BIPRU* 8.9 (Consolidated concentration risk requirements) apply instead.

2.1.18 R A *firm* must include in full any *subsidiary undertaking* in respect of which the *firm* applies *BIPRU 2.1* in the calculations under *BIPRU 2.1.7R*.

Minimum standards

2.1.19 R A *firm* must not apply *BIPRU 2.1* to a *subsidiary undertaking* to which the *firm's solo consolidation waiver* applies *BIPRU 2.1* unless in addition it meets the conditions in *BIPRU 2.1.20R* to *BIPRU 2.1.24R*.

2.1.20 R The risk evaluation, measurement and control procedures of the *firm* must cover the *subsidiary undertaking* referred to in *BIPRU 2.1.19R*.

2.1.21 R The *firm* must hold more than 75% of the voting rights attaching to the *shares* in the capital of the *subsidiary undertaking* referred to in *BIPRU 2.1.19R* and must have the right to appoint or remove a majority of the members of the *governing body* of the *subsidiary undertaking*.

2.1.22 R The material *exposures* or material liabilities of the *subsidiary undertaking* referred to in *BIPRU 2.1.19R* must be to the *firm*.

2.1.23 R Where the *firm* is a *parent institution in a Member State*, it must have measures in place that ensure the satisfactory allocation of risks within the group consisting of the *firm* and each *subsidiary undertaking* to which *BIPRU 2.1* is applied.

2.1.24 R A *firm* must be able to demonstrate fully to the *FSA* the circumstances and arrangements, including legal arrangements, by virtue of which there are no material practical or legal impediments, and none are foreseen, to the prompt transfer of the *capital resources* of the *subsidiary undertaking* referred to in *BIPRU 2.1.19R* or repayment of liabilities when due by the *subsidiary undertaking* to the *firm*.

2.1.25 G The following are the criteria that the *FSA* will take into account when considering whether the condition in *BIPRU 2.1.24R* is going to be met:

- (1) the speed with which funds can be transferred or liabilities repaid to the *firm* and the simplicity of the method for the transfer or repayment;
- (2) whether there are any interests other than those of the *firm* in the *subsidiary undertaking* and what impact those other interests may have on the *firm's* control over the *subsidiary undertaking* and on the ability of the *firm* to require a transfer of funds or repayment of liabilities;
- (3) whether the prompt transfer of funds or repayment of liabilities to the *firm* might harm the reputation of the *firm* or its *subsidiary undertakings*;

- (4) whether there are any tax disadvantages for the *firm* or the *subsidiary undertaking* as a result of the transfer of funds or repayment of liabilities;
- (5) whether there are any exchange controls that may have an impact on the transfer of funds or repayment of liabilities;
- (6) whether there are assets in the *subsidiary undertaking* available either to be transferred or liquidated for the purposes of the transfer of funds or repayment of liabilities;
- (7) whether any regulatory requirements impact on the ability of the *subsidiary undertaking* to transfer funds or repay liabilities promptly;
- (8) whether the purpose of the *subsidiary undertaking* prejudices the prompt transfer of funds or repayment of liabilities;
- (9) whether the legal structure of the *subsidiary undertaking* prejudices the prompt transfer of funds or repayment of liabilities;
- (10) whether the contractual relationships of the *subsidiary undertaking* with the *firm* and other third parties prejudices the prompt transfer of funds or repayment of liabilities;
- (11) whether past and proposed flows of funds between the *subsidiary undertaking* and the *firm* demonstrate the ability to make prompt transfer of funds or repayment of liabilities; and
- (12) whether the degree of solo consolidation by the *firm* undermines the *FSA's* ability to assess the soundness of the *firm* as a legal entity (taking into account any other *subsidiary undertakings* to which *BIPRU 2.1* is being applied).

- 2.1.26 G The effect of *BIPRU 2.1.19R* is that even though a *firm's solo consolidation waiver* applies *BIPRU 2.1* with respect to a *subsidiary undertaking*, the *firm* should not apply *BIPRU 2.1* with respect to that *subsidiary undertaking* unless in addition it meets the conditions in *BIPRU 2.1.20R* to *BIPRU 2.1.24R*.
- 2.1.27 G A *firm* should not apply *BIPRU 2.1* to a *subsidiary undertaking* to which the *firm's solo consolidation waiver* applies if it ceases to be a *subsidiary undertaking* of the *firm* even if the *solo consolidation waiver* is not varied by removing the *subsidiary undertaking*.
- 2.1.28 G If a *subsidiary undertaking* referred to in *BIPRU 2.1.27G* later becomes a *subsidiary undertaking* again the *firm* should not apply *BIPRU 2.1* to it unless the *solo consolidation waiver* is varied to re-apply it with respect to the *subsidiary undertaking*.

2.2 Internal capital adequacy standards

Application

2.2.1 G *BIPRU 2.2* applies to a *BIPRU firm*.

Purpose

- 2.2.2 G (1) *BIPRU 2.2* sets out *guidance* on *GENPRU 1.2* (Adequacy of financial resources) so far as it applies to a *BIPRU firm*. In particular it sets out *guidance* on how a *firm* should carry out its *ICAAP*, as well as some factors the *FSA* will take into consideration when undertaking a *SREP*. The terms *ICAAP* and *SREP* are explained in *BIPRU 2.2.4G*. *BIPRU 2.2.41R - BIPRU 2.2.43R* are *rules* that apply to a *firm* with an *IRB permission*.
- (2) *BIPRU 2.2* is for the most part written on the basis that *GENPRU 1.2* (Adequacy of financial resources) applies to a *firm* on a solo basis. However it is still relevant when *GENPRU 1.2* applies on a consolidated basis. When *GENPRU 1.2* applies on a consolidated basis, *BIPRU 2.2* should be read with appropriate adjustments.

Meaning of capital

2.2.3 G For the purpose of *BIPRU 2.2*, “capital” refers to a *firm’s* financial resources, *capital resources* and internal capital, all as referred to in the *overall Pillar 2 rule*.

The ICAAP and the SREP: Introduction

- 2.2.4 G The adequacy of a *firm’s* capital needs to be assessed both by a *firm* and the *FSA*. This process involves:
- (1) an *internal capital adequacy assessment process (ICAAP)*, which a *firm* is obliged to carry out in accordance with the *ICAAP rules*; and
 - (2) a *supervisory review and evaluation process (SREP)*, which is conducted by the *FSA*.

The ICAAP and the SREP: The ICAAP

- 2.2.5 G The obligation to conduct an *ICAAP*, includes requirements on a *firm* to:
- (1) carry out regularly assessments of the amounts, types and distribution of financial resources, *capital resources* and internal capital that it considers adequate to cover the nature and level of the risks to which it is or might be exposed (*GENPRU 1.2.30R* to *GENPRU 1.2.41G* (the *overall Pillar 2 rule* and related *rules*);
 - (2) identify the major sources of risk to its ability to meet its liabilities as they fall due (the *overall Pillar 2 rule*);

- (3) conduct stress and scenario tests (the *general stress and scenario testing rule*), taking into account, in the case of a *firm* with an *IRB permission*, the stress test required by *BIPRU 4.3.39R* to *BIPRU 4.3.40R* (Stress tests used in assessment of capital adequacy for a *firm* with an *IRB permission*);
 - (4) ensure that the processes, strategies and systems required by the *overall Pillar 2 rule* and used in its *ICAAP*, are both comprehensive and proportionate to the nature, scale and complexity of that *firm's* activities (*GENPRU 1.2.35R*); and
 - (5) document its *ICAAP* (*GENPRU 1.2.60R*).
- 2.2.6 G Where a *firm* is a member of a group, it should base its *ICAAP* on the consolidated financial position of the group. The group assessment should include information on diversification benefits and transferability of resources between members of the group and an apportionment of the capital required by the group as a whole to the *firm* (*GENPRU 1.2.44G* to *GENPRU 1.2.56G* (Application of *GENPRU 1.2* on a solo and consolidated basis: Processes and tests)). A *firm* may, instead of preparing the *ICAAP* itself, adopt as its *ICAAP* an assessment prepared by other group members.
- 2.2.7 G A *firm* should ensure that its *ICAAP* is:
- (1) the responsibility of the *firm's governing body*;
 - (2) reported to the *firm's governing body*; and
 - (3) forms an integral part of the *firm's* management process and decision-making culture.

The ICAAP and the SREP: The SREP

- 2.2.8 G The *FSA* will review an *ICAAP* and, if the *firm* has an *IRB permission*, the result of the *firm's* stress test carried out under *BIPRU 4.3.39R* to *BIPRU 4.3.40R* (Stress tests used in assessment of capital adequacy for a *firm* with an *IRB permission*), as part of its *SREP*. Provided that the *FSA* is satisfied with the appropriateness of a *firm's* capital assessment, the *FSA* will take into account that *firm's ICAAP* and stress test in its *SREP*. More material on stress tests for a *firm* with an *IRB permission* can be found in *BIPRU 2.2.41R* to *BIPRU 2.2.45G*.
- 2.2.9 G The *SREP* is a process under which the *FSA*:
- (1) reviews the arrangements, strategies, processes and mechanisms implemented by a *firm* to comply with *GENPRU*, *BIPRU* and *SYSC* and with requirements imposed by or under the *regulatory system* and evaluates the risks to which the *firm* is or might be exposed;
 - (2) determines whether the arrangements, strategies, processes and mechanisms implemented by the *firm* and the capital held by the *firm* ensures a sound management and coverage of the risks in (1); and

- (3) (if necessary) requires the *firm* to take the necessary actions or steps at an early stage to address any failure to meet the requirements referred to in (1).
- 2.2.10 G As part of its *SREP*, the *FSA* may ask a *firm* to provide it with the results of that *firm's ICAAP*, together with an explanation of the process used. Where appropriate, the *FSA* will ask for additional information on the *ICAAP*.
- 2.2.11 G As part of its *SREP*, the *FSA* will consider whether the amount of capital which a *firm* should hold to meet its *CRR* in *GENPRU 2.1* (Calculation of capital resources requirements) is sufficient for that *firm* to comply with the *overall financial adequacy rule*. Where the amount of capital which the *FSA* considers a *firm* should hold is not the same as that which results from a *firm's ICAAP*, the *FSA* expects to discuss any such difference with that *firm*. Where necessary, the *FSA* may consider the use of its powers under section 166 of the *Act* (reports by skilled persons) to assist in such circumstances.
- 2.2.12 G After completing a review as part of the *SREP*, the *FSA* will normally give that *firm* individual guidance (*individual capital guidance*), advising it of the amount of capital which it should hold to meet the *overall financial adequacy rule*.
- 2.2.13 G If a *firm* considers that *ICG* given to it is inappropriate to its circumstances it should, consistent with *Principle 11* (relations with regulators), inform the *FSA* that it disagrees with that *guidance*. The *FSA* may reissue *individual capital guidance* if after discussion with the *firm* the *FSA* concludes that the amount of capital that the *firm* should hold to meet the *overall financial adequacy rule* is different from the amount initially suggested by the *FSA*.
- 2.2.14 G The *FSA* will not give *individual capital guidance* to the effect that the amount of capital advised in that *guidance* is lower than the amount of capital which a *firm* should hold to meet its *CRR*.
- 2.2.15 G If, after discussion, the *FSA* and a *firm* still do not agree on an adequate level of capital, the *FSA* may consider using its powers under section 45 of the *Act* to vary on its own initiative a *firm's Part IV permission* so as to require it to hold capital in accordance with the *FSA's* view of the capital necessary to comply with the *overall financial adequacy rule*. *SUP 7* provides further information about the *FSA's* powers under section 45.

The drafting of individual capital guidance

- 2.2.16 G If the *FSA* gives *individual capital guidance* to a *firm*, the *FSA* will state what amount and quality of capital the *FSA* considers the *firm* needs to hold in order to comply with the *overall financial adequacy rule*. It will generally do so by saying that the *firm* should hold *capital resources* of an amount at least equal to a specified percentage of that *firm's capital resources requirement*.
- 2.2.17 G (1) *Individual capital guidance* may refer to two types of *capital resources*.
- (2) The first type is referred to as general capital. It refers to total *tier one capital resources* and *tier two capital resources* after deductions.

- (3) The second type is referred to as total capital. It refers to total *tier one capital resources*, *tier two capital resources* and *tier three capital resources* after deductions.
- 2.2.18 G (1) In both of the cases in *BIPRU 2.2.17G capital resources* should be calculated in the same way as they are in *GENPRU 2.2 (Capital resources)*. This includes the *rules* limiting the amount of capital that can be included in the various tiers of capital when *capital resources* are being calculated.
- (2) *GENPRU 2.2.42R* does not allow *innovative tier one capital* to count as *tier one capital resources* for certain purposes. This restriction does not apply for the purposes in *BIPRU 2.2.17G*.
- 2.2.19 G (1) *Individual capital guidance* may also be given with respect to group capital resources. This paragraph explains how such *guidance* should be interpreted unless the *individual capital guidance* specifies another interpretation.
- (2) If *BIPRU 8.2.1R (General consolidation rule for a UK consolidation group)* applies to the *firm* the *guidance* relates to its *UK consolidation group*. If *BIPRU 8.3.1R (General consolidation rule for a non-EEA sub-group)* applies to the *firm* the *guidance* relates to its *non-EEA sub-group*. If both apply to the *firm* the *guidance* relates to its *UK consolidation group* and to its *non-EEA sub-group*.
- (3) The *guidance* will be on the *overall financial adequacy rule* as it applies on a consolidated basis under *GENPRU 1.2.59R (Application of GENPRU 1.2 on a solo and consolidated basis: Adequacy of resources)* and insofar as it refers to capital resources.
- (4) *BIPRU 2.2.16G* to *BIPRU 2.2.18G* apply for the purpose of this paragraph as they apply to *guidance* given on a solo basis. References to *capital resources* should be read as being to *consolidated capital resources*.

Failure to meet individual capital guidance

- 2.2.20 G A *firm's* continuing to hold capital in accordance with its *individual capital guidance* and its ability to carry on doing so is a fundamental part of the *FSA's* supervision of that *firm*. Therefore if a *firm's capital resources* have fallen, or are expected to fall, below the level advised in *individual capital guidance*, then, consistent with *Principle 11 (Relations with regulators)*, a *firm* should inform the *FSA* of this fact as soon as practicable, explaining why this has happened or is expected to happen and:
- (1) what action the *firm* intends to take to increase its capital resources or to reduce its risks and hence its capital requirements; or
- (2) what modification the *firm* considers should be made to the *individual capital guidance* which it has been given.

- 2.2.21 G In the circumstance set out in *BIPRU 2.2.20G*, the *FSA* may ask a *firm* for alternative or more detailed proposals and plans or further assessments and analyses of capital adequacy and risks faced by the *firm*. The *FSA* will seek to agree with the *firm* appropriate timescales and scope for any such additional work, in light of the circumstances which have arisen.
- 2.2.22 G If a *firm* has not accepted *individual capital guidance* given by the *FSA* it should, nevertheless, inform the *FSA* as soon as practicable if its capital resources have fallen, or are expected to fall, below the level suggested by that *individual capital guidance*.
- 2.2.23 G *BIPRU 2.2.20G - BIPRU 2.2.22G* also apply to *individual capital guidance* given on a consolidated basis as referred to in *BIPRU 2.2.19G*.

Proportionality of an ICAAP

- 2.2.24 G *BIPRU 2.2.25G to 2.2.27G* set out what the *FSA* considers to be a proportional approach to preparing an *ICAAP* as referred to in *GENPRU 1.2.35R* (The processes, strategies and systems required by the *overall Pillar 2 rule* should be comprehensive and proportionate), according to the relative degree of complexity of a *firm's* activities. If a *firm* adopts the appropriate approach, it may enable the *FSA* more easily to review a *firm's ICAAP* when the *FSA* undertakes its *SREP*. The *FSA* is also likely to place more reliance on an *ICAAP* which takes the appropriate form described in *BIPRU 2.2.25G to 2.2.27G* than would otherwise be the case although there may also be circumstances in which the *FSA* will be able to rely on an *ICAAP* that is not drawn up in that form.
- 2.2.25 G (1) This paragraph applies to a *firm* whose activities are simple.
- (2) In carrying out its *ICAAP* it could:
- (a) identify and consider that *firm's* largest losses over the last 3 to 5 years and whether those losses are likely to recur;
 - (b) prepare a short list of the most significant risks to which that *firm* is exposed;
 - (c) consider how that *firm* would act, and the amount of capital that would be absorbed, in the event that each of the risks identified were to materialise;
 - (d) consider how that *firm's CRR* might alter under the scenarios in (c) and how its *CRR* might alter in line with its business plans for the next 3 to 5 years;
 - (e) consider whether any of the risks in the *overall Pillar 2 rule* is applicable to the *firm* (it is unlikely that any of those risks not already identified in (a) or (b) will apply to a *firm* whose activities are simple);

- (f) document the ranges of capital required in the scenarios identified and form an overall view on the amount and quality of capital which that *firm* should hold, ensuring that its senior management is involved in arriving at that view; and
 - (g) (in order to determine the amount of capital that would be absorbed in the circumstances detailed in (c)) carry out simple sensitivity tests where the *firm* analyses the impact of a shift in the key risk parameters identified in (b) on the earnings of the *firm*.
- (3) A *firm* is also expected to form a view on the consolidated amount of capital it should hold as well as the capital required to be held in respect of each of the individual risks identified under the *overall Pillar 2 rule*. For that purpose, it may conservatively sum the results of the individual tests performed in (2)(c). If the *firm* chooses however to reduce that sum on the understanding that not all risks will materialise at the same time, then the *firm* should perform scenario tests that demonstrate that a reduction in capital is legitimate.
- (4) A *firm* should consider the impact of an economic or industry downturn on its future earnings taking into account its business plans.

2.2.26 G In relation to a *firm* whose activities are moderately complex, in carrying out its *ICAAP BIPRU 2.2.25G*(3) to (4) apply. In addition, it could:

- (1) having consulted the management in each major business line, prepare a comprehensive list of the major risks to which the business is exposed;
- (2) estimate, with the aid of historical data, where available, the range and distribution of possible losses which might arise from each of those risks and consider using shock stress tests to provide risk estimates;
- (3) consider the extent to which that *firm*'s *CRR* adequately captures the risks identified in (1) and (2);
- (4) for areas in which the *CRR* is either inadequate or does not address a risk, estimate the additional capital (if any) needed to protect that *firm* and its *customers*, in addition to any other risk mitigation action that *firm* plans to take;
- (5) consider the risk that that *firm*'s own analyses of capital adequacy may be inaccurate and that it may suffer from management weaknesses, which affect the effectiveness of its risk management and mitigation;
- (6) project that *firm*'s business activities forward in detail for one year and in less detail for the next 3 to 5 years and estimate how that *firm*'s capital and *CRR* would alter, assuming that business develops as expected;

- (7) assume that business does not develop as expected and consider how that *firm's* capital and *CRR* would alter and what that *firm's* reaction to a range of adverse economic scenarios might be (see *GENPRU 1.2.30R* to *GENPRU 1.2.43G* (the *overall Pillar 2 rule* and related rules);
- (8) document the results obtained from the analyses in (2), (4), (6), and (7) in a detailed report for that *firm's* senior management, and, where relevant, its *governing body*; and
- (9) ensure that systems and processes are in place to review against performance the accuracy of the estimates made in (2), (4), (6) and (7).

2.2.27

- G (1) This paragraph applies to a proportional *ICAAP* in the case of a *firm* whose activities are complex.
- (2) A proportional approach to that *firm's ICAAP* should cover the matters identified in *BIPRU 2.2.26G*, but is likely also to involve the use of models, most of which will be integrated into its day-to-day management and operation.
- (3) Models of the sort referred to in (2) may be linked so as to generate an overall estimate of the amount of capital that a *firm* considers appropriate to hold for its business needs. For example, a *firm* is likely to use value at risk models for *market risk* (see *BIPRU 7.10*), advanced modelling approaches for credit risk (see *BIPRU 4*) and, possibly, *advanced measurement approaches* for *operational risk* (see *BIPRU 6.5*). A *firm* might also use economic scenario generators to model stochastically its business forecasts and risks. A *firm* may also link such models to generate information on the economic capital desirable for that *firm*. A model which a *firm* uses to generate its target amount of economic capital is known as an economic capital model (ECM). Economic capital is the target amount of capital which maximises the return for a *firm's* stakeholders for a desired level of risk.
- (4) A *firm* is also likely to be part of a *group* and to be operating internationally. There is likely to be centralised control over the models used throughout the *group*, the assumptions made and their overall calibration.

- (5) The more a *firm* integrates into its business such economic capital modelling, the more it is likely to focus on managing risks for the benefit of its stakeholders. Consequently, ECMs may produce capital estimates that differ from the amount of capital needed for regulatory purposes. For the *FSA* to rely on the results of a *firm*'s models, including ECMs, a *firm* should be able to explain the basis and results of its models and how the amount of capital produced by its models reflects the amount of capital needed for regulatory purposes. It may be that those amounts are not equal. Where they are not equal, the *FSA* will expect a *firm* to discuss any differences with the *FSA*. However, it may prove difficult to reconcile the outcome of a *firm*'s modelling with the *FSA*'s own assessment of the adequacy of that *firm*'s capital. This may be the case when, for instance, matters of judgment are involved in arriving at a *firm*'s capital assessment, or the *FSA* relies on information which cannot be fully disclosed to the *firm* (for example comparisons with the *firm*'s peers). Nevertheless, a *firm* whose ECM produces a different amount of capital to that required for regulatory purposes is still obliged to comply with the *overall Pillar 2 rule*. A *firm* should therefore be able to explain to the *FSA* how the outcome of its ECM is adjusted so that it complies with the *overall financial adequacy rule* and the *overall Pillar 2 rule*.
- (6) Stress testing should provide senior management with a consolidated view of the amount of risk the *firm* is or might be exposed to under the chosen stress events. Senior management should therefore be presented with information that considers the possibility of the risks materialising simultaneously in various proportions. For instance, it would be misrepresentative to simulate *market risk* stressed events without considering that, in those circumstances, market *counterparties* may be more likely to default. Accordingly, a *firm* could:
- (a) carry out combined stress tests where assets and liabilities are individually subjected to simultaneous changes in two or more risk drivers; for instance, the change in value of each loan made by a *firm* may be estimated using simultaneous changes to both interest rates and stock market or property values;
 - (b) integrate the results of market and credit risk models rather than aggregating the results of each model separately; and
 - (c) consider scenarios which include systemic effects on the *firm* of wider failures in the *firm*'s market or systems upon which the *firm* depends and also any possible systemic effects caused by the *firm* itself suffering losses which affect other market participants which in turn exacerbate the *firm*'s position.
- (7) Furthermore, if a complex *firm* uses an ECM it should validate the assumptions of the model through a comprehensive stress testing programme. In particular this validation should:

- (a) test correlation assumptions (where risks are aggregated in this way) using combined stresses and scenario analyses;
- (b) use stress tests to identify the extent to which the *firm's* risk models omit non-linear effects, for instance the behaviour of derivatives in market risk models; and
- (c) consider not just the effect of parallel shifts in interest rate curves, but also the effect of curves becoming steeper or flatter.

Guidance on risks to be covered in an ICAAP

- 2.2.28 G *BIPRU 2.2.30G to BIPRU 2.2.40G set out guidance on some of the sources of risk identified in the overall Pillar 2 rule. BIPRU 2.2.41R to 2.2.45G have material relating to a firm with an IRB permission.*
- 2.2.29 G (1) *A firm may take into account factors other than those identified in the overall Pillar 2 rule when it assesses the level of capital it wishes to hold. These factors might include external rating goals, market reputation and its strategic goals. However, a firm should be able to distinguish, for the purpose of its dialogue with the FSA, between capital it holds in order to comply with the overall financial adequacy rule and to meet the risks set out in the overall Pillar 2 rule and that held for other purposes.*
- (2) *The calibration of the CRR assumes that a firm's business is well-diversified, well-managed with assets matching its liabilities and good controls, and stable with no large, unusual or high risk transactions. A firm may find it helpful to assess the extent to which its business in fact differs from these assumptions and therefore what adjustments it might be reasonable for it to make to the CRR to arrive at an adequate level of capital resources.*

Interest rate risk arising from non-trading book activities

- 2.2.30 G *A firm should assess its exposure to changes in interest rates, in particular risks arising from the effect of interest rate changes on non-trading book activities that are not captured by the CRR. In doing so, a firm may wish to use stress tests to determine the impact on its balance sheet of a change in market conditions.*

Securitisation risk

- 2.2.31 G *A firm should assess its exposure to risks transferred through the securitisation of assets should those transfers fail for whatever reason. A firm should consider the effect on its financial position of a securitisation arrangement failing to operate as anticipated or of the values and risks transferred not emerging as expected.*

Residual risk

- 2.2.32 G A *firm* should assess its exposure to residual risks that may result from the partial performance or failure of *credit risk mitigation* techniques for reasons that are unconnected with their intrinsic value. This could result from, for instance, ineffective documentation, a delay in payment or the inability to realise payment from a guarantor in a timely manner. Given that residual risks can always be present, a *firm* should assess the appropriateness of its *CRR* against its assumptions which underlie any risk mitigation measures it may have in place.

Concentration risk

- 2.2.33 G A *firm* should assess, and monitor, in detail its exposure to sectoral, geographic, liability and asset concentrations. The *FSA* considers that concentrations in these areas increase a *firm's* exposure to credit risk. Where a *firm* identifies such concentrations it should consider the adequacy of its *CRR*.

Liquidity risk

- 2.2.34 G In accordance with the *overall Pillar 2 rule* a *firm* should consider its exposure to *liquidity risk* and assess its response should that risk materialise.
- 2.2.35 G When assessing *liquidity risk*, a *firm* should consider the extent to which there is a mismatch between assets and liabilities.
- 2.2.36 G A *firm* should also, when assessing *liquidity risk*, consider the amount of assets it holds in highly liquid, marketable forms that are available should unexpected cash flows lead to a liquidity problem. The price concession of liquidating assets is of prime concern when assessing such *liquidity risk* and should therefore be built into a *firm's ICAAP*.
- 2.2.37 G Some further areas to consider in developing the *liquidity risk* scenario might include:
- (1) any mismatching between expected asset and liability cash flows;
 - (2) the inability to sell assets quickly;
 - (3) the extent to which a *firm's* assets have been pledged; and
 - (4) the possible need to reduce large asset positions at different levels of market liquidity and the related potential costs and timing constraints.

Business risk: General

- 2.2.38 G A *firm's CRR*, being risk-sensitive, may vary as business cycles and economic conditions fluctuate over time. A deterioration in business or economic conditions could require a *firm* to raise capital or, alternatively, to contract its businesses, at a time when market conditions are most unfavourable to raising capital. Such an effect is known as procyclicality.

- 2.2.39 G To reduce the impact of cyclical effects, a *firm* should aim to maintain an adequate capital buffer during an upturn in business and economic cycles such that it has sufficient capital available to protect itself in unfavourable market conditions.
- 2.2.40 G To assess its expected capital requirements over the economic and business cycles, a *firm* may wish to project forward its financial position taking account of its business strategy and expected growth according to a range of assumptions as to the state of the economic or business environment which it faces. For example, an *ICAAP* should include an analysis of the impact that the actions of a *firm's* competitors might have on its performance, in order to see what changes in its environment the *firm* could sustain. Projections over a three to five year period would be appropriate in most circumstances. A *firm* may then calculate its projected *CRR* and assess whether it could be met from expected financial resources.

Business risk: Stress tests for firms using the IRB approach

- 2.2.41 R A *firm* with an *IRB permission* must ensure that there is no significant risk that it will not be able to meet its capital resource requirements for credit risk under *GENPRU 2.1* (Calculation of capital resources requirements) at all times throughout an economic cycle, including the capital resources requirements for credit risk indicated by any stress test carried out under *BIPRU 4.3.39R* to *BIPRU 4.3.40R* (Stress tests used in assessment of capital adequacy for a *firm* with an *IRB permission*) as being likely to apply in the scenario tested. For the purpose of deciding what *capital resources* are or will be available to meet those credit risk requirements from time to time a *firm* must exclude *capital resources* that are likely to be required to meet its other capital requirements under *GENPRU 2.1* at the relevant time. A *firm* must also be able to demonstrate to the *FSA* at any time that it is complying with this *rule*.
- 2.2.42 R *BIPRU 2.2.41R* applies to a *firm* on a solo basis if *BIPRU 4* (IRB approach) applies to it on a solo basis and applies on a consolidated basis if *BIPRU 4* does.
- 2.2.43 R If *BIPRU 2.2.41R* applies to a *firm* on a consolidated basis the following adjustments are made to *BIPRU 2.2.41R* in accordance with the general principles of *BIPRU 8* (Group risk – consolidation):
- (1) references to *capital resources* are to the *consolidated capital resources* of the *firm's UK consolidation group* or, as the case may be, its *non-EEA sub-group*; and
 - (2) references to the capital requirements in *GENPRU 2.1* (Calculation of capital resources requirements) are to the consolidated capital requirements with respect to the *firm's UK consolidation group* or, as the case may be, its *non-EEA sub-group* under *BIPRU 8* (Group risk - consolidation).

- 2.2.44 G If a *firm's* current available *capital resources* are less than the capital resources requirement indicated by the stress test that need not be a breach of *BIPRU 2.2.41R*. The *firm* may wish to set out any countervailing effects and off-setting actions that can be demonstrated to the satisfaction of the *FSA* as being likely to reduce the difference referred to in the first sentence. The *FSA* is only likely to consider a demonstration of such actions as credible if those actions are set out in a capital management plan based on the procedures in *GENPRU 1.2.73G* (Stress tests and scenario analyses throughout an economic or business cycle) and including a plan of the type referred to in *GENPRU 1.2.73G(4)* that has been approved by the *firm's* senior management or *governing body*.
- 2.2.45 G The countervailing factors and off-setting actions that a *firm* may rely on as referred to in *BIPRU 2.2.44G* include, but are not limited to, projected balance sheet shrinkage, growth in *capital resources* resulting from retained profits between the date of the stress test and the projected start of the economic downturn, the possibility of raising new capital in a downturn, the ability to reduce dividend payments or other distributions, and the ability to allocate capital from other risks which can be shown to be negatively correlated with the *firm's* credit risk profile.

Systems and controls

- 2.2.46 G A *firm* may decide to hold additional capital to mitigate any weaknesses in its overall control environment. These weaknesses might be indicated by the following:
- (1) a failure by a *firm* to complete an assessment of its systems and controls to establish whether they comply with *SYSC*; or
 - (2) a failure by a *firm's* senior management to approve its financial results; or
 - (3) a failure by a *firm* to consider an analysis of relevant internal and external information on its business and control environment.
- 2.2.47 G In considering if there are any systems and control weaknesses and their effect on the adequacy of the *CRR*, a *firm* should be able to demonstrate to the *FSA* that all the issues identified in *SYSC 3.2* (Areas covered by systems and controls) have been considered and that appropriate plans and procedures exist to deal adequately with adverse scenarios.

Risks which may be considered according to the nature of the activities of a firm

- 2.2.48 G (1) *BIPRU 2.2.49G* to *BIPRU 2.2.70G* set out *guidance* for:
- (a) a *bank* or *building society*;
 - (b) an asset management *firm*; and
 - (c) a securities *firm*;
- whose activities are either simple or moderately complex.

- (2) *BIPRU 2.2.49G to BIPRU 2.2.70G* provide examples of the sorts of risks which such a *firm* might typically face and of stress tests or scenario analyses which it might carry out as part of its *ICAAP*.
- (3) The material on securities *firms* is also relevant to a *commodities firm*.

Banks and building societies

- 2.2.49 G The *FSA* considers that the concentration risk resulting from concentrated portfolios is significant for most *banks* and *building societies*.
- 2.2.50 G If a *bank* or *building society* chooses to use the *CRR* as a starting point for its capital assessment, it should remember that, when assessing its exposure to concentration risk, the calculation of the *CRR* is based on the assumption that a *firm* is well-diversified.
- 2.2.51 G In assessing the degree of credit concentration, a *bank* or *building society* should consider its degree of credit concentration in a particular economic or geographic area. Where the business of a *firm* is, by its nature, concentrated (for example, a specialised *firm* lending to one sector only), a *firm* should consider the impact of adverse economic factors, such as a rise in unemployment in the area in which it has a concentration of *exposures*, and its impact on asset quality. A gradual change of cultural environment could also affect a *bank* or *building society* and a *firm* should consider whether this issue should be the subject of scenario analysis.
- 2.2.52 G Typically, a *building society's* portfolio is concentrated. The extent to which a *building society* can diversify its business is limited. A *building society* should, nevertheless, consider the impact of geographic concentrations on its capital by, for instance, analysing the effect of local economic factors such as unemployment and its impact on arrears, house prices and loan-to-value ratios.
- 2.2.53 G Similarly, a *building society* should consider the concentration in its portfolio of certain product types that have, inherently, a more than average risk (for example, lifetime mortgages). It should, through scenario analyses in relation to its portfolio, assess the potential impact on its profitability and capital of those scenarios.
- 2.2.54 G In relation to the *BIPRU 10* (Concentration risk), a *bank* or *building society* should take into account factors such as future business growth and cyclicity when it assesses the amount of capital which it will need to remain in compliance with those *rules*. A *firm* may also consider in its assessment whether any *large exposures* that it has identified are positively correlated.
- 2.2.55 G Where a *bank* or *building society* lends to a *counterparty* which it assesses as representing a high credit risk, it should assess whether compliance with the *rules* in *BIPRU* in relation to credit risk is sufficient for it to manage that risk prudently.

- 2.2.56 G The performance of specialised portfolios may, in some instances, depend on key individuals. This factor exacerbates concentration risk because the skill of those individuals in part limits the risk arising from a concentrated portfolio. The impact of those individuals is likely to be correspondingly greater in small *firms*. In developing its stress tests and scenario analyses, a *bank* or *building society* should therefore consider the impact of losing key individuals on its ability to operate normally, as well as the direct impact on its revenues.
- 2.2.57 G A *bank* or *building society* should assess the sensitivity of its financial position to adverse movements in interest rates. For instance, a *bank* or *building society* should assess its sensitivity to interest rate risk arising from interest rate mismatches between assets and liabilities. A *building society* is exposed to interest rate risk to the extent that it borrows on a short term basis but lends over a longer period.
- 2.2.58 G When assessing the adequacy of its capital, a *bank* or *building society* should not only consider the vulnerability of its revenue, but also the sensitivity of its funding and, in particular, its ability to raise additional funding in time of economic stress. A *bank* or *building society* should therefore consider whether its funding pool is sufficiently diversified. For example, where a *bank* is reliant solely on its parent to provide funding, its access to funds may be suddenly restricted should the parent's creditworthiness be downgraded. Similarly, a *bank* or *building society* may consider the impact of an increase in bond rates or a rating downgrade, if relevant, on its capital cost and its subsequent ability to raise capital.
- 2.2.59 G A *bank* or *building society* should assess the impact of its business plans on its capital over the time horizon which it uses in its business plans. A *bank* or *building society* should assess the impact on its capital of diversifying its activities and the risk it runs of failing to manage that new business successfully. For that purpose, it may consider the cost of a price war to enter a new competitive market or the risk of mis-pricing some products as a result of not having sufficient expertise in its new area of business.
- 2.2.60 G A *bank* or *building society* is also exposed to reputational risk, as its ability to underwrite new business is heavily reliant on the standing of the reputation of the *firm*. A *bank* or *building society* may consider the impact on its financial position of legal disputes which damage its reputation.

An asset management firm

- 2.2.61 G An asset manager is primarily exposed to *operational risk* and reputational risk.
- 2.2.62 G When assessing reputational risk an asset manager should consider issues such as:
- (1) how poor performance can affect its ability to generate profits;
 - (2) the effect on its financial position should one or more of its key fund managers leave that *firm*;

- (3) the effect on its financial position should it lose some of its largest customers; and
 - (4) how poor customer services can affect its financial position; for example, a *firm* which has outsourced the management of customer accounts may want to consider the impact on its own reputation of the service provider failing to deliver the service.
- 2.2.63 G As an asset manager's mandates become more complex, the risk of it failing to comply fully with the terms of its contracts increases. In the event of such failure, a *firm* can be exposed to substantial losses resulting from *customers'* claims and legal actions. Although the *FSA* would expect an asset manager to have in place adequate controls to mitigate that risk, it may also like to consider the potential cost to it should *customers* claim that it has not adhered to mandates. Past claims and compensation may provide a useful benchmark for an asset manager to assess its sensitivity to future legal action. In assessing the adequacy of its capital, an asset manager may therefore consider whether it could absorb the highest operational loss it has suffered over the last 3 to 5 years.
- 2.2.64 G In relation to the issues identified in *BIPRU 2.2.63G*, an asset manager should consider, for example:
- (1) the direct cost to it resulting from fraud or theft;
 - (2) the direct cost arising from *customers'* claims and legal action in the future; an asset manager could consider the impact on its financial position if a legal precedent were to encourage its *customers* to take legal action against that *firm* for failing to advise correctly on a certain type of product; the relevance of such scenarios is likely to depend on whether the asset manager is acting on a discretionary basis or solely as advisor; and
 - (3) where it has obtained professional indemnity insurance, the deductibles and individual or aggregate limits on the sums insured.
- 2.2.65 G The *FSA* expects an asset manager to consider the impact of economic factors on its ability to meet its liabilities as they fall due. An asset manager should therefore develop scenarios which relate to its strategic and business plan. An asset manager might therefore consider:
- (1) the effect of a market downturn affecting both transaction volumes and the market values of assets in its funds; in assessing the impact of such a scenario, an asset manager may consider the extent to which it can remain profitable (for example, by rapidly scaling down its activities and reducing its costs);
 - (2) the impact on current levels of capital if it plans to undertake a significant restructuring; and

- (3) the impact on current levels of capital if it plans to enter a new market or launch a new product; it should assess the amount of capital it needs to hold, when operating for the first time in a market in which it lacks expertise.

A securities firm

- 2.2.66 G (1) A securities *firm* may consider the impact of the situations listed in (a) to (c) on its capital levels when assessing its exposure to concentration risk:
- (a) the potential loss that could arise from large exposures to a single *counterparty*;
 - (b) the potential loss that could arise from exposures to large transactions or to a product type; and
 - (c) the potential loss resulting from a combination of events such as a sudden increase in volatility leaving a hitherto fully-margined client unable to meet the margin calls due to the large size of the underlying *position* and the subsequent difficulties involved in liquidating its *position*.
- (2) An example of the analysis in (1)(b) relates to a securities *firm* which relies on the income generated by a large, one-off corporate finance transaction. It may want to consider the possibility of legal action arising from that transaction which prevents the payment of its fees. Additionally, an underwriting *firm* may, as a matter of routine, commit to place a large amount of securities. It may therefore like to assess the impact of losses arising from a failure to place the securities successfully.
- 2.2.67 G Where a securities *firm* deals in illiquid securities (for example, unlisted securities or securities listed on illiquid markets), or holds illiquid assets, potentially large losses can arise from trades that have failed to settle or because of large unrealised market losses. A securities *firm* may therefore consider the impact of *liquidity risk* on its exposure to:
- (1) credit risk; and
 - (2) *market risk*.
- 2.2.68 G Counterparty risk *rules* only partially capture the risk of settlement failure as the quantification of risk is only based on mark-to-market values and does not take account of the volatility of the securities over the settlement period. A securities *firm's* assessment of its exposure to counterparty risk should take into account:
- (1) whether it acts as arranger only or whether it also executes trades;
 - (2) the types of execution venues which it uses; for example, the London Stock Exchange or a retail service provider (RSP) have more depth than alternative trading systems (ATS); and

- (3) whether it offers extended settlements and free delivery compared to delivery versus payment business.
- 2.2.69 G (1) A securities *firm* should also consider the impact of external factors on the levels of capital it needs to hold. Scenarios covering such external factors should relate to its strategy and business plan. A securities *firm* might wish to consider the questions in (2) to (7).
- (2) Whether it plans to participate in a one-off transaction that might strain temporarily or permanently its capital.
- (3) Whether the unevenness of its revenue suggests that it should hold a capital buffer. Such an assessment could be based, for instance, on an analysis of past revenue and the volatility of its capital.
- (4) How its income might alter as interest rates fluctuate where it is obliged to pay interest to its clients in excess of interest it earns on client money deposits.
- (5) How its capital would be affected by a market downturn. For instance, how sensitive that *firm* is to a sharp reduction of trading volumes.
- (6) How political and economic factors will affect that *firm's* business. For instance, a *commodity firm* may wish to consider the impact of a sharp increase in prices on initial margins and, consequently, on its liquidity.
- (7) Whether it anticipates expanding its activities (for example, by offering clearing services), and if so, the impact on its capital.
- 2.2.70 G A securities *firm* may also want to assess the impact of its internal credit limits on its levels of capital. For instance, a *firm* whose internal procedures authorise dealing without cash in the account or without pre-set dealing limits might consider more capital is required than if it operated stricter internal credit limits.

Capital models

- 2.2.71 G A *firm* may approach its assessment of adequate capital by developing a model, including an ECM (see *BIPRU 2.2.27G*), for some or all of its business risks. The assumptions required to aggregate risks modelled and the confidence levels adopted should be considered by a *firm's* senior management. A *firm* should also consider whether any relevant risks, including systems and control risks, are not captured by the model.
- 2.2.72 G A *firm* should not expect the *FSA* to accept as adequate any particular model that it develops or automatically to reflect the results from the model in any *individual capital guidance*. However, the *FSA* will take into account the results of a sound and prudent model when giving *individual capital guidance* (see *GENPRU 1.2.19G* (Outline of provisions related to *GENPRU 2.1* (Adequacy of financial resources))).
- 2.2.73 G There is no prescribed approach as to how a *firm* should develop its internal capital model. However, a *firm* should be able to demonstrate:

- (1) the confidence levels set and whether these are linked to its corporate strategy;
 - (2) the time horizons set for the different types of business that it undertakes;
 - (3) the extent of historic data used and back-testing carried out;
 - (4) that it has in place a process to verify the correctness of the model's outputs; and
 - (5) that it has the skills and resources to operate, maintain and develop the model.
- 2.2.74 G In relation to the use of an ECM (see *BIPRU 2.2.27G*), the *FSA* is likely to place more reliance on a *firm's ICAAP* if the *firm* provides the following information:
- (1) a comparison of the amount of capital that the ECM generates in respect of each of the risks captured in the *CRR* before aggregation with the corresponding components of the *CRR* calculation; and
 - (2) evidence that the *guidance* in *BIPRU 2.2.71G* to *2.2.78G* has been followed.
- 2.2.75 G If a *firm* adopts a top-down approach to developing its internal model, it should be able to allocate the outcome of the internal model to risks it has previously identified in relation to each separate legal entity, business unit or business activity, as appropriate. In relation to a *firm* which is a member of a group, *GENPRU 1.2.53R* (Application of *GENPRU 1.2* on a solo and consolidated basis: Processes and tests) sets out how internal capital identified as necessary by that *firm's ICAAP* should be allocated.
- 2.2.76 G If a *firm's* internal model makes explicit or implicit assumptions in relation to correlations within or between risk types, or in relation to diversification benefits between business types, the *firm* should be able to explain to the *FSA*, with the support of empirical evidence, the basis of those assumptions.
- 2.2.77 G A *firm's* model should also reflect the past experience of both the *firm* and the sectors in which it operates.
- 2.2.78 G The values assigned to inputs into a *firm's* model should be derived either stochastically, by assuming the value of an item can follow an appropriate probability distribution and by selecting appropriate values at the tail of the distribution, or deterministically, using appropriate prudent assumptions. For options or guarantees which change in value significantly in certain economic or demographic circumstances, a stochastic approach would normally be appropriate.

2.3 Interest rate risk in the non-trading book

Application

2.3.1 R This section of the *Handbook* applies to a *BIPRU firm*.

- 2.3.2 G (1) Interest rate risk in the *non-trading book* will normally be a major source of risk for:
- (a) a *bank*;
 - (b) a *building society*; and
 - (c) a *BIPRU investment firm* that deals on own account (including underwriting on a *firm* commitment basis) and whose *non-trading book* business equals or exceeds 15% of its total business.
- (2) However it will not normally be a significant risk for any other *BIPRU investment firm*.
- (3) The test in (1)(c) should be carried out in the same way as it is for the purpose of the 5% test in *BIPRU 1.2.17R* (Definition of the trading book).
- (4) Where *BIPRU 2.3* is applied on a consolidated basis (see *BIPRU 2.3.13R*) the test in (1)(c) should be carried out in the same way as it is under *BIPRU 8.7.24R* (Trading book size for the purposes of consolidation).
- 2.3.3 G Interest rate risk in the *non-trading book* may arise from a number of sources for example:
- (1) risks related to the mismatch of repricing of assets and liabilities and off balance sheet short and long-term positions;
 - (2) risks arising from hedging exposure to one interest rate with exposure to a rate which reprices under slightly different conditions;
 - (3) risk related to the uncertainties of occurrence of transactions e.g. when expected future transactions do not equal the actual transactions; and
 - (4) risks arising from consumers redeeming fixed rate products when market rates change.

Purpose

2.3.4 G *BIPRU 2.3* sets out more detail on how the systems and controls requirements in *SYSC 3* (Systems and controls) and *GENPRU 1.2.30R* (Processes, strategies and systems for risks) and the requirements about stress and scenario testing in *GENPRU 1.2.36R* apply to interest rate risk in the *non-trading book*.

2.3.5 G *BIPRU 2.3* implements Article 124(5) of the *Banking Consolidation Directive*.

Proportionality

2.3.6 G The *guidance* on proportionality in *BIPRU 2.2* applies to *BIPRU 2.3*.

Stress testing for interest rate risk: General requirement

2.3.7 R (1) As part of its obligations under *GENPRU 1.2.30R* (Processes, strategies and systems for risks) and *GENPRU 1.2.36R* (Stress and scenario tests) a *firm* must carry out an evaluation of its exposure to the interest rate risk arising from its non-trading activities.

(2) The evaluation under (1) must cover the effect of a sudden and unexpected parallel change in interest rates of 200 basis points in both directions.

(3) A *firm* must immediately notify the *FSA* if any evaluation under this *rule* suggests that, as a result of the change in interest rates described in (2), the economic value of the *firm* would decline by more than 20% of its *capital resources*.

2.3.8 G A *firm* should, under *BIPRU 2.3.8R(2)*, apply a 200 basis point shock to each major currency exposure.

2.3.9 G For a larger and/or more complex *firm*, appropriate systems to evaluate and manage interest rate risk in the *non-trading book* may include:

(1) the ability to measure the exposure and sensitivity of the *firm's* activities, if material, to changes in the shape of the yield curve, changes between different market rates (i.e. basis risk) and changes to assumptions (for example those about customer behaviour);

(2) consideration as to whether a purely static analysis of the impact on their current portfolio of a given shock or shocks should be supplemented by a more dynamic simulation approach; and

(3) scenarios in which different interest rate paths are computed and in which some of the assumptions (e.g. about behaviour, contribution to risk and balance sheet size and composition) are themselves functions of interest rate level.

- 2.3.10 G Under *GENPRU* 1.2.60R, a *firm* is required to make a written record of its assessments made under *GENPRU* 1.2. A *firm's* record of its approach to evaluating and managing interest rate risk as it affects the *firm's* non-trading activities should cover the following issues:
- (1) the internal definition of and boundary between “banking book” and “trading activities” (see *BIPRU* 1.2);
 - (2) the definition of economic value and its consistency with the method used to value assets and liabilities (e.g. discounted cashflows);
 - (3) the size and the form of the different shocks to be used for internal calculations;
 - (4) the use of a dynamic and / or static approach in the application of interest rate shocks;
 - (5) the treatment of commonly called “pipeline transactions” (including any related hedging);
 - (6) the aggregation of multicurrency interest rate exposures;
 - (7) the inclusion (or not) of non-interest bearing assets and liabilities (including capital and reserves);
 - (8) the treatment of current and savings accounts (i.e. the maturity attached to exposures without a contractual maturity);
 - (9) the treatment of fixed rate assets (liabilities) where customers still have a right to repay (withdraw) early;
 - (10) the extent to which sensitivities to small shocks can be scaled up on a linear basis without material loss of accuracy (i.e. covering both convexity generally and the non-linearity of pay-off associated with explicit option products);
 - (11) the degree of granularity employed (for example offsets within a time bucket); and
 - (12) whether all future cash flows or only principal balances are included.
- 2.3.11 G The *FSA* will periodically review whether the level of the shock referred to in *BIPRU* 2.3.7R(2) is appropriate in the light of changing circumstances, in particular the general level of interest rates (for instance periods of very low interest rates) and their volatility. A *firm's* internal systems should therefore be flexible enough to compute its sensitivity to any standardised shock that is prescribed. If a 200 basis point shock would imply negative interest rates or if such a shock would otherwise be considered inappropriate, the *FSA* will consider adjusting the requirements accordingly.

Stress testing for interest rate risk: Frequency

- 2.3.12 R (1) A *firm* must carry out the evaluations required by *BIPRU 2.3.7R* as frequently as necessary for it to be reasonably satisfied that it has at all times a sufficient understanding of the degree to which it is exposed to the risks referred to in that *rule* and the nature of that exposure. In any case it must carry out those evaluations no less frequently than required by (2) or (3).
- (2) The minimum frequency of the evaluation in *BIPRU 2.3.7R(1)* is once each year.
- (3) The minimum frequency of the evaluation in *BIPRU 2.3.7R(2)* is once each quarter.

Consolidation

- 2.3.13 R *GENPRU 1.2.45R* to *GENPRU 1.2.59R* (Application of *GENPRU 1.2* on a solo and consolidated basis) apply to *BIPRU 2.3* as they apply to *GENPRU 1.2.30R* and *GENPRU 1.2.36R*.

- 3 Standardised credit risk
- 3.1 Application and purpose
- Application
- 3.1.1 R *BIPRU 3 applies to a BIPRU firm.*
- Purpose
- 3.1.2 G *BIPRU 3 implements:*
- (1) Articles 78 to 80, paragraph (1) of Article 81, Article 83, Annex II and Parts 1 and 3 of Annex VI of the *Banking Consolidation Directive*;
 - (2) Article 18 of the *Capital Adequacy Directive* so far as it applies Articles 78 to 80, paragraph (1) of Article 81, Article 83 and Parts 1 and 3 of Annex VI of the *Banking Consolidation Directive* to *investment firms*; and
 - (3) Article 40 of the *Capital Adequacy Directive* for the purposes of the calculation of credit risk under the *Banking Consolidation Directive*.
- 3.1.3 G *BIPRU 3.1 sets out how a firm should calculate the credit risk capital component, which is one of the elements that make up the credit risk capital requirement under GENPRU 2.1.51R. Part of that calculation involves calculating risk weighted exposure amounts for exposures in the firm's non-trading book. The rest of BIPRU 3 sets out how the firm should carry out that calculation.*
- 3.1.4 G *BIPRU 5 deals with the effect of credit risk mitigation on the calculation of risk weighted exposure amounts. BIPRU 13 deals with the calculation of exposure values for certain kinds of products. BIPRU 14.3 deals with the calculation of the counterparty risk capital component for unsettled transactions in the trading book and non-trading book. BIPRU 14.4 deals with capital resources with respect to free deliveries.*
- Calculation of the credit risk capital component
- 3.1.5 R *The credit risk capital component of a firm is 8% of the total of its risk weighted exposure amounts for exposures falling into BIPRU 3.1.6R, calculated in accordance with BIPRU 3.*
- 3.1.6 R *An exposure falls into this rule if:*
- (1) it is in a firm's *non-trading book*; and

- (2) it has not been deducted from the *firm's capital resources* under *GENPRU 2.2*.

- 3.2 The central principles of the standardised approach to credit risk
- 3.2.1 R Subject to *BIPRU* 13:
- (1) the *exposure* value of an asset item must be its balance-sheet value, subject to any value adjustments required by *GENPRU* 1.3; and
- (2) the *exposure* value of an off-balance sheet item listed in the table in *BIPRU* 3.7.2R must be the percentage of its value set out in that table.
- [**Note:** *BCD* Article 78(1) part]
- 3.2.2 R The off-balance sheet items listed in the table in *BIPRU* 3.7.2R must be assigned to the risk categories as indicated in that table.
- [**Note:** *BCD* Article 78(1) part]
- 3.2.3 R Where an *exposure* is subject to *funded credit protection*, a *firm* may modify the *exposure* value applicable to that item in accordance with *BIPRU* 5.
- [**Note:** *BCD* Article 78(3)]
- 3.2.4 G *BIPRU* 13 sets out the method for determination of the *exposure* value of a *financial derivative instrument*, with the effects of contracts of novation and other netting agreements taken into account for the purposes of that method in accordance with *BIPRU* 13.7.
- [**Note:** reference to *BCD* Article 78(2) first sentence. Implementation in *BIPRU* 13]
- 3.2.5 G *BIPRU* 13.3 and *BIPRU* 13.8 set out the provisions applying to the treatment and determination of the *exposure* value of *repurchase transactions, securities or commodities lending or borrowing transactions, long settlement transactions* and *margin lending transactions (SFTs)*.
- [**Note:** reference to *BCD* Article 78(2) second sentence. Implementation in *BIPRU* 13]
- 3.2.6 G *BIPRU* 13 also sets out the methods for the determination of *exposure* values for *long settlement transactions*.
- 3.2.7 G *BIPRU* 13.8 provides that, in the case of a *firm* using the *financial collateral comprehensive method* under *BIPRU* 5, where an *exposure* takes the form of an *SFT*, the *exposure* value should be increased by the volatility adjustment appropriate to such *securities* or *commodities* set out in *BIPRU* 5.4.30R to *BIPRU* 5.4.65R

(Supervisory volatility adjustments approach and the own estimates of volatility adjustments approach).

[**Note:** reference to *BCD* Article 78(1), part. Implementation in *BIPRU* 13]

- 3.2.8 G *BIPRU* 13.3.13R and *BIPRU* 13.8.8R set out the provisions relating to determination of the *exposure* value of certain credit risk *exposures* outstanding with a *central counterparty*, where the *central counterparty's counterparty credit risk exposures* with all participants in its arrangements are fully collateralised on a daily basis.

[**Note:** reference to *BCD* Article 78(4). Implementation in *BIPRU* 13]

Exposure Classes

- 3.2.9 R A *firm* must assign each *exposure* to one of the following *exposure* classes:
- (1) claims or contingent claims on central governments or *central banks*;
 - (2) claims or contingent claims on regional governments or local authorities;
 - (3) claims or contingent claims on administrative bodies and non-commercial *undertakings*;
 - (4) claims or contingent claims on *multilateral development banks*;
 - (5) claims or contingent claims on *international organisations*;
 - (6) claims or contingent claims on *institutions*;
 - (7) claims or contingent claims on *corporates*;
 - (8) retail claims or contingent retail claims;
 - (9) claims or contingent claims secured on real estate property;
 - (10) past due items;
 - (11) items belonging to regulatory high-risk categories;
 - (12) claims in the form of *covered bonds*;
 - (13) *securitisation* positions;
 - (14) short-term claims on *institutions* and *corporates*;

(15) claims in the form of *CIUs*; or

(16) other items.

[**Note:** *BCD* Article 79(1)]

3.2.10 R To be eligible for the *retail exposure* class, an *exposure* must meet the following conditions:

(1) the *exposure* must be either to an individual *person* or *persons*, or to a small or medium sized entity;

(2) the *exposure* must be one of a significant number of *exposures* with similar characteristics such that the risks associated with such lending are substantially reduced; and

(3) the total amount owed to the *firm*, its *parent undertakings* and its *subsidiary undertakings*, including any past due *exposure*, by the obligor client or *group of connected clients*, but excluding claims or contingent claims secured on residential real estate collateral, must not, to the knowledge of the *firm*, exceed €1 million.

[**Note:** *BCD* Article 79(2)]

3.2.11 R A *firm* must take reasonable steps to acquire the knowledge referred to in *BIPRU* 3.2.10R(3).

[**Note:** *BCD* Article 79(2)(c) last sentence]

3.2.12 R *Securities* are not eligible for the *retail exposure* class.

[**Note:** *BCD* Article 79(2) last sentence]

3.2.13 R The present value of retail minimum lease payments is eligible for the *retail exposure* class.

[**Note:** *BCD* Article 79(3)]

Retail exposures: Significance

3.2.14 G A key driver of the preferential *risk weight* afforded *retail exposures* is the lower correlation and systematic risk associated with such *exposures*. This aspect is unrelated to the absolute number of *retail exposures*. Accordingly in defining what constitutes a significant number of *retail exposures* for the purpose of *BIPRU* 3.2.10R(2), a *firm* need only satisfy itself that the number of *retail exposures* is sufficiently large to diversify away idiosyncratic risk. This assessment will be subject to supervisory review and part of a *firm's SREP*. It will be looked at as one of the issues relating to overall diversification.

Retail exposures: Aggregation: Reasonable steps

- 3.2.15 G In deciding what steps are reasonable for the purposes of *BIPRU* 3.2.11R, a *firm* may take into account complexity and cost, as well as the materiality of the impact upon its capital calculation. A *firm* should be able to demonstrate to the *FSA* that it has complied with the obligation to take reasonable steps under *BIPRU* 3.2.11R in the way it takes these factors into account..

Retail exposures: Aggregation: Single risk

- 3.2.16 G (1) The definition of *group of connected clients* is set out in the *Glossary*. Paragraph (2) of that definition is "two or more *persons* ... who are to be regarded as constituting a single risk because they are so interconnected that, if one of them were to experience financial problems, the other or all of the others would be likely to encounter repayment difficulties".
- (2) Say that a *firm* has *exposures* to A and B. When deciding whether A and B come within paragraph (2) of the definition two conditions should be satisfied. Firstly the connections between A and B should mean that if A experiences financial problems, B should be likely to encounter repayment difficulties. Secondly, the connections between A and B should mean that if B experiences financial problems, A should be likely to encounter repayment difficulties.
- (3) The *guidance* in *BIPRU* 3.2.16G is provided for the purpose of *BIPRU* 3.2.10R only and not for the purposes of any other provision in the Handbook that uses the defined term *group of connected clients*.

Retail exposures: Aggregation: Personal and business exposures

- 3.2.17 G If a *firm* has *exposures* to an owner of a *retail SME* in his personal capacity and *exposures* to the *retail SME* the *firm* should aggregate the two types of *exposure* for the purpose of *BIPRU* 3.2.10R(3), although it should not include claims secured on residential real estate collateral. In deciding what steps are reasonable for the purposes of *BIPRU* 3.2.11R in aggregating these two types of *exposure*, a *firm* may take into account the materiality of those personal *exposures*. A *firm* should be able to demonstrate to the *FSA* that it has complied with the obligation to take reasonable steps under *BIPRU* 3.2.11R when taking into account materiality in this way.

Retail exposures: Exchange rate

- 3.2.18 G Where an exposure is denominated in a currency other than the euro, a *firm* may calculate the euro equivalent for purposes of *BIPRU* 3.2.10R using any appropriate set of exchange rates provided its choice has no obvious bias and that the *firm* is consistent in its

approach to choosing rates.

Retail exposures: Frequency of monitoring

- 3.2.19 G A *firm* may monitor compliance with the €1m threshold in *BIPRU* 3.2.10R on the basis of approved limits provided it has internal control procedures that are sufficient to ensure that amounts owed cannot diverge from approved limits to such an extent as to give rise to a material breach of the €1m threshold.
- 3.2.20 R (1) To calculate *risk weighted exposure amounts*, *risk weights* must be applied to all *exposures*, unless deducted from *capital resources*, in accordance with the provisions of *BIPRU* 3.4.
- (2) The application of *risk weights* must be based on the *standardised credit risk exposure class* to which the *exposure* is assigned and, to the extent specified in *BIPRU* 3.4, its credit quality.
- (3) Credit quality may be determined by reference to:
- (a) the credit assessments of *eligible ECAs* in accordance with the provisions of *BIPRU* 3; or
- (b) the credit assessments of export credit agencies as described in *BIPRU* 3.4.
- [Note: *BCD* Article 80(1)]
- 3.2.21 R For the purposes of applying a *risk weight*, as referred to in *BIPRU* 3.2.20R, the *exposure* value must be multiplied by the *risk weight* specified or determined in accordance with the *standardised approach*.
- [Note: *BCD* Article 80(2)]
- 3.2.22 R Notwithstanding *BIPRU* 3.2.20R, where an *exposure* is subject to credit protection the *risk weight* applicable to that item may be modified in accordance with *BIPRU* 5.
- [Note: *BCD* Article 80(4)]
- 3.2.23 R *Risk weighted exposure amounts* for *securitised exposures* must be calculated in accordance with *BIPRU* 9.
- [Note: *BCD* Article 80(5)]
- 3.2.24 R *Exposures* the calculation of *risk weighted exposure amounts* for which is not otherwise provided for under the *standardised approach* must be assigned a *risk weight* of 100%.

[Note: BCD Article 80(6)]

Zero risk-weighting for intra-group exposures

- 3.2.25 R (1) Subject to *BIPRU* 3.2.35R, and with the exception of *exposures* giving rise to liabilities in the form of the items referred to in *BIPRU* 3.2.26R, a *firm* is not required to comply with *BIPRU* 3.2.20R (Calculation of risk weighted exposures amounts under the standardised approach) in the case of the *exposures* of the *firm* to a counterparty which is its *parent undertaking*, its *subsidiary undertaking* or a *subsidiary undertaking* of its *parent undertaking* or to which the *firm* is linked by a *consolidation Article 12(1) relationship* provided that the following conditions are met:
- (a) the counterparty is:
 - (i) an *institution* whose head office is in an *EEA State*; or
 - (ii) an *institution* not within (a)(i), *financial holding company*, *financial institution*, *asset management company* or *ancillary services undertaking* subject to appropriate prudential requirements;
 - (b) the condition in *BIPRU* 3.2.27R is satisfied;
 - (c) the counterparty is subject to the same risk evaluation, measurement and control procedures as the *firm*;
 - (d) the counterparty is established in the *United Kingdom* and either it is incorporated in the *United Kingdom* or (if that counterparty is of a type that falls within the scope of that Regulation) the centre of its main interests is situated within the *United Kingdom* within the meaning of the Council Regulation of 29 May 2000 on insolvency proceedings (Regulation 1346/2000/EC); and
 - (e) there is no current or foreseen material practical or legal impediment to the prompt transfer of *capital resources* or repayment of liabilities from the counterparty to the *firm*.
- (2) Where a *firm* chooses under (1) not to apply *BIPRU* 3.2.20R, it must assign a *risk weight* of 0% to the *exposure*.
- (3) A *firm* need not apply the treatment in (1) and (2) to every *exposure* that is eligible for that treatment.

[Note: BCD Article 80(7), part]

- 3.2.26 R A *firm* must not apply the treatment in BIPRU 3.2.25R to *exposures* giving rise to liabilities in the form of any of the following items:
- (1) in the case of a *BIPRU firm*, any *tier one capital* or *tier two capital*; and
 - (2) in the case of any other *undertaking*, any item that would be *tier one capital* or *tier two capital* if the *undertaking* were a *BIPRU firm*.

[Note: BCD Article 80(7), part]

- 3.2.27 R (1) The condition referred to in BIPRU 3.2.25R(1)(b) is that both the *counterparty* and the *firm* are:
- (a) included within the scope of consolidation on a full basis with respect to the same *UK consolidation group* and BIPRU 8.3.1R applies to the *firm* with respect to that *UK consolidation group*; or
 - (b) included within the scope of consolidation on a full basis with respect to the same *group* by a *competent authority* of an *EEA State* other than the *United Kingdom* under the *CRD implementation measures* about consolidated supervision for that *EEA State*; or
 - (c) (provided that this consolidation is carried out to standards equivalent to those in (a) and (b)) included within the scope of consolidation on a full basis with respect to the same *group* by a *third country competent authority* under prudential rules for the *banking sector* or *investment services sector* of or administered by that *third country competent authority*.
- (2) A *group* is subject to consolidation to equivalent standards for the purpose of (1)(c) only if the *firm* or another *EEA firm* in that *group* has been notified in writing by the *FSA* or a *competent authority* of another *EEA State* pursuant to Article 143 of the *Banking Consolidation Directive* that that *group* is subject to equivalent supervision.

[Note: BCD Article 80(7), part]

- 3.2.28 G For the purpose of BIPRU 3.2.25R(1)(c) it is the risk management functions of the group that should be integrated, rather than the group's operational management. A *firm* should ensure that if risk management functions are integrated in this way it should be possible for the *FSA* to undertake qualitative supervision of the management of the integrated risk management function.

- 3.2.29 G An *undertaking* is included within the scope of consolidation of a group on a full basis as referred to in *BIPRU 3.2.27R(1)* if it is at the head of the group or if its assets and liabilities are taken into account in full as referred to in *BIPRU 8.5.2R* (Basis of inclusion of undertakings in consolidation).
- 3.2.30 G In the case of an *undertaking* that is a *firm* the requirement in *BIPRU 3.2.25R(1)(e)* for the prompt transfer of *capital resources* refers to *capital resources* in excess of the capital and financial resources requirements to which it is subject under the *regulatory system*.
- 3.2.31 G The requirement in *BIPRU 3.2.25R(1)(e)* for the prompt repayment of liabilities refers to the prompt repayment of liabilities when due.
- 3.2.32 G The *guidance* in *BIPRU 3.2.30G - BIPRU 3.2.31G* does not apply to *BIPRU 2.1* (Solo consolidation) even though the provisions have similar wording. This is because the purpose of the provisions in *BIPRU 2.1* is to define the conditions under which two *undertakings* should be treated as a single *undertaking*. The purpose of *BIPRU 3.2.25R(1)* is to define the circumstances in which it is appropriate to apply a zero *risk weight*.
- 3.2.33 G A *firm* that has chosen to apply the treatment in *BIPRU 3.2.25R* should monitor the *exposures* to which a 0% *risk weight* is applied under that treatment and report these to the *FSA* as required.
- 3.2.34 G If a *firm* has an *IRB permission* and *exposures* are exempted from the *IRB approach* under *BIPRU 4.2.26R(6)* the *firm* may apply a 0% *risk weight* to them under *BIPRU 3.2.25R(2)* (Zero risk weighting for intra-group exposures) if the conditions in *BIPRU 3.2.25R(1)* are satisfied.
- 3.2.35 R
- (1) A *firm* may not apply *BIPRU 3.2.25R* unless it has given one month's prior notice to the *FSA* that it intends do so.
 - (2) A *firm* need only give the *FSA* the notice required in (1) once rather than with respect to each *exposure*.
 - (3) A *firm* may stop applying *BIPRU 3.2.25R* or may stop applying it to some *exposures*.
 - (4) If a *firm* stops applying *BIPRU 3.2.25R* it may start to apply it again if it notifies the *FSA* under (1) that it intends do so.
 - (5) A *firm* must notify the *FSA* if it becomes aware that any *exposure* that it has treated as exempt under *BIPRU 3.2.25R* has ceased to meet the conditions for exemption or if the *firm* ceases to treat an *exposure* under that *rule*.

3.2.36 G The *FSA* may discuss with a *firm* that makes the notification required in *BIPRU* 3.2.35R(1) the reasons why the *firm* believes it meets the conditions in *BIPRU* 3.2.25R(1).

3.2.37 G *BIPRU* 3 Annex 1G is a flow chart guide to assessing whether an intra-group *exposure* can be zero *risk weighted* using the *standardised approach* subject to the conditions set out in *BIPRU* 3.2.25R – *BIPRU* 3.2.35G.

Exposures to recognized third-country investment firms, clearing houses and investment exchanges

3.2.38 R For the purposes of the *standardised approach* (including as it applies for the purposes of *BIPRU* 14) and without prejudice to *BIPRU* 13.3.13R and *BIPRU* 13.8.8R (Exposure to a central counterparty), *exposures to recognised third-country investment firms* and *exposures to recognised clearing houses, designated clearing houses, recognised investment exchanges* and *designated investment exchanges* must be treated as exposures to *institutions*.

[**Note:** *CAD* Article 40]

3.3 The use of the credit assessments of ratings agencies

- 3.3.1 R An external credit assessment may be used to determine the *risk weight* of an *exposure* in accordance with *BIPRU 3.2.20R* to *BIPRU 3.2.26R* only if the *ECAI* which provides it is recognised by the *FSA* as an *eligible ECAI* for the purposes of the *standardised approach to credit risk*.

[Note: *BCD* Article 81(1)]

Recognition of ratings agencies

- 3.3.2 G The *FSA* will recognise an *ECAI* as an *eligible ECAI* for the purposes of *BIPRU 3*, or will refuse to recognise an *ECAI* or will revoke its recognition of an *ECAI* as an *eligible ECAI* in accordance with the *Capital Requirements Regulations 2006*.
- 3.3.3 G Regulation 22 of the *Capital Requirements Regulations 2006* deals with recognition by the *FSA* of *eligible ECAs* for *exposure risk weighting* purposes. Regulation 25 deals with revoking recognition.
- 3.3.4 G The criteria which the *FSA* must apply when assessing *ECAs* for recognition for *exposure risk weighting* purposes are set out in Regulation 22 and Schedule 1 to the *Capital Requirements Regulations 2006*. In making an assessment against those criteria and in carrying out the mapping process described in *BIPRU 3.3.7G* to *BIPRU 3.3.9G* the *FSA* will have regard to the approach set out in the Committee of European Banking Supervisors' "Guidelines on the recognition of External Credit Assessment Institutions" dated 20 January 2006. The *FSA* does not expect to recognise an *ECAI* unless the information set out in those guidelines has been submitted to it.
- 3.3.5 G The list of *eligible ECAs* is published on the *FSA* website. When the *FSA* recognises an *ECAI* as an *eligible ECAI*, it publishes that decision by amending the list of *eligible ECAs* on the *FSA* website to include the name of the *eligible ECAI*. When the *FSA* determines that the recognition of an *ECAI* should be revoked, it publishes that decision by deleting the name of the *ECAI* from the list on the *FSA* website
- 3.3.6 G The list of *eligible ECAs* includes those who have been recognised as eligible for *exposure risk weighting* purposes by a *competent authority* of another *EEA State* and are subsequently recognised as *eligible ECAs* by the *FSA* without carrying out its own evaluation process under Regulation 22(2) of the *Capital Requirements Regulations 2006*.

Mapping of credit assessments

- 3.3.7 G Under Regulation 22(3) of the *Capital Requirements Regulations 2006* the *FSA* is obliged to determine, taking into account the requirements set out in Schedule 2 to the *Capital Requirements Regulations 2006*, with which of the *credit quality steps* set out in Part 1 of Annex VI of the *Banking Consolidation Directive* the relevant credit assessments of an *eligible ECAI* are to be associated. Those determinations should be objective and consistent.
- 3.3.8 R The *credit quality step* with which a relevant credit assessment of an *eligible ECAI* is to be associated is that in the table mapping the credit assessments of *eligible ECAs* to *credit quality steps* published by the *FSA* under Regulation 22(3) of the *Capital Requirements Regulations 2006*.
- 3.3.9 G The table mapping the credit assessments of *eligible ECAs* to *credit quality steps* is published on the *FSA* website and amended from time to time in line with additions to and deletions from the list of *eligible ECAs*. The table includes mappings made by a *competent authority* of another *EEA State* which are subsequently recognised by the *FSA* without carrying out its own determination process under Regulation 22(5) of the *Capital Requirements Regulations 2006*.

3.4 Risk weights under the standardised approach to credit risk

Risk weights: Exposures to central governments or central banks: Treatment

3.4.1 R Without prejudice to *BIPRU 3.4.2R* to *BIPRU 3.4.9R*, *exposures* to central governments and *central banks* must be assigned a 100% *risk weight*.

[Note: *BCD Annex VI Part 1 point 1*]

3.4.2 R Subject to *BIPRU 3.4.4R*, *exposures* to central governments and *central banks* for which a credit assessment by a *nominated ECAI* is available must be assigned a *risk weight* according to the table in *BIPRU 3.4.3R* in accordance with the assignment by the *FSA* in accordance with the *Capital Requirements Regulations 2006* of the credit assessments of *eligible ECAIs* to six steps in a *credit quality assessment scale*.

[Note: *BCD Annex VI Part 1 point 2*]

Table: Exposures to central governments and central banks for which a credit assessment by a nominated ECAI is available

3.4.3 R This table belongs to *BIPRU 3.4.2R*.

<i>Credit quality step</i>	1	2	3	4	5	6
<i>Risk weight</i>	0 %	20 %	50 %	100 %	100 %	150 %

3.4.4 R *Exposures* to the European Central Bank must be assigned a 0% *risk weight*.

[Note: *BCD Annex VI Part 1 point 3*]

Exposures in the national currency of the borrower

3.4.5 R *Exposures* to *EEA States*' central governments and *central banks* denominated and funded in the domestic currency of that central government and *central bank* must be assigned a *risk weight* of 0%.

[Note: *BCD Annex VI Part 1 point 4*]

3.4.6 R When the *competent authorities* of a third country which apply supervisory and regulatory arrangements at least equivalent to those applied in the *EEA* assign a *risk weight* which is lower than that indicated in *BIPRU 3.4.1R* to *BIPRU 3.4.3R* to *exposures* to their central government and *central bank*

denominated and funded in the domestic currency, a *firm* may *risk weight* such *exposures* in the same manner.

[Note: *BCD* Annex VI Part 1 point 5]

Use of credit assessments by export credit agencies

3.4.7 R An export credit agency credit assessment may be recognised by a *firm* for the purpose of determining the *risk weight* to be applied to an *exposure* under the *standardised approach* if either of the following conditions is met:

- (1) the credit assessment is a consensus risk score from export credit agencies participating in the OECD “Arrangement on Guidelines for Officially Supported Export Credits”; or
- (2) the export credit agency publishes its credit assessments, and the export credit agency subscribes to the OECD agreed methodology, and the credit assessment is associated with one of the eight minimum export insurance premiums (MEIP) that the OECD agreed methodology establishes.

[Note: *BCD* Annex VI Part 1 point 6]

3.4.8 R *Exposures* for which a credit assessment by an export credit agency is recognised for *risk weighting* purposes must be assigned a *risk weight* according to the table in *BIPRU* 3.4.9R.

[Note: *BCD* Annex VI Part 1 point 7]

Table: Exposure for which a credit assessment by an export credit agency is recognised

3.4.9 R This table belongs to *BIPRU* 3.4.8R.

MEIP	0	1	2	3	4	5	6	7
<i>Risk weight</i>	0%	0%	20%	50%	100%	100%	100%	150%

Exposures to regional governments or local authorities: General

3.4.10 R Without prejudice to *BIPRU* 3.4.15R to *BIPRU* 3.4.19R:

- (1) a *firm* must *risk weight exposures* to regional governments and local authorities in accordance with *BIPRU* 3.4.11R to *BIPRU* 3.4.14R;

and

- (2) the preferential treatment for short-term *exposures* specified in *BIPRU 3.4.37R*, *BIPRU 3.4.390R* and *BIPRU 3.4.44R* must not be applied.

[Note: *BCD Annex VI Part 1 point 8*]

Exposures to regional governments or local authorities: Central government risk weight based method

- 3.4.11 R (1) *Exposures* to regional governments and local authorities must be assigned a *risk weight* according to the *credit quality step* to which *exposures* to the central government of the jurisdiction in which the regional government or local authority is established are assigned in accordance with the table in *BIPRU 3.4.12R*.
- (2) *Exposures* to an unrated regional government or local authority must not be assigned a *risk weight* lower than that applied to *exposures* to its central government.

[Note: *BCD Annex VI Part 1 points 25 and 26*]

Table: Central government risk weight based method

- 3.4.12 R This table belongs to *BIPRU 3.4.11R*.

<i>Credit quality step</i> to which central government is assigned	1	2	3	4	5	6
<i>Risk weight of exposure</i>	20%	50%	100%	100%	100%	150%

- 3.4.13 R For *exposures* to regional governments and local authorities established in countries where the central government is unrated, the *risk weight* must be not more than 100%.

[Note: BCD Annex VI Part 1 point 27]

- 3.4.14 R For *exposures* to regional governments and local authorities with an original effective maturity of three months or less, the *risk weight* must be 20%.

[Note: BCD Annex VI Part 1 point 28]

- 3.4.15 R A *firm* must treat an *exposure* to a regional government or local authority of the *United Kingdom* listed in BIPRU 3 Annex 2R as an *exposure* to the central government of the *United Kingdom*.

[Note: BCD Annex VI Part 1 point 9]

- 3.4.16 G The *FSA* will include a regional government or local authority in the list in BIPRU 3 Annex 2R where there is no difference in risk between *exposures* to that body and *exposures* to the central government of the *United Kingdom* because of the specific revenue-raising powers of the regional government or local authority, and the existence of specific institutional arrangements the effect of which is to reduce the risk of default.

[Note: BCD Annex VI Part 1 point 9]

- 3.4.17 R A *firm* must treat an *exposure* to a regional government or local authority of an *EEA State* other than the *United Kingdom* as an *exposure* to the central government in whose jurisdiction that regional government or local authority is established if that regional government or local authority is included on the list of regional governments and local authorities drawn up by the *competent authority* in that *EEA State* under a *CRD implementation measure* with respect to point 9 of Part 1 of Annex VI of the *Banking Consolidation Directive*.

[Note: BCD Annex VI Part 1 point 9]

- 3.4.18 R *Exposures* to churches or religious communities constituted in the form of a legal *person* under public law must, in so far as they raise taxes in accordance with legislation conferring on them the right to do so, be treated as *exposures* to regional governments and local authorities, except that BIPRU 3.4.15R and BIPRU 3.4.17R do not apply.

[Note: BCD Annex VI Part 1 point 10]

- 3.4.19 R When competent authorities of a third country jurisdiction which apply supervisory and regulatory arrangements at least equivalent to those applied in the *EEA* treat *exposures* to regional governments and local authorities as *exposures* to their central government, a *firm* may *risk weight exposures* to such regional governments and local authorities in the same manner.

[Note: BCD Annex VI Part 1 point 11]

Exposures to administrative bodies and non-commercial undertakings

- 3.4.20 R *BIPRU 3.4.21R to BIPRU 3.6.26R set out the provisions applying to exposures to administrative bodies and non-commercial undertakings.*

Treatment

- 3.4.21 R Without prejudice to *BIPRU 3.4.22R to BIPRU 3.4.26R*, exposures to administrative bodies and non-commercial undertakings must be assigned a 100% risk weight.

[Note: BCD Annex VI Part 1 point 12]

Public sector entities

- 3.4.22 R Without prejudice to *BIPRU 3.4.23R to BIPRU 3.4.26R*, exposures to public sector entities must be assigned a 100% risk weight.

[Note: BCD Annex VI Part 1 point 13]

- 3.4.23 R A firm may treat an exposure to a public sector entity as an exposure to a regional government or local authority in accordance with *BIPRU 3.4.11R to BIPRU 3.4.14R*.

[Note: BCD Annex VI Part 1 point 14]

- 3.4.24 R In exceptional circumstances a firm may treat an exposure to a public sector entity established in the United Kingdom as an exposure to the central government of the United Kingdom if there is no difference in risk between exposures to that body and exposures to the central government of the United Kingdom because of the existence of an appropriate guarantee by the central government.

[Note: BCD Annex VI Part 1 point 15]

- 3.4.25 R Where a competent authority of another EEA State implements points 14 or 15 of Part 1 of Annex VI of the *Banking Consolidation Directive* by exercising the discretion to treat exposures to public sector entities as exposures to institutions or as exposures to the central government of the EEA State concerned, a firm may risk weight exposures to the relevant public sector entities in the same manner

[Note: BCD Annex VI Part 1 point 16]

- 3.4.26 R When *competent authorities* of a third country jurisdiction, which apply supervisory and regulatory arrangements at least equivalent to those applied in the *EEA*, treat *exposures to public sector entities* as *exposures to institutions*, a *firm* may risk weight *exposures to the relevant public sector entities* in the same manner.

[Note: BCD Annex VI Part 1 point 17]

Exposures to multilateral development banks: Treatment

- 3.4.27 R Without prejudice to *BIPRU 3.4.28R* to *BIPRU 3.4.29R*:
- (1) a *firm* must treat *exposures to multilateral development banks* in the same manner as *exposures to institutions* in accordance with *BIPRU 3.4.34R* to *BIPRU 3.4.39R* (Exposures to institutions: credit assessment based method); and
 - (2) the preferential treatment for short-term *exposures* specified in *BIPRU 3.4.37R*, *BIPRU 3.4.39R* and *BIPRU 3.4.44R* must not be applied.

[Note: BCD Annex VI Part 1 point 19]

- 3.4.28 R An *exposure to a multilateral development bank* listed in point (1) of the definition in the *glossary* must be assigned a 0% *risk weight*.

[Note: BCD Annex VI Part 1 point 20]

- 3.4.29 R A *risk weight* of 20% must be assigned to the portion of unpaid capital subscribed to the European Investment Fund.

[Note: BCD Annex VI Part 1 point 21]

Exposures to international organisations

- 3.4.30 R *Exposures to the following international organisations* must be assigned a 0% *risk weight*:
- (1) the European Community;
 - (2) the International Monetary Fund; and
 - (3) the Bank for International Settlements.

[Note: BCD Annex VI Part 1 point 22]

Exposures to institutions: General

- 3.4.31 R *BIPRU 3.4.32R to BIPRU 3.4.48R set out the treatment to be accorded to exposures to institutions.*

Exposures to institutions: Treatment

- 3.4.32 R Without prejudice to *BIPRU 3.4.33R to BIPRU 3.4.47R*, *exposures to financial institutions* authorised and supervised by the *competent authorities* responsible for the authorisation and supervision of *credit institutions* and subject to prudential requirements equivalent to those applied to *credit institutions* must be *risk weighted* as *exposures to institutions*.

[Note: BCD Annex VI Part 1 point 24]

Exposures to institutions: Risk weight floor on exposures to unrated institutions

- 3.4.33 R *Exposures to an unrated institution* must not be assigned a *risk weight* lower than that applied to *exposures to its central government*.

[Note: BCD Annex VI Part 1 point 25]

Exposures to institutions: Credit assessment based method

- 3.4.34 R *Exposures to institutions* with an original effective maturity of more than three months for which a credit assessment by a *nominated ECAI* is available must be assigned a *risk weight* according to the table in *BIPRU 3.4.35R* in accordance with the assignment by the *FSA* in accordance with the *Capital Requirements Regulations 2006* of the credit assessments of *eligible ECAIs* to six steps in a *credit quality assessment scale*.

[Note: BCD Annex VI Part 1 point 29]

Table: Exposures to institutions with an original effective maturity of more than three months for which a credit assessment by a nominated ECAI is available

- 3.4.35 R This table belongs to *BIPRU 3.4.34R*.

<i>Credit quality step</i>	1	2	3	4	5	6
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<i>Credit quality step</i>	1	2	3	4	5	6
<i>Risk weight</i>	20%	50%	50%	100%	100%	150%

- 3.4.36 R Without prejudice to *BIPRU 3.4.33R*, *exposures to unrated institutions* must be assigned a *risk weight* of 50%.

[**Note:** *BCD Annex VI Part 1 point 30*]

- 3.4.37 R *Exposures to an institution with an original effective maturity of three months or less for which a credit assessment by a nominated ECAI is available must be assigned a risk weight according to the table in BIPRU 3.4.38R in accordance with the assignment by the FSA in accordance with the Capital Requirements Regulations 2006 of the credit assessments of eligible ECAs to six steps in a credit quality assessment scale.*

[**Note:** *BCD Annex VI Part 1 point 31*]

Table: Exposures to an institution with an original effective maturity of three months or less for which a credit assessment by a nominated ECAI is available

- 3.4.38 R This table belongs to *BIPRU 3.4.37R*.

<i>Credit quality step</i>	1	2	3	4	5	6
<i>Risk weight</i>	20%	20%	20%	50%	50%	150%

- 3.4.39 R Without prejudice to *BIPRU 3.4.33R*, *exposures to unrated institutions* having an original effective maturity of three months or less must be assigned a 20% *risk weight*

[**Note:** *BCD Annex VI Part 1 point 32*]

Exposures to institutions: Interaction with short-term credit assessments

- 3.4.40 R If there is no short-term credit assessment as set out in *BIPRU 3.4.112R*, the general preferential treatment for short-term *exposures* as specified in *BIPRU 3.4.37R* applies to all *exposures* to *institutions* of up to three months residual maturity.

[Note: *BCD Annex VI Part 1 point 34*]

- 3.4.41 R If there is a short-term credit assessment as set out in *BIPRU 3.4.112R* and such an assessment determines the application of a more favourable or identical *risk weight* than the use of the general preferential treatment for short-term *exposures*, as specified in *BIPRU 3.4.37R*, then the short-term assessment and *risk weighting* specified in *BIPRU 3.4.112R* must be used for that specific *exposure* only. Other short-term *exposures* must follow the general preferential treatment for short-term *exposures*, as specified in *BIPRU 3.4.37R*.

[Note: *BCD Annex VI Part 1 point 35*]

- 3.4.42 R If there is a short-term credit assessment as set out in *BIPRU 3.4.112R* and such an assessment determines a less favourable *risk weight* than the use of the general preferential treatment for short-term *exposures*, as specified in *BIPRU 3.4.37R*, then the general preferential treatment for short-term *exposures* must not be used and all unrated short-term claims must be assigned the same *risk weight* as that applied by the specific short-term assessment.

[Note: *BCD Annex VI Part 1 point 36*]

- 3.4.43 G *BIPRU 3 Annex 2G* contains a flow diagram guide to determining the *risk weight* to be applied to short-term *exposures* to *institutions* according to whether a short-term credit assessment is available.

Exposures to institutions: Short-term exposures in the national currency of the borrower

- 3.4.44 R A *firm* may assign to an *exposure* to an *institution* formed under the law of the *United Kingdom* of a residual maturity of 3 months or less denominated and funded in pounds sterling a *risk weight* that is one category less favourable than the preferential *risk weight*, as described in *BIPRU 3.4.5R* (Exposures in the national currency of the borrower), assigned to *exposures* to the central government of the *United Kingdom*.

[Note: *BCD Annex VI Part 1 point 37*]

- 3.4.45 R (1) Where a *competent authority* of another *EEA State* implements point 37 of Part 1 of Annex VI of the *Banking Consolidation Directive* by exercising the discretion to allow the treatment in that point, a *firm*

may assign to the relevant national currency *exposures* the *risk weight* permitted by that *CRD implementation measure*.

- (2) When the *competent authority* of a third country which applies supervisory and regulatory arrangements at least equivalent to those applied in the *EEA* assigns to an *exposure* to an *institution* formed under the law of that third country of a residual maturity of 3 months or less denominated and funded in the national currency a *risk weight* that is one category less favourable than the preferential *risk weight*, as described in *BIPRU* 3.4.6R (Exposures in the national currency of the borrower), assigned to *exposures* to the central government of that third country, a *firm* may *risk weight* such *exposures* in the same manner.

[**Note:** *BCD* Annex VI Part 1 point 37]

- 3.4.46 R No *exposures* of a residual maturity of 3 months or less denominated and funded in the national currency of the borrower may be assigned a *risk weight* less than 20%.

[**Note:** *BCD* Annex VI Part 1 point 38]

Exposures to institutions: Investments in regulatory capital instruments

- 3.4.47 R Investments in *equity* or regulatory capital instruments issued by *institutions* must be *risk weighted* at 100%, unless deducted from *capital resources*.

[**Note:** *BCD* Annex VI Part 1 point 39]

Exposures to institutions: Minimum reserves required by the ECB

- 3.4.48 R Where an *exposure* to an *institution* is in the form of minimum reserves required by the European Central Bank or by the *central bank* of an *EEA State* to be held by the *firm*, a *firm* may assign the *risk weight* that would be assigned to *exposures* to the *central bank* of the *EEA State* in question provided:

- (1) the reserves are held in accordance with Regulation (EC) No. 1745/2003 of the European Central Bank of 12 September 2003 or a subsequent replacement regulation or in accordance with national requirements in all material respects equivalent to that Regulation; and
- (2) in the event of the bankruptcy or insolvency of the *institution* where the reserves are held, the reserves will be fully repaid to the *firm* in a timely manner and will not be available to meet other liabilities of the

institution.

[Note: BCD Annex VI Part 1 point 40]

Exposures to corporates: General

- 3.4.49 G *BIPRU 3.4.50R to BIPRU 3.4.52R set out the treatment to be accorded to exposures to corporates.*

Exposures to corporates: Treatment

- 3.4.50 R *Exposures for which a credit assessment by a nominated ECAI is available must be assigned a risk weight according to the table in BIPRU 3.4.51R in accordance with the assignment by the FSA in accordance with the Capital Requirements Regulations 2006 of the credit assessments of eligible ECAIs to six steps in a credit quality assessment scale.*

[Note: BCD Annex VI Part 1 point 41]

Table: Exposures for which a credit assessment by a nominated ECAI is available

- 3.4.51 R This table belongs to *BIPRU 3.4.50R*.

<i>Credit quality step</i>	1	2	3	4	5	6
<i>Risk weight</i>	20%	50%	100%	100%	150%	150%

- 3.4.52 R *Unrated exposures must be assigned a 100% risk weight or the risk weight of its central government, whichever is the higher.*

[Note: BCD Annex VI Part 1 point 42]

Retail exposures

- 3.4.53 R *Exposures that comply with the criteria listed in BIPRU 3.2.10R must be assigned a risk weight of 75%. However a firm may treat such an exposure under BIPRU 3.2.24R (100% risk weight).*

[Note: BCD Annex VI Part 1 point 43]

Exposures secured by real estate property

- 3.4.54 R *BIPRU 3.4.55R to BIPRU 3.4.94R* set out the treatment to be accorded to *exposures* secured by real estate property.
- 3.4.55 R Without prejudice to *BIPRU 3.4.56R to BIPRU 3.4.94R*, *exposures* fully secured by real estate property must be assigned a *risk weight* of 100%.

[Note: BCD Annex VI Part 1 point 44]

Exposures secured by mortgages on residential property

- 3.4.56 R Without prejudice to *BIPRU 3.4.85R*, an *exposure* or any part of an *exposure* fully and completely secured, to the satisfaction of the *firm*, by mortgages on residential property which is or shall be occupied or let by the owner or the beneficial owner in the case of personal investment companies must be assigned a *risk weight* of 35%.

[Note: BCD Annex VI Part 1 point 45]

- 3.4.57 R *Exposures* fully and completely secured, to the satisfaction of the *firm*, by shares in Finnish residential housing companies, operating in accordance with the Finnish Housing Company Act of 1991 or subsequent equivalent legislation, in respect of residential property which is or shall be occupied or let by the owner must be assigned a *risk weight* of 35%.

[Note: BCD Annex VI Part 1 point 46]

- 3.4.58 R Without prejudice to *BIPRU 3.4.85R*, an *exposure* or any part of an *exposure* to a tenant under a property leasing transaction concerning residential property under which the *firm* is the lessor and the tenant has an option to purchase, must be assigned a *risk weight* of 35% provided that the *firm* is satisfied that the *exposure* of the *firm* is fully and completely secured by its ownership of the property.

[Note: BCD Annex VI Part 1 point 47]

- 3.4.59 G An Ijara mortgage is an example of an *exposure* described in *BIPRU 3.4.58R*.
- 3.4.60 R (1) In the exercise of its judgement for the purposes of *BIPRU 3.4.56R to BIPRU 3.4.58R*, a *firm* may be satisfied only if the conditions in (2) to (6) are met.

- (2) The value of the property does not materially depend upon the credit quality of the obligor. This requirement does not preclude situations where purely macroeconomic factors affect both the value of the property and the performance of the borrower.
- (3) The risk of the borrower does not materially depend upon the performance of the underlying property or project, but rather on the underlying capacity of the borrower to repay the debt from other sources. As such, repayment of the facility does not materially depend on any cash flow generated by the underlying property serving as collateral.
- (4) The minimum requirements about:
 - (a) legal certainty in *BIPRU 3.4.64R*;
 - (b) monitoring of property values in *BIPRU 3.4.66R*;
 - (c) documentation in *BIPRU 3.4.72R*; and
 - (d) insurance in *BIPRU 3.4.73R*;
 are met.
- (5) The valuation *rules* set out in *BIPRU 3.4.77R* to *BIPRU 3.4.80R* are met.
- (6) The value of the property exceeds the *exposures* by a substantial margin as set out in *BIPRU 3.4.81R*, *BIPRU 3.4.83R*, *BIPRU 3.4.84R* or *BIPRU 3.4.85R* (as applicable).

[Note: *BCD Annex VI Part 1 point 48*]

3.4.61 R *BIPRU 3.4.60R(3)* does not apply to *exposures* fully and completely secured by mortgages on residential property which is situated within the *United Kingdom*.

[Note: *BCD Annex VI Part 1 point 49*]

3.4.62 G The *Banking Consolidation Directive* permits a *competent authority* to disapply the condition in *BIPRU 3.4.60R(3)*, if it has evidence that a well-developed and long-established residential real estate market is present in its territory with loss rates which are sufficiently low to justify such treatment. *BIPRU 3.4.61R* implements that option. However, if the evidence changes so that these conditions are no longer satisfied, the *FSA* may be obliged to revoke *BIPRU 3.4.61R*.

3.4.63 R If a *CRD implementation measure* of another *EEA State* exercises the

discretion in point 49 of Part 1 of Annex VI of the *Banking Consolidation Directive* to dispense with the condition corresponding to *BIPRU 3.4.60R(3)* (The risk of the borrower should not materially depend upon the performance of the underlying property or project) , a *firm* may apply a *risk weight* of 35% to such *exposures* fully and completely secured by mortgages on residential property situated in that *EEA State*.

[**Note:** *BCD Annex VI Part 1 point 50*]

- 3.4.64 R The requirements about legal certainty referred to in *BIPRU 3.4.60R(4)(a)* are as follows:
- (1) the mortgage or *charge* must be enforceable in all relevant jurisdictions which are relevant at the time of conclusion of the credit agreement, and the mortgage or *charge* must be properly filed on a timely basis;
 - (2) the arrangements must reflect a perfected lien (i.e. all legal requirements for establishing the pledge shall have been fulfilled); and
 - (3) the protection agreement and the legal process underpinning it must enable the *firm* to realise the value of the protection within a reasonable timeframe.

[**Note:** *BCD Annex VIII Part 2 point 8(a)*]

- 3.4.65 G The term protection agreement in *BIPRU 3.4.64R(3)* refers to the contract or deed by which the mortgage or charge is established.

- 3.4.66 R (1) The requirements about monitoring of property values referred to in *BIPRU 3.4.60R(4)(b)* are as follows:
- (a) the value of the property must be monitored on a frequent basis and at a minimum once every three years for residential real estate;
 - (b) more frequent monitoring must be carried out where the market is subject to significant changes in conditions;
 - (c) statistical methods may be used to monitor the value of the property and to identify property that needs revaluation;
 - (d) the property valuation must be reviewed by an independent valuer when information indicates that the value of the property may have declined materially relative to general market prices; and
 - (e) for loans exceeding €3 million or 5% of the *capital resources* of the *firm*, the property valuation must be reviewed by an

independent valuer at least every three years.

- (2) For the purposes of (1), ‘independent valuer’ means a person who possesses the necessary qualifications, ability and experience to execute a valuation and who is independent from the credit decision process.

[Note: BCD Annex VIII Part 2 point 8(b)]

- 3.4.67 G A property will need to be revalued over time to ensure that the original purchase price does not overstate the degree of security provided by the property. Ijara providers should undertake revaluations in the same way as providers of conventional mortgages.
- 3.4.68 G For the purposes of *BIPRU* 3.4.66R(1)(a), the monitoring of property values should be an inherent part of risk managing and tracking the portfolio. The requirement to monitor property values does not include the physical assessment of each property in the portfolio.
- 3.4.69 G For the purposes of *BIPRU* 3.4.66R(1)(d) and (e), the review of a property valuation is more in-depth than the normal monitoring process required by *BIPRU* 3.4.66R(1)(a). This requirement is likely to include a review of the property value on an individual *exposure* basis. Where an *exposure* is secured by multiple properties, the review can be undertaken at the level of the *exposure*, rather than at the level of each individual property.
- 3.4.70 G The review of property values required by *BIPRU* 3.4.66(1)(e) may lead to an amendment of the value assigned to the property under by *BIPRU* 3.4.80R.
- 3.4.71 G For the purposes of *BIPRU* 3.4.66R(2), necessary qualifications need not be professional qualifications but the firm should be able to demonstrate that he or she has the necessary ability and experience to undertake the review.
- 3.4.72 R The requirements about documentation referred to in *BIPRU* 3.4.60R(4)(c) are that the types of residential real estate accepted by the *firm* and its lending policies in this regard must be clearly documented.

[Note: BCD Annex VIII Part 2 point 8(c)]

- 3.4.73 R The requirements about insurance referred to in *BIPRU* 3.4.60R(4)(d) are that the *firm* must have procedures to monitor that the property taken as protection is adequately insured against damage.

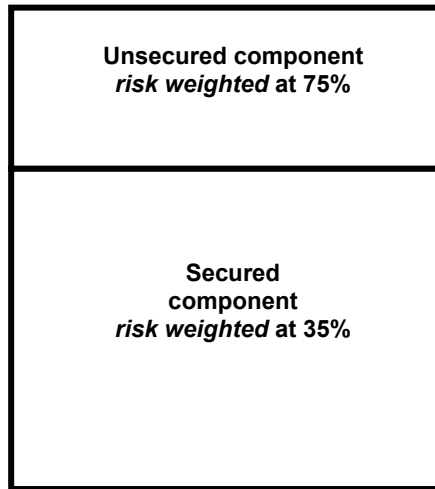
[Note: BCD Annex VIII Part 2 point 8(d)]

- 3.4.74 G For the purposes of *BIPRU* 3.4.73R a *firm* should, as a minimum, ensure that it is a requirement of each loan that the property taken as collateral must have adequate buildings insurance at all times, which should be reviewed when any new loan is extended against the property.

- 3.4.75 G A *firm* may deal with the risk that insurance on properties taken as protection may be inadequate by taking out insurance at the level of the portfolio.
- 3.4.76 R The valuation *rules* referred to in *BIPRU* 3.4.60R(5) are set out in *BIPRU* 3.4.77R to *BIPRU* 3.4.80R.
- 3.4.77 R The property must be valued by an independent valuer at or less than the market value. In those *EEA States* that have laid down rigorous criteria for the assessment of the mortgage lending value in statutory or regulatory provisions the property may instead be valued by an independent valuer at or less than the mortgage lending value.
- [Note: *BCD* Annex VIII Part 3 point 62]
- 3.4.78 R Market value means the estimated amount for which the property should exchange on the date of valuation between a willing buyer and a willing seller in an arm's length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion. The market value must be documented in a transparent and clear manner.
- [Note: *BCD* Annex VIII Part 3 point 63]
- 3.4.79 R Mortgage lending value means the value of the property as determined by a prudent assessment of the future marketability of the property taking into account long-term sustainable aspects of the property, the normal and local market conditions, the current use and alternative appropriate uses of the property. Speculative elements must not be taken into account in the assessment of the mortgage lending value. The mortgage lending value must be documented in a transparent and clear manner.
- [Note: *BCD* Annex VIII Part 3 point 64]
- 3.4.80 R The value of the collateral must be the market value or mortgage lending value reduced as appropriate to reflect the results of the monitoring required under *BIPRU* 3.4.64R(4)(b) and *BIPRU* 3.4.66R and to take account of any prior claims on the property.
- [Note: *BCD* Annex VIII Part 3 point 65]
- 3.4.81 R A *firm* may not treat an *exposure* as fully and completely secured by residential property located in the *United Kingdom* for the purpose of *BIPRU* 3.4.56R or *BIPRU* 3.4.58R unless the amount of the *exposure* or of the secured part of the *exposure* referred to in *BIPRU* 3.4.56R or *BIPRU* 3.4.58R, as the case may be, is 80% or less of the value of the residential property on which it is secured.
- 3.4.82 G (1) The application of *BIPRU* 3.4.81R may be illustrated by an example. If a firm has a mortgage *exposure* of £100,000 secured on residential property in the *United Kingdom* that satisfies the criteria listed in *BIPRU* 3.4.56R to *BIPRU* 3.4.80R and the value of that property is

£100,000, then £80,000 of that *exposure* may be treated as fully and completely secured and *risk weighted* at 35%. The remaining £20,000 may be *risk weighted* at 75% provided the *exposure* meets the criteria in *BIPRU* 3.2.10R. The portion *risk weighted* at 75% should be treated as a *retail exposure* for the purposes of the aggregation calculations specified in *BIPRU* 3.2.10R(3). A diagrammatic illustration of this example is in (2).

(2)



EXAMPLE

- £100,000 loan secured on property valued at £100,000
- First £80,000 (80% LTV) *risk weighted* at 35%
- Remaining £20,000 *risk weighted* at 75% if meets retail criteria: counts to retail aggregation calculation
- Overall *risk weight* = 43%

(2) The same approach applies to *exposures* described in *BIPRU* 3.4.58R. On initiation a 35% *risk weight* should be applied to the first 80% of the principal/"purchase price" outstanding, with a 75% *risk weight* being applied to the remainder of the principal (assuming that the *exposure* meets the requirements in *BIPRU* 3.2 to be treated as a *retail exposure*).

3.4.83 R A *firm* may only treat an *exposure* as fully and completely secured by residential property situated in another *EEA State* for the purposes of *BIPRU* 3.4.56R or *BIPRU* 3.4.58R if it would be treated as fully and completely secured by the relevant *CRD implementation measures* in that *EEA State* implementing points 45 and 47 of Part 1 of Annex VI of the *Banking Consolidation Directive*.

3.4.84 R For the purposes of *BIPRU* 3.4.56R or *BIPRU* 3.4.58R, a *firm* may only treat an *exposure* as fully and completely secured by residential property situated in the territory of a *third-country competent authority* that is listed as equivalent for credit risk in *BIPRU* 8 Ann 3R if it would be treated as fully and completely secured under the applicable requirements of that *third country competent authority* (including any applicable loan-to-value ceiling).

3.4.85 R For the purposes of *BIPRU* 3.4.56R or *BIPRU* 3.4.58R, where the residential property in question is situated in the territory of a *third-country competent authority* that is not listed as equivalent for credit risk in *BIPRU* 8 Ann 3R:

(1) a *firm* must not treat an *exposure* as fully and completely secured by the residential property in question unless the value of the property exceeds the *exposures* by a substantial margin, which must be at least 20%;

(2) the *firm* must apply a *risk weight* of 50% to the *exposure*.

- 3.4.86 G For the purposes of *BIPRU* 3.4.85R(1) and in order to satisfy itself that an *exposure* is fully and completely secured by the relevant property, a *firm* should make its own assessment of the appropriate margin in each case, using its knowledge of the market in the relevant country and of its own portfolio.
- 3.4.87 G If a *firm* has more than one *exposure* secured on the same property they should be aggregated and treated as if they were a single *exposure* secured on the property for the purposes of *BIPRU* 3.4.56R and *BIPRU* 3.4.58R and *BIPRU* 3.4.81R, *BIPRU* 3.4.83R and *BIPRU* 3.4.84R.
- 3.4.88 G If an *exposure* is secured on property that is used in part for residential purposes in accordance with *BIPRU* 3.4.56R and partly for commercial purposes (such as a farm, public house, guest house or shop) it may be treated as secured by residential real estate if the *firm* can demonstrate that the property's main use is, or will be, residential and that the value of the property is not significantly affected by its commercial use.

Exposures secured by mortgages on commercial real estate

- 3.4.89 R *Exposures* or any part of an *exposure* secured by mortgages on offices or other commercial premises which cannot properly be considered to fall within any other *standardised credit risk exposure class* or to qualify for a lower *risk weight* under *BIPRU* 3 must be assigned a *risk weight* of 100%.

[**Note:** *BCD* Annex VI Part 1 point 51]

- 3.4.90 R *Exposures* fully and completely secured by shares in Finnish housing companies, operating in accordance with the Finnish Housing Company Act of 1991 or subsequent equivalent legislation, in respect of offices or other commercial premises may be assigned a *risk weight* of 50%.

[**Note:** *BCD* Annex VI Part 1 point 52]

- 3.4.91 R If a *CRD implementation measure* in another *EEA State* implements the discretion in point 51 of Part 1 of Annex VI of the *Banking Consolidation Directive*, a *firm* may apply the same treatment as that *CRD implementation measure* to *exposures* falling within the scope of that *CRD implementation measure* which are fully and completely secured by mortgages on offices or other commercial premises situated in that *EEA State*.

[**Note:** *BCD* Annex VI Part 1 points 51 and 57]

- 3.4.92 R If a *CRD implementation measure* in another *EEA State* implements the discretion in point 53 of Part 1 of Annex VI of the *Banking Consolidation Directive*, a *firm* may apply the same treatment as that *CRD implementation*

measure to exposures related to property leasing transactions concerning offices or other commercial premises situated in that *EEA State* and governed by statutory provisions whereby the lessor retains full ownership of the rented assets until the tenant exercises his option to purchase, as long as that *exposure* falls within the scope of that *CRD implementation measure*.

[**Note:** *BCD Annex VI Part 1 points 53 and 57*]

- 3.4.93 R In particular, if a *firm* applies *BIPRU 3.4.91R* or *BIPRU 3.4.92R*, it must comply with the corresponding *CRD implementation measures* in relation to points 54-56 of Part 1 of Annex VI of the *Banking Consolidation Directive*.

[**Note:** *BCD Annex VI Part 1 points 54 to 56*]

- 3.4.94 R (1) If a *CRD implementation measure* in another *EEA State* implements the discretion in point 58 of Part 1 of Annex VI of the *Banking Consolidation Directive* to dispense with the condition in point 54(b) for *exposures* fully and completely secured by mortgages on commercial property situated in that *EEA State*, a *firm* may apply the same treatment as that *CRD implementation measure to exposures* fully and completely secured by mortgages on commercial property situated in that *EEA State* falling within the scope of that *CRD implementation measure*.
- (2) However a *firm* may not apply the treatment in (1) if the eligibility to use that treatment under the *CRD implementation measure* referred to in (1) ceases as contemplated under point 59 of Annex VI of the *Banking Consolidation Directive* (condition in point 54(b) must apply where conditions in point 58 are not satisfied).

[**Note:** *BCD Annex VI Part 1 points 58, 59 and 60*]

Past due items

- 3.4.95 G *BIPRU 3.4.96R* to *BIPRU 3.4.101R* set out the treatment to be accorded to past due items.

- 3.4.96 R Without prejudice to the provisions contained in *BIPRU 3.4.97R* to *BIPRU 3.4.101R*, the unsecured part of any item that is past due for more than 90 days (irrespective of the amount of that item or of the unsecured portion of that item) must be assigned a *risk weight* of:

- (1) 150% if value adjustments are less than 20% of the unsecured part of the *exposure* gross of value adjustments; and
- (2) 100% if value adjustments are no less than 20% of the unsecured part of the *exposure* gross of value adjustments.

[Note: BCD Annex VI Part 1 point 61]

- 3.4.97 R For the purpose of defining the secured portion of the past due item, eligible collateral and guarantees must be those eligible for *credit risk mitigation* purposes under *BIPRU 5*.

[Note: BCD Annex VI Part 1 point 62]

- 3.4.98 G For the purposes of *BIPRU 3.4.97R*, the secured portion of a past due item is dealt with under *BIPRU 5* (Credit risk mitigation). A *firm* may treat the secured portion of an *exposure* covered by a mortgage indemnity product that meets the relevant *CRM* eligibility criteria as secured for the purposes of *BIPRU 3.4.97R*. The *risk weight* to be applied to the secured portion is determined under *BIPRU 5.7.21R* to *BIPRU 5.7.24R*. The *risk weight* of the unsecured portion is determined in accordance with *BIPRU 3.4.96R*.

- 3.4.99 R *Exposures* indicated in *BIPRU 3.4.56R* to *BIPRU 3.4.63R* (*Exposures* secured by mortgages on residential property) must be assigned a *risk weight* of 100% net of value adjustments if they are past due for more than 90 days. If value adjustments are no less than 20% of the *exposure* gross of value adjustments, the *risk weight* to be assigned to the remainder of the *exposure* is 50%.

[Note: BCD Annex VI Part 1 point 64]

- 3.4.100 G The application of *BIPRU 3.4.96R* and *BIPRU 3.4.99R* may be illustrated on the basis of a £110,000 loan on a property valued at £100,000, where £80,000 of the loan is secured and £30,000 of the exposure is unsecured and provisions of £20,000 are taken:

(1) Option 1 (application of *BIPRU 3.4.96R*):

- (a) provision of £20,000 taken on £80,000 secured *exposure*;
- (b) provision exceeds 20%, so the *firm* should *risk weight* the remaining £60,000 secured *exposure* at 50%;
- (c) the *risk weight* to be applied to the unsecured *exposure* of £30,000 is 50%;
- (d) the average *risk weight* to be assigned to the net *exposure* of £90,000 is 83%.

(2) Option 2 (application of *BIPRU 3.4.99R*):

- (a) provision of £20,000 taken on £30,000 unsecured *exposure*;
- (b) provision exceeds 20%, so the *firm* should *risk weight* the

remaining £10,000 unsecured *exposure* at 100%;

- (c) the *risk weight* to be applied to the secured *exposure* of £80,000 is 100%;
- (d) the average *risk weight* to be assigned to the net *exposure* of £90,000 is 100%.

3.4.101 R *Exposures* indicated in *BIPRU* 3.4.89R to *BIPRU* 3.4.94R (*Exposures* secured by mortgages on commercial real estate) must be assigned a *risk weight* of 100% if they are past due for more than 90 days.

[**Note:** *BCD* Annex VI Part 1 point 65]

3.4.102 R Non past due items to be assigned a 150% *risk weight* under *BIPRU* 3.4 and for which value adjustments have been established may be assigned a *risk weight* of:

- (1) 100% if value adjustments are no less than 20% of the *exposure* value gross of value adjustments; and
- (2) 50%, if value adjustments are no less than 50% of the *exposure* value gross of value adjustments.

[**Note:** *BCD* Annex VI Part 1 point 67]

Items belonging to regulatory high-risk categories

3.4.103 R *BIPRU* 3.4.104R sets out the treatment to be accorded to items belonging to regulatory high-risk categories.

3.4.104 R *Exposures* listed in *BIPRU* 3 Annex 3R must be assigned a *risk weight* of 150%.

[**Note:** *BCD* Annex VI Part 1 point 66]

3.4.105 G For the purposes of point 66 of Part 1 of Annex VI of the *Banking Consolidation Directive*, the *exposures* listed in *BIPRU* 3 Annex 3R are in the view of the *FSA* associated with particularly high risk.

Exposures in the form of covered bonds

3.4.106 R *BIPRU* 3.4.107R to *BIPRU* 3.4.110R set out the treatment to be accorded to *exposures* in the form of *covered bonds*.

3.4.107 R (1) *Covered bonds* means covered bonds as defined in paragraph (1) of the definition in the *glossary* (Definition based on Article 22(4) of the *UCITS Directive*) and collateralised by any of the following eligible assets:

- (a) *exposures* to or guaranteed by central governments, *central banks*, *public sector entities*, regional governments and local authorities in the *EEA*;
- (b)
 - (i) *exposures* to or guaranteed by non-*EEA* central governments, non-*EEA* *central banks*, *multilateral development banks*, *international organisations* that qualify for the *credit quality step 1*;
 - (ii) *exposures* to or guaranteed by non-*EEA* *public sector entities*, non-*EEA* regional governments and non-*EEA* local authorities that are *risk weighted* as *exposures* to *institutions* or central governments and *central banks* according to *BIPRU 3.4.23*, *BIPRU 3.4.24*, *BIPRU 3.4.10* or *BIPRU 3.4.16* to *BIPRU 3.4.17* respectively and that qualify for the *credit quality step 1*; and
 - (iii) *exposures* in the sense of this point (b) that qualify as a minimum for the *credit quality step 2*, provided that they do not exceed 20% of the nominal amount of outstanding *covered bonds* of issuing *institutions* ;
- (c) *exposures* to *institutions* that qualify for the *credit quality step 1* but so that:
 - (i) the total exposure of this kind must not exceed 15% of the nominal amount of the outstanding *covered bonds* of the issuing *credit institution*;
 - (ii) *exposures* caused by transmission and management of payments of the obligors of, or liquidation proceeds in respect of, loans secured by real estate to the holders of *covered bonds* must not be comprised by the 15% limit; and
 - (iii) *exposures* to *institutions* in the *EEA* with a maturity not exceeding 100 days are not comprised by the step 1 requirement but those *institutions* must as a minimum qualify for *credit quality step 2*;
- (d) loans secured:
 - (i) by residential real estate or shares in Finnish residential housing companies as referred to in *BIPRU 3.4.57R* up to the lesser of the principal amount of the liens that are combined with any prior liens and 80% of the value of the pledged properties; or
 - (ii) by senior units issued by French Fonds Communs de Créances or by equivalent *securitisation* entities governed by the laws of an *EEA State* *securitising*

residential real estate *exposures* provided that at least 90% of the assets of such Fonds Communs de Créances or of equivalent *securitisation* entities governed by the laws of an *EEA State* are composed of mortgages that are combined with any prior liens up to the lesser of the principal amounts due under the units, the principal amounts of the liens, and 80% of the value of the pledged properties and the units qualify for *credit quality step 1* where such units do not exceed 20% of the nominal amount of the outstanding issue;

- (e)
 - (i) loans secured by commercial real estate or shares in Finnish housing companies as referred to in *BIPRU 3.4.57R* up to the lesser of the principal amount of the liens that are combined with any prior liens and 60% of the value of the pledged properties; or
 - (ii) loans secured by senior units issued by French Fonds Communs de Créances or by equivalent *securitisation* entities governed by the laws of an *EEA State securitising* commercial real estate *exposures* provided that, at least, 90% of the assets of such Fonds Communs de Créances or of equivalent *securitisation* entities governed by the laws of an *EEA State* are composed of mortgages that are combined with any prior liens up to the lesser of the principal amounts due under the units, the principal amounts of the liens, and 60% of the value of the pledged properties and the units qualify for *credit quality step 1* where such units do not exceed 20% of the nominal amount of the outstanding issue; or
 - (iii) a *firm* may recognise loans secured by commercial real estate as eligible where the loan to value ratio of 60% is exceeded up to a maximum level of 70% if the value of the total assets pledged as collateral for the *covered bonds* exceed the nominal amount outstanding on the *covered bond* by at least 10%, and the bondholders' claim meets the legal certainty requirements set out in *BIPRU 3* and *5*; the bondholders' claim must take priority over all other claims on the collateral; or
 - (f) loans secured by ships where only liens that are combined with any prior liens within 60% of the value of the pledged ship.
- (2) For the purposes of (1)(d)(ii) and (1)(e)(ii) *exposures* caused by transmission and management of payments of the obligors of, or liquidation proceeds in respect of, loans secured by pledged

properties of the senior units or debt *securities* must not be comprised in calculating the 90% limit.

- (3) For the purposes of *BIPRU* 3.4.107R to *BIPRU* 3.4.110R “collateralised” includes situations where the assets described in subpoints (1)(a) to (1)(f) are exclusively dedicated in law to the protection of the bond-holders against losses.
- (4) Until 31 December 2010 the 20% limit for senior units issued by French Fonds Communs de Créances or by equivalent *securitisation* entities specified in subpoints (d) and (e) does not apply, provided that those senior units have a credit assessment by a *nominated ECAI* which is the most favourable category of credit assessment made by the *ECAI* in respect of *covered bonds*.
- (5) Until 31 December 2010 the figure of 60% in (1)(f) can be replaced with a figure of 70%.

[Note: *BCD* Annex VI Part 1 point 68]

- 3.4.108 R A *firm* must for real estate collateralising *covered bonds* meet the minimum requirements set out in *BIPRU* 3.4.64R to *BIPRU* 3.4.73R and the valuation rules set out in *BIPRU* 3.4.77R to *BIPRU* 3.4.80R.

[Note: *BCD* Annex VI Part 1 point 69]

- 3.4.109 R Notwithstanding *BIPRU* 3.4.107R to *BIPRU* 3.4.108R, *covered bonds* meeting the definition of Article 22(4) of the *UCITS Directive* and issued before 31 December 2007 are also eligible for the preferential treatment until their maturity.

[Note: *BCD* Annex VI Part 1 point 70]

- 3.4.110 R *Covered bonds* must be assigned a *risk weight* on the basis of the *risk weight* assigned to senior unsecured *exposures* to the *credit institution* which issues them. The following correspondence between *risk weights* applies:
- (1) if the *exposures* to the *institution* are assigned a *risk weight* of 20%, the *covered bond* must be assigned a *risk weight* of 10%;
 - (2) if the *exposures* to the *institution* are assigned a *risk weight* of 50%, the *covered bond* must be assigned a *risk weight* of 20%;
 - (3) if the *exposures* to the *institution* are assigned a *risk weight* of 100%, the *covered bond* must be assigned a *risk weight* of 50%; and
 - (4) if the *exposures* to the *institution* are assigned a *risk weight* of 150%, the *covered bond* must be assigned a *risk weight* of 100%.

[Note: *BCD* Annex VI Part 1 point 71]

Items representing securitisation positions

- 3.4.111 R *Risk weighted exposure* amounts for *securitisation* positions must be determined in accordance with *BIPRU 9*.

[**Note:** *BCD Annex VI Part 1 point 72*]

Short-term exposures to institutions and corporates

- 3.4.112 R Short-term *exposures* to an *institution* or *corporate* for which a short-term credit assessment by a *nominated ECAI* is available must be assigned a *risk weight* according to the table in *BIPRU 3.4.113R* in accordance with the mapping by the *FSA* in accordance with the *Capital Requirements Regulations 2006* of the credit assessments of *eligible ECAs* to six steps in a *credit quality assessment scale*.

[**Note:** *BCD Annex VI Part 1 point 73*]

- 3.4.113 R Table: Short-term exposures on an institution or corporate for which a short-term credit assessment by a nominated ECAI is available
This table belongs to *BIPRU 3.4.112R*.

<i>Credit quality step</i>	1	2	3	4	5	6
<i>Risk weight</i>	20%	50%	100%	150%	150%	150%

Exposures in the form of collective investment undertakings (CIUs)

- 3.4.114 R *BIPRU 3.4.115R* to *BIPRU 3.4.125R* set out the treatment to be accorded to *exposures* in the form of *CIUs*.

- 3.4.115 R Without prejudice to *BIPRU 3.4.116R* to *BIPRU 3.4.125R*, *exposures* in *CIUs* must be assigned a *risk weight* of 100%.

[**Note:** *BCD Annex VI Part 1 point 74*]

- 3.4.116 R *Exposures* in the form of *CIUs* for which a credit assessment by a *nominated ECAI* is available must be assigned a *risk weight* according to the table in *BIPRU 3.4.117R* in accordance with the assignment by the *FSA* in accordance with the *Capital Requirements Regulations 2006* of the credit assessments of *eligible ECAs* to six steps in a *credit quality assessment*

scale.

[**Note:** *BCD Annex VI Part 1 point 75*]

- 3.4.117 R Table: Exposures in the form of CIUs for which a credit assessment by a nominated ECAI is available
This table belongs to *BIPRU 3.4.116R*.

<i>Credit quality step</i>	1	2	3	4	5	6
<i>Risk weight</i>	20%	50%	100%	100%	150%	150%

- 3.4.118 R Where a *firm* considers that a position in a *CIU* is associated with particularly high risks it must assign that position a *risk weight* of 150%.

[**Note:** *BCD Annex VI Part 1 point 76*]

- 3.4.119 G A *firm* should consider a *CIU* as being high risk where there is no external credit assessment from an *eligible ECAI* and where the *CIU* has specific features (such as high levels of leverage or lack of transparency) that prevent it from meeting the eligibility criteria laid out in *BIPRU 3.4.121R*.

- 3.4.120 G Other examples of high risk *CIUs* are: one in which a substantial element of the *CIU's* property is made up of items that would attract a *risk weight* of over 100%; or one whose mandate (as referred to in *BIPRU 3.4.124R*) would permit it to invest in a substantial amount of such items.

- 3.4.121 R Where *BIPRU 3.4.116R* does not apply, a *firm* may determine the *risk weight* for a *CIU* as set out in *BIPRU 3.4.123R* to *BIPRU 3.4.125R*, if the following eligibility criteria are met:

- (1) one of the following conditions is satisfied:
 - (a) the *CIU* is managed by a company which is subject to supervision in an *EEA State*; or
 - (b) the following conditions are satisfied:
 - (i) the *CIU* is managed by a company which is subject to supervision that is equivalent to that laid down in Community law; and
 - (ii) cooperation between *competent authorities* is

sufficiently ensured; and

- (2) the *CIU's* prospectus or equivalent document includes:
 - (a) the categories of assets in which the *CIU* is authorised to invest; and
 - (b) if investment limits apply, the relative limits and the methodologies to calculate them; and
- (3) the business of the *CIU* is reported on at least an annual basis to enable an assessment to be made of the assets and liabilities, income and operations over the reporting period.

[**Note:** *BCD* Annex VI Part 1 point 77]

- 3.4.122 R If another *EEA competent authority* approves a third country *CIU* as eligible under a *CRD implementation measure* with respect to point 77(a) of Part 1 of Annex VI of the *Banking Consolidation Directive* then a *firm* may make use of this recognition.

[**Note:** *BCD* Annex VI Part 1 point 78]

- 3.4.123 R Where a *firm* is aware of the underlying *exposures* of a *CIU*, it may look through to those underlying *exposures* in order to calculate an average *risk weight* for the *CIU* in accordance with the *standardised approach*.

[**Note:** *BCD* Annex VI Part 1 point 79]

- 3.4.124 R Where a *firm* is not aware of the underlying *exposures* of a *CIU*, it may calculate an average *risk weight* for the *CIU* in accordance with the *standardised approach* subject to the following rules: it will be assumed that the *CIU* first invests, to the maximum extent allowed under its mandate, in the *standardised credit risk exposure classes* attracting the highest capital requirement, and then continues making investments in descending order until the maximum total investment limit is reached.

[**Note:** *BCD* Annex VI Part 1 point 80]

- 3.4.125 R A *firm* may rely on a third party to calculate and report, in accordance with the methods set out in *BIPRU* 3.4.123R to *BIPRU* 3.4.124R, a *risk weight* for the *CIU* provided that the correctness of the calculation and report is adequately ensured.

[**Note:** *BCD* Annex VI Part 1 point 81]

Other items

- 3.4.126 R *BIPRU* 3.4.127R to *BIPRU* 3.4.133R set out the treatment to be accorded to

other items as referred to in *BIPRU* 3.2.9(16).

Treatment

- 3.4.127 R Tangible assets within the meaning of Article 4(10) of the *Bank Accounts Directive* must be assigned a *risk weight* of 100%.
- [Note: *BCD* Annex VI Part 1 point 82]
- 3.4.128 R Prepayments and accrued income for which a *firm* is unable to determine the counterparty in accordance with the *Bank Accounts Directive*, must be assigned a *risk weight* of 100%.
- [Note: *BCD* Annex VI Part 1 point 83]
- 3.4.129 R Cash items in the process of collection must be assigned a 20% *risk weight*. Cash in hand and equivalent cash items must be assigned a 0% *risk weight*.
- [Note: *BCD* Annex VI Part 1 point 84]
- 3.4.130 R Holdings of equity and other participations except where deducted from *capital resources* must be assigned a *risk weight* of at least 100%.
- [Note: *BCD* Annex VI Part 1 point 86]
- 3.4.131 R Gold bullion held in own vaults or on an allocated basis to the extent backed by bullion liabilities must be assigned a 0% *risk weight*.
- [Note: *BCD* Annex VI Part 1 point 87]
- 3.4.132 R In the case of asset sale and *repurchase agreements* and outright forward purchases, the *risk weight* must be that assigned to the assets in question and not to the counterparties to the transactions.
- [Note: *BCD* Annex VI Part 1 point 88]
- 3.4.133 R Where a *firm* provides credit protection for a number of *exposures* under terms that the *n*th default among the *exposures* triggers payment and that this credit event terminates the contract, and where the product has an external credit assessment from an *eligible ECAI* the *risk weights* prescribed in *BIPRU* 9 must be assigned. If the product is not rated by an *eligible ECAI*, the *risk weights* of the *exposures* included in the basket must be aggregated, excluding *n-1 exposures*, up to a maximum of 1250% and multiplied by the nominal amount of the protection provided by the credit derivative to obtain the *risk weighted* asset amount. The *n-1 exposures* to be excluded from the aggregation must be determined on the basis that they include those *exposures* each of which produces a lower *risk weighted exposure amount*

than the *risk weighted exposure amount* of any of the *exposures* included in the aggregation.

[**Note:** *BCD* Annex VI Part 1 point 89]

3.5 Simplified method of calculating risk weights

- 3.5.1 G This section (*BIPRU 3.5*) sets out a simplified approach to calculating *risk weights*. This approach is only relevant to an *exposure* class for which *risk weights* are determined by the ratings of a *nominated ECAI* or an export credit agency. For other *exposure* classes a *firm* should use the normal approach under the *standardised approach*.
- 3.5.2 G The approach in this section is only likely to be relevant for a *limited licence firm* or a *limited activity firm* that has only incidental credit *exposures* and for whom it would be prohibitively costly to establish the systems needed to include the credit assessments of *ECAs* and export credit agencies in its regulatory capital calculations. However the approach may be used by other *firms* if appropriate. A *firm* should notify the *FSA* if it adopts the approach in this section.
- 3.5.3 G Rather than *risk weighting exposures* individually, a *firm* eligible to apply the simplified approach should apply a single *risk weight* to all *exposures* in each *exposure* class. The simplified *risk weight* for *exposures* in a particular class will be the *risk weighting* for unrated entities for each *exposure* class in which the external credit assessments influence *risk weights*.
- 3.5.4 G The table in *BIPRU 3.5.5G* has a summary of the *risk weights* that a *firm* should use if it uses the simplified method of calculating *risk weights* referred to in *BIPRU 3.5.1G*.
- 3.5.5 G Table : Simplified method of calculating risk weights

This table belongs to *BIPRU 3.5.4G*.

Exposure class	Exposure sub-class	Risk weights	Comments
Central government	<i>Exposures to United Kingdom government or Bank of England in sterling</i>	0%	
	<i>Exposures to United Kingdom government or Bank of England in the currency of another EEA State</i>	0%	See Note 2.

Exposure class	Exposure sub-class	Risk weights	Comments
	<i>Exposures to EEA State's central government or central bank in currency of that state</i>	0%	
	<i>Exposures to EEA State's central government or central bank in the currency of another EEA State</i>	0%	See Notes 2 and 3.
	<i>Exposures to central governments or central banks of certain countries outside the EEA in currency of that country</i>	See next column	The <i>risk weight</i> is whatever it is under local law. See <i>BIPRU</i> 3.4.6R for precise details.
	<i>Exposures to European Central Bank</i>	0%	
	<i>Other exposures</i>	100%	
Regional/local governments	<i>Exposures to the Scottish Parliament, National Assembly for Wales and Northern Ireland Assembly in sterling</i>	0%	
	<i>Exposures to the Scottish Parliament, National Assembly for Wales and Northern Ireland Assembly in the currency of another EEA State</i>	0%	See Note 2.
	<i>Exposures to EEA States' equivalent regional/local governments in currency of that state</i>	0%	See <i>BIPRU</i> 3.4.17R for details of type of local/regional government covered.
	<i>Exposures to EEA States' equivalent regional/local governments in the currency of another EEA State</i>	0%	See <i>BIPRU</i> 3.4.17R for details of type of local/regional government covered. See Notes 2 and 3.

Exposure class	Exposure sub-class	Risk weights	Comments
	<i>Exposures to local or regional governments of certain countries outside the EEA in currency of that country</i>	0%	See <i>BIPRU 3.4.19R</i> for details of type of local/regional government covered. See Note 1.
	<i>Exposures to United Kingdom or EEA States' local/regional government in currency of that state if the exposure has original effective maturity of 3 months or less</i>	20%	
	<i>Exposures to United Kingdom or EEA States' local/regional government in the currency of another EEA State if the exposure has original effective maturity of 3 months or less</i>	20%	See Note 2. See Note 3 for local/regional government of an <i>EEA State</i> other than the <i>United Kingdom</i>
	<i>Exposures to local or regional governments of countries outside the EEA in currency of that country if the exposure has original effective maturity of 3 months or less</i>	20%	See Note 1.
	<i>Other exposures</i>	100%	
<i>PSE</i>	<i>Exposures to a PSE of the United Kingdom or of an EEA State if that PSE is guaranteed by its central government and if the exposure is be in currency of that PSE's state.</i>	0%	<i>BIPRU 3.4.24R</i> describes the <i>United Kingdom PSEs</i> covered and <i>BIPRU 3.4.25R</i> describes the <i>EEA PSEs</i> covered.
	<i>Exposures to PSE of a country outside the EEA if that PSE is guaranteed by the country's central government and if the exposure is in currency of that country.</i>	0%	See <i>BIPRU 3.4.26R</i> and Note 1.

Exposure class	Exposure sub-class	Risk weights	Comments
	<i>Exposures to a PSE of the United Kingdom or of an EEA State in currency of that state if the exposure has original effective maturity of 3 months or less</i>	20%	
	<i>Exposures to a PSE of the United Kingdom or of an EEA State in the currency of another EEA State if the exposure has original effective maturity of 3 months or less</i>	20%	See Notes 2 and 3.
	<i>Exposures to PSE of a country outside the EEA in currency of that country if the exposure has original effective maturity of 3 months or less</i>	20%	See Note 1.
	<i>Other exposures</i>	100%	
<i>Multilateral development banks</i>	<i>Exposures to multilateral development banks listed in paragraph (1) of the glossary definition</i>	0%	Simplified approach does not apply. Normal <i>rules</i> apply.
	<i>Other exposures</i>	Various	Treated as an <i>institution</i>
European Community, the International Monetary Fund and the Bank for International Settlements		0%	Simplified approach does not apply. Normal <i>rules</i> apply.
<i>Institutions</i>	<i>Exposures to United Kingdom institution in sterling with original effective maturity of three months or less</i>	20%	

Exposure class	Exposure sub-class	Risk weights	Comments
	<i>Exposures to United Kingdom institution in the currency of another EEA State with original effective maturity of three months or less</i>	20%	See Note 2.
	<i>Exposures to institution whose head office is in another EEA State in the currency of that state with original effective maturity of three months or less</i>	20%	
	<i>Exposures to institution whose head office is in another EEA State in the currency of another EEA State with original effective maturity of three months or less</i>	20%	See Notes 2 and 3.
	<i>Exposures to institution with a head office in a country outside the EEA in the currency of that country with original effective maturity of three months or less</i>	20%	See Note 1.
	<i>Exposures to United Kingdom institution in sterling with original effective maturity of over three months</i>	50%	
	<i>Exposures to United Kingdom institution in the currency of another EEA State with original effective maturity of over three months</i>	50%	See Note 2.

Exposure class	Exposure sub-class	Risk weights	Comments
	<i>Exposures to an EEA institution with a head office in another EEA State in the currency of that state with original effective maturity of over months</i>	50%	
	<i>Exposures to an EEA institution with a head office in another EEA State in the currency of another EEA State with original effective maturity of over months</i>	50%	See Notes 2 and 3.
	<i>Exposures to institution with a head office in a country outside the EEA in the currency of that country with original effective maturity of over months</i>	50%	See Note 1.
	<i>Other exposures</i>	100%	
<i>Corporates</i>		100%	
<i>Retail exposures</i>		75%	Simplified approach does not apply. Normal <i>rules</i> apply.
Mortgages on residential or commercial property		Various	Simplified approach does not apply. Normal <i>rules</i> apply.
Past due items		Various	Simplified approach does not apply. Normal <i>rules</i> apply.
High risk items		150%	Simplified approach does not apply. Normal <i>rules</i> apply.

Exposure class	Exposure sub-class	Risk weights	Comments
<i>Covered bonds</i>		Various	<i>Risk weights</i> are based on the <i>risk weight</i> of issuer as described in <i>BIPRU</i> 3.4.110R. The <i>risk weight</i> of the issuer for this purpose should be calculated under the simplified approach.
<i>Securitisation exposures</i>		Generally 1250%. May look through to underlying <i>exposures</i> if <i>BIPRU</i> 9 allows.	Use the <i>BIPRU</i> 9 rules for unrated <i>exposures</i> under the <i>standardised approach</i>
Short term <i>exposures</i> with rating			See <i>BIPRU</i> 3.4.112R. Not applicable as uses <i>ECAI</i> ratings.
<i>CIUs</i>	May look through to underlying under <i>BIPRU</i> 3.4.123R	Various	Simplified approach does not apply. Normal <i>rules</i> apply. May use simplified approach to underlying if simplified approach applies to underlying.
	May use average <i>risk weight</i> under <i>BIPRU</i> 3.4.124R	Various	Simplified approach does not apply. Normal <i>rules</i> apply. May use simplified approach to underlyings if simplified approach applies to underlying.
	High risk under <i>BIPRU</i> 3.4.118R	150%	Simplified approach does not apply. Normal <i>rules</i> apply.
	Others	100%	
Other items under <i>BIPRU</i> 3.2.9R(16)		Various	Simplified approach does not apply. Normal <i>rules</i> apply.

Exposure class	Exposure sub-class	Risk weights	Comments
<p>Note 1: The <i>risk weight</i> should not be lower than the <i>risk weight</i> that applies for national currency <i>exposures</i> of the central government of the third country in question under <i>BIPRU 3.5</i>. That means that this <i>risk weight</i> only applies if the third country is one of those to which <i>BIPRU 3.4.6R</i> (Preferential <i>risk weight</i> for <i>exposures</i> of the central government of countries outside the <i>EEA</i> that apply equivalent prudential standards) applies.</p>			
<p>Note 2: This is a transitional measure. It lasts until 31 December 2012.</p>			
<p>Note 3: The <i>risk weight</i> should not be lower than the <i>risk weight</i> that applies for <i>exposures</i> of the central government of the <i>EEA State</i> in question in the currency of another <i>EEA State</i> under <i>BIPRU 3.5</i>.</p>			

- 3.5.6 G If an *exposure* is guaranteed and if under *BIPRU 5* the *firm* may treat the *exposure* as being to the guarantor, the simplified approach may be used for the guarantor. The key provisions are *BIPRU 5.7.23R* to *BIPRU 5.7.25R*.
- 3.5.7 G If an *exposure* is collateralised and if under *BIPRU 5* the *firm* may recognise the collateral, the simplified approach may be used to determine the *risk weight* to be applied to the collateralised *exposure*. The key provisions are *BIPRU 5.4.18R* to *BIPRU 5.4.21R*.
- 3.5.8 R If a *firm* does not nominate one or more *eligible ECAIs* as referred to in *BIPRU 3.6.4R* the *firm* must not use the *financial collateral comprehensive method*.

- 3.6 Use of rating agencies' credit assessments for the determination of risk weights under the standardised approach to credit risk
- 3.6.1 R The use of *ECAI* credit assessments for the calculation of a *firm's risk weighted exposure amounts* must be consistent and in accordance with *BIPRU 3.5*. Credit assessments must not be used selectively.
- [Note: *BCD* Article 83(1)]
- 3.6.2 R Where the FSA's recognition of an *ECAI* is not limited to its solicited credit assessments, a *firm* may use an unsolicited credit assessment of an *eligible ECAI* for the calculation of a *firm's risk weighted exposure amounts*.
- [Note: *BCD* Article 83(2)]
- 3.6.3 G The FSA's recognition of an *ECAI* may be limited to its solicited credit assessments. Where this is the case a *firm* should not use unsolicited assessments. The FSA may indicate that the unsolicited ratings of an *eligible ECAI* are not to be used for the purposes of *BIPRU 3* if those assessments are considered to be inferior in quality to the general quality of solicited assessments or if it considers that the *ECAI's* strategy in relation to the issuing of unsolicited assessments is founded in the placing of undue pressure on the rated entity to pay for a rating..
- Treatment
- 3.6.4 R A *firm* may nominate one or more *eligible ECAs* to be used for the determination of *risk weights* to be assigned to asset and off-balance sheet items.
- [Note: *BCD* Annex VI Part 3 point 1]
- 3.6.5 R A *firm* which decides to use the credit assessments produced by an *eligible ECAI* for a certain class of items must use those credit assessments consistently for all *exposures* belonging to that class.
- [Note: *BCD* Annex VI Part 3 point 2]
- 3.6.6 R A *firm* which decides to use the credit assessments produced by an *eligible ECAI* must use them in a continuous and consistent way over time.
- [Note: *BCD* Annex VI Part 3 point 3]
- 3.6.7 R A *firm* can only use *ECAs'* credit assessments that take into account all amounts both in principal and in interest owed to it.

[Note: BCD Annex VI Part 3 point 4]

- 3.6.8 R If only one credit assessment is available from a *nominated ECAI* for a rated item, that credit assessment must be used to determine the *risk weight* for that item.

[Note: BCD Annex VI Part 3 point 5]

- 3.6.9 R If two credit assessments are available from *nominated ECAs* and the two correspond to different *risk weights* for a rated item, the higher *risk weight* must be applied.

[Note: BCD Annex VI Part 3 point 6]

- 3.6.10 R If more than two credit assessments are available from *nominated ECAs* for a rated item, the two assessments generating the two lowest *risk weights* must be referred to. If the two lowest *risk weights* are different, the higher *risk weight* must be assigned. If the two lowest *risk weights* are the same, that *risk weight* must be assigned.

[Note: BCD Annex VI Part 3 point 7]

- 3.6.11 R
- (1) If a *firm* has decided to make use of the credit assessments of export credit agencies, when *risk weighting exposures* to central governments or *central banks*, if two or more credit assessments are available to a *firm* from export credit agencies or if credit assessments are available to a *firm* from both *nominated ECAs* and export credit agencies, the *firm* must adopt the approach in this *rule*.
 - (2) If two credit assessments are available and correspond to different *risk weights* for a rated item, the higher *risk weight* must be applied.
 - (3) If more than two credit assessments are available for a rated item, the assessments generating the two lowest *risk weights* must be referred to:
 - (a) if the two lowest *risk weights* are the same, that *risk weight* must be applied; or
 - (b) if the two lowest *risk weights* are different, the higher of the two must be applied.
 - (4) If a *firm* does not for the purposes of *BIPRU 3* make any use of the consensus risk scores referred to in *BIPRU 3.4.7R(1)* it may treat those scores as not being available to it for the purpose of this *rule*. Likewise, if a *firm* does not for the purposes of *BIPRU 3* make any use of the credit assessments of a particular export credit agency as

referred to in *BIPRU 3.4.7R(2)* it may treat those assessments as not being available to it for the purpose of this *rule*.

Issuer and issue credit assessment

- 3.6.12 R Where a credit assessment exists for a specific issuing program or facility to which the item constituting the *exposure* belongs, this credit assessment must be used to determine the *risk weight* to be assigned to that item.

[**Note:** *BCD Annex VI Part 3 point 8*]

- 3.6.13 R Where no directly applicable credit assessment exists for a certain item, but a credit assessment exists for a specific issuing program or facility to which the item constituting the *exposure* does not belong or a general credit assessment exists for the issuer, then that credit assessment must be used if it produces a higher *risk weight* than would otherwise be the case or if it produces a lower *risk weight* and the *exposure* in question ranks *pari passu* or senior in all respects to the specific issuing program or facility or to senior unsecured *exposures* of that issuer as relevant.

[**Note:** *BCD Annex VI Part 3 point 9*]

- 3.6.14 R *BIPRU 3.6.12R* and *BIPRU 3.6.13R* are not to prevent the application of *BIPRU 3.4.107R* to *BIPRU 3.4.110R* (Exposures in the form of covered bonds).

[**Note:** *BCD Annex VI Part 3 point 10*]

- 3.6.15 R Credit assessments for issuers within a corporate group cannot be used as credit assessment of another issuer within the same corporate group.

[**Note:** *BCD Annex VI Part 3 point 11*]

Long-term and short-term credit assessments

- 3.6.16 R Short-term credit assessments may only be used for short-term asset and off-balance sheet items constituting *exposures* to *institutions* and *corporates*.

[**Note:** *BCD Annex VI Part 3 point 12*]

- 3.6.17 R Any short-term credit assessment may only apply to the item the short-term credit assessment refers to, and it must not be used to derive *risk weights* for any other item.

[**Note:** *BCD Annex VI Part 3 point 13*]

3.6.18 R Notwithstanding *BIPRU* 3.6.17R, if a short-term rated facility is assigned a 150% *risk weight*, then all unrated unsecured *exposures* on that obligor whether short-term or long-term must also be assigned a 150% *risk weight*.

[**Note:** *BCD* Annex VI Part 3 point 14]

3.6.19 R Notwithstanding *BIPRU* 3.6.17R, if a short-term rated facility is assigned a 50% *risk weight*, no unrated short-term *exposure* may be assigned a *risk weight* lower than 100%.

[**Note:** *BCD* Annex VI Part 3 point 15]

Domestic and foreign currency items

3.6.20 R A credit assessment that refers to an item denominated in the obligor's domestic currency cannot be used to derive a *risk weight* for another *exposure* on that same obligor that is denominated in a foreign currency.

[**Note:** *BCD* Annex VI Part 3 point 16]

3.6.21 R Notwithstanding *BIPRU* 3.6.20R, when an *exposure* arises through a *firm's* participation in a loan that has been extended by a *multilateral development bank* whose preferred creditor status is recognised in the market, the credit assessment on the obligors' domestic currency item may be used for *risk weighting* purposes.

[**Note:** *BCD* Annex VI Part 3 point 17]

3.7 Classification of off-balance-sheet items

- 3.7.1 R In accordance with *BIPRU 3.2.1R(2)* and *BIPRU 3.2.2R*, a *firm* must:
- (1) assign an off-balance sheet item listed in the table in *BIPRU 3.7.2R* to the risk category indicated in column 1 of that table; and
 - (2) determine the *exposure* value of that item as the percentage of its value for the appropriate risk category as set out in column 3 of the table in *BIPRU 3.7.2R*.

Table: Classification of off-balance-sheet items

- 3.7.2 R This table belongs to *BIPRU 3.7.1R*

[**Note:** *BCD Annex II*]

Category	Item	Percentage
Full risk	Guarantees having the character of credit substitutes Credit derivatives Acceptances Endorsements on bills not bearing the name of another <i>credit institution</i> Transactions with recourse Irrevocable standby letters of credit having the character of credit substitutes Assets purchased under outright forward purchase agreements Forward forward deposits The unpaid portion of partly-paid <i>shares</i> and <i>securities</i> Asset sale and repurchase agreements as defined in Article 12(3) and (5) of the <i>Bank Accounts Directive</i> Other items also carrying full risk	100%

Category	Item	Percentage
Medium risk	<p>Documentary credits issued and confirmed (see also medium/low risk).</p> <p>Warranties and indemnities (including tender, performance, customs and tax bonds) and guarantees not having the character of credit substitutes.</p> <p>Irrevocable standby letters of credit not having the character of credit substitutes.</p> <p>Undrawn credit facilities (agreements to lend, purchase <i>securities</i>, provide guarantees or acceptance facilities) with an original maturity of more than one year.</p> <p>Note issuance facilities (NIFs) and revolving underwriting facilities (RUFs).</p>	50%
Medium/low risk	<p>Documentary credits in which underlying shipment acts as collateral and other self-liquidating transactions.</p> <p>Undrawn credit facilities (agreements to lend, purchase <i>securities</i>, provide guarantees or acceptance facilities) with an original maturity of up to and including one year which may not be cancelled unconditionally at any time without notice or that do not effectively provide for automatic cancellation due to deterioration in a borrower's creditworthiness.</p>	20%

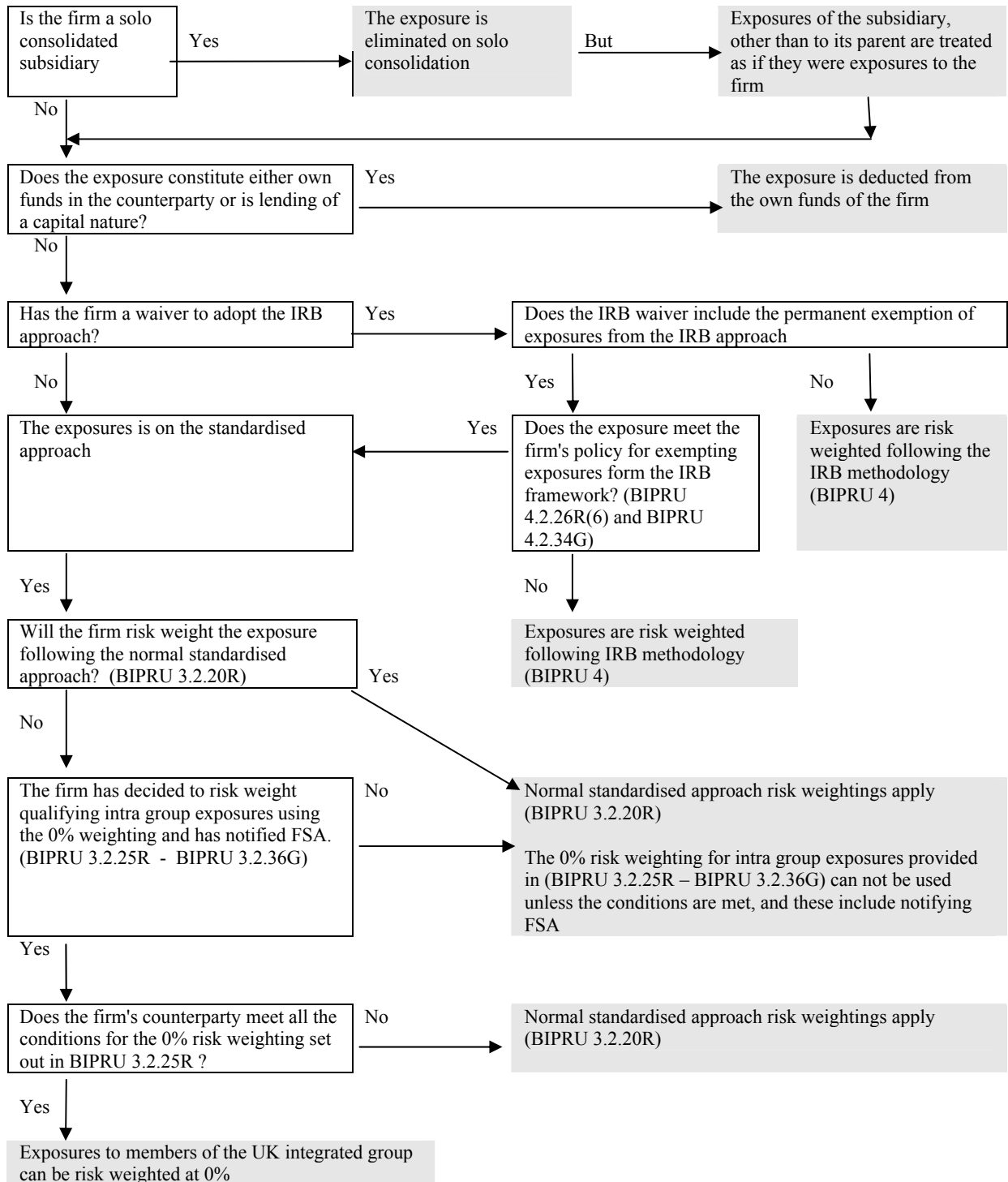
Category	Item	Percentage
Low risk	Undrawn credit facilities (agreements to lend, purchase <i>securities</i> , provide guarantees or acceptance facilities) which may be cancelled unconditionally at any time without notice, or that do effectively provide for automatic cancellation due to deterioration in a borrower's creditworthiness. Retail credit lines may be considered as unconditionally cancellable if the terms permit the <i>firm</i> to cancel them to the full extent allowable under consumer protection and related legislation.	0%

BIPRU 3 Annex 1 G

Guidance on the standardised approach zero risk weighting for intra-group exposures

This flow chart belongs to *BIPRU 3.2.25R – BIPRU 3.2.35G*.

Flowchart – zero risk weighting for intra-group exposures



3 Annex 2R

Regional governments and local authorities eligible for the treatment in BIPRU 3.4.15R

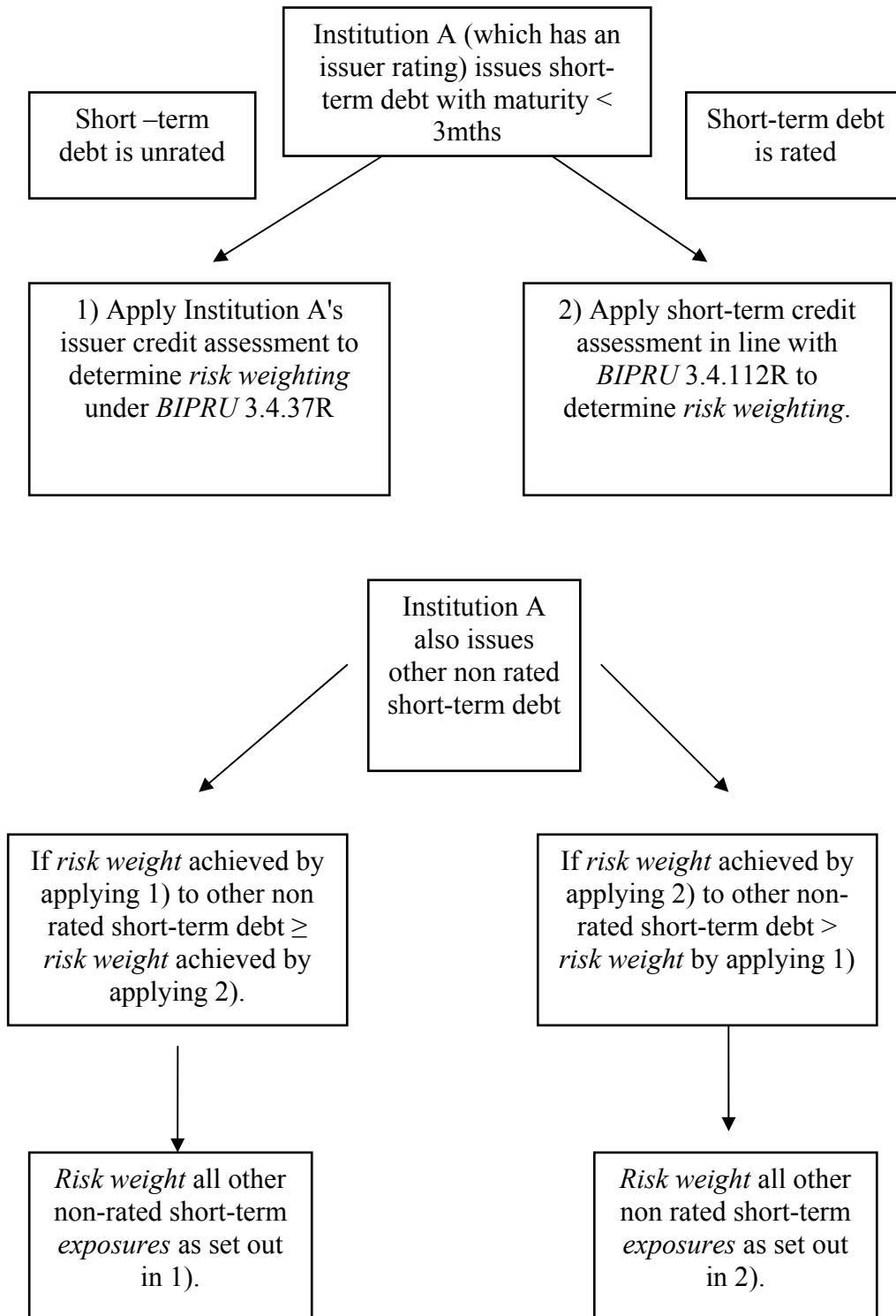
- | | |
|-----|-----------------------------|
| (1) | The Scottish Parliament |
| (2) | National Assembly for Wales |
| (3) | Northern Ireland Assembly |

3 Annex 3R

High risk exposures

- | | |
|-----|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| (1) | <i>Exposures</i> arising out of <i>venture capital business</i> (whether or not the <i>firm</i> itself carries on the <i>venture capital business</i>). |
| (2) | Any <i>exposure</i> of the type referred to in <i>BIPRU 3.4.118R</i> (High risk position in a <i>CIU</i>) that is illiquid and held with a view to long-term sale or realisation. |

Exposures to institutions: Interaction with short-term credit assessments in BIPRU 3.4.40R



- 4 The IRB approach
- 4.1 The IRB approach: Application, purpose and overview
- Application
- 4.1.1 R *BIPRU 4 applies to a firm with an IRB permission.*
- Purpose
- 4.1.2 G *BIPRU 4 implements the following provisions of the Banking Consolidation Directive:*
- (1) Articles 84 - 89; and
 - (2) Annex VII.
- 4.1.3 G *BIPRU 4 also implements Annex VIII of the Banking Consolidation Directive so far as it applies to the IRB approach. In particular, it implements (in part):*
- (1) from Part 1 of that Annex, points 12-16, 19-22, 26(g)(ii) and 27;
 - (2) from Part 2 of that Annex, points 8-11; and
 - (3) from Part 3 of that Annex, points 1, 11, 20, 23-24, 58(h), 61, 64-79 and 90-93.
- 4.1.4 G *BIPRU 4 also implements article 40 of the Capital Adequacy Directive as it applies to the IRB approach.*
- 4.1.5 G Other material on the *IRB approach* can be found in *BIPRU 8* (Group risk), *BIPRU 9* (Securitisation), *BIPRU 13* (The calculation of exposure values for financial derivatives, securities financing transactions and long settlement transactions) and *BIPRU 14* (Capital requirements for settlement and counterparty risk). *BIPRU 5* (Credit risk mitigation) also contains material applicable to the *IRB approach*.
- Overview
- 4.1.6 G The *IRB approach* is an alternative to the *standardised approach* for calculating a *firm's* credit risk capital requirements. It may be applied to all a *firm's exposures* or to some of them, subject to various limitations on partial use as set out in *BIPRU 4.2*. Under the *IRB approach* capital requirements are based on a *firm's* own estimates of certain parameters together with other parameters set out in the *Banking Consolidation Directive*.
- 4.1.7 G *Exposures* are divided into a number of distinct *exposure* classes. These are listed in *BIPRU 4.3.2R*. There is a special treatment for purchased receivables, although they do not form an *exposure* class on their own.
-

- 4.1.8 G For *exposures* in the *sovereign, institution and corporate IRB exposure class*, there is a *foundation IRB approach* under which a *firm* provides its own estimates of *PD* and an *advanced IRB approach* under which a *firm* additionally provides its own estimates of *LGD* and *conversion factors*. The distinction between the *foundation IRB approach* and the *advanced IRB approach* only applies to this *IRB exposure class*.
- 4.1.9 G For *retail exposures*, a *firm* provides its own estimates of *PD*, *LGD* and *conversion factors*.
- 4.1.10 G For the *corporate exposure* class there is a separate sub-class of *specialised lending exposure*. A *firm* may calculate *risk weights* for these *exposures*, where it is able to do so, in the same way as it does for the rest of its *corporate exposure* class, i.e. using the *foundation IRB approach* or the *advanced IRB approach*. Where a *firm* is not able to use this approach it may calculate *risk weights* for *specialised lending exposures* by slotting them into predetermined *risk weights*.
- 4.1.11 G For *equity exposures* there are two approaches based on market based measures and a third under which a *firm* uses its own estimates of *PD* only.
- IRB permissions: general
- 4.1.12 G The *rules* in *GENPRU* and *BIPRU* do not allow a *firm* to use the *IRB approach*. A *firm* that wishes to use the *IRB approach* should therefore apply for permission to use the *IRB approach* using the application procedure explained in *BIPRU* 1.3. If a *firm's* application is granted, its terms will be set out in an *IRB permission*.
- 4.1.13 G The *FSA* recognises that the nature of *IRB approaches* will vary between *firms*. The scope of and the requirements and conditions set out in an *IRB permission* may therefore differ in substance or detail from *BIPRU* 4 in order to address individual circumstances adequately. However any differences will only be allowed if they are compliant with the *Banking Consolidation Directive*. An *IRB permission* will implement any such variation by modifying the relevant provisions of *GENPRU* and *BIPRU*. An *IRB permission* may also include additional conditions to meet the particular circumstances of the *firm*.
- 4.1.14 G (1) The *FSA* will only grant an *IRB permission* if it is satisfied that the *firm's* systems for the management and rating of credit risk *exposures* are sound and implemented with integrity and, in particular, that they meet the standards in *BIPRU* 4.2.2R in accordance with the *minimum IRB standards*.
- (2) Under *BIPRU* 4.2.11R, a *firm* applying for an *IRB permission* is required to demonstrate that it has been using for the *IRB exposure classes* in question *rating systems* that were broadly in line with the *minimum IRB standards* for internal risk measurement and management purposes for at least three years prior to the date of its *IRB permission*.
-

- (3) Under *BIPRU 4.2.13R*, a *firm* applying for the use of own estimates of *LGDs* and/or *conversion factors* should demonstrate that it has been estimating and employing own estimates of *LGDs* and/or *conversion factors* in a manner that was broadly consistent with the *minimum IRB standards* for use of own estimates for at least three years prior to the date of its *IRB permission* or of a variation of its *IRB permission* that, in either case, entitles the *firm* to use own estimates of *LGDs* and/or *conversion factors*.

Link to standard rules: Incorporation of the IRB output into the capital calculation

- 4.1.15 G An *IRB permission* will modify *GENPRU 2.1.51R* (Calculation of the credit risk capital requirement) by amending, to the extent set out in the *IRB permission*, the calculation of the *credit risk capital requirement* in accordance with *BIPRU 4* and the other provisions of the *Handbook* relating to the *IRB approach*.
- 4.1.16 R A *firm* must calculate its *credit risk capital component* as the sum of:
- (1) (for *exposures* to which the *standardised approach* is applied) the *credit risk capital component* as calculated under *BIPRU 3.1.5R*; and
 - (2) (for *exposures* to which the *IRB approach* is applied to which the *standardised approach* would otherwise apply in accordance with *BIPRU 3.1.5R* (Credit risk capital component)), 8% of the total of the *firm's risk weighted exposure amounts* calculated in accordance with the *IRB approach*.
- 4.1.17 G For *exposures* covered by an *IRB permission*, *BIPRU 5* (Credit risk mitigation) is modified by *BIPRU 4.10*.
- 4.1.18 G Under *BIPRU 4.9*, a *firm* is required to deal with *securitisation positions* under those provisions of *BIPRU 9* applicable to a *firm* using the *IRB approach*.
- 4.1.19 G *Exposures* treated under *BIPRU 13* are required to be dealt with in accordance with the *IRB approach* to the extent set out in *BIPRU 13*.
- 4.1.20 G By modifying *GENPRU 2.1.51R* to allow the *firm* to use the *IRB approach* to calculate all or part of its *risk weighted exposure amounts*, the *FSA* is treating it like an application rule. The modification means that the provisions of *BIPRU* relating to the *IRB approach* supersede the rules relating to the *standardised approach* for *exposures* coming within the scope of the *IRB permission*.
- 4.1.21 R A reference in the *Handbook* to a provision of the *IRB approach*, in the case of a *firm*:
- (1) excludes any provision of the *IRB approach* set out in the *Handbook* that is not applied to that *firm* by its *IRB permission*;
 - (2) includes any additional provision contained in the *firm's IRB permission*; and
 - (3) takes into account any other amendments made to the provisions in the *Handbook* relating to the *IRB approach* made by the *firm's IRB permission*.
-

- 4.1.22 R To the extent that a *firm's IRB permission* does not allow it to use a particular approach in the *Handbook* relating to the *IRB approach* the *Handbook* provision in question does not apply to the *firm*.
- 4.1.23 R If a provision of the *Handbook* relating to the *IRB approach* says that a *firm* may do something if its *IRB permission* allows it, a *firm* may do that thing unless its *IRB permission* expressly says that it may not do so except that:
- (1) *BIPRU 4.2.18R - BIPRU 4.2.19R* (Sequential implementation of IRB approach) and *BIPRU 4.2.26R(1)-(5)* (Combined use of standardised approach with IRB approach) only apply if expressly permitted by a *firm's IRB permission*;
 - (2) a *firm* may not use the *advanced IRB approach* for the *sovereign, institution and corporate IRB exposure class* except to the extent expressly permitted by the *firm's IRB permission*;
 - (3) if a *firm* uses its own estimates of *LGD* and *conversion factors* it may only take into account *unfunded credit protection* to reduce *LGD* in the manner set out in its *IRB permission*;
 - (4) if a *firm* uses its own estimates of *LGD* and *conversion factors* it may only recognise the effects of financial collateral under *BIPRU 10.6.17R* (Exemptions for firms using own estimates of *LGD* and *conversion factors* under the *IRB approach*) in the manner set out in its *IRB permission*;
 - (5) a *firm* must deal with *equity exposures* in the manner set out in its *IRB permission*; and
 - (6) (in the case of *collateral* that is only eligible for recognition under paragraph 21 of Part 1 of Annex VIII of the *Banking Consolidation Directive* (Other physical collateral)) a *firm* may not recognise as eligible collateral an item of a type referred to in *BIPRU 4.10.16R* (Other physical collateral) unless that item is of a type specified as permitted in its *IRB permission*.
- 4.1.24 G An *IRB permission* will set out *firm-specific* material. This will generally include:
- (1) details about the *firm's* methodology for carrying out the *IRB approach*, including the models and *rating systems* that a *firm* should use;
 - (2) reporting requirements; and
 - (3) requirements about internal control structure.
- Compliance
- 4.1.25 R If a *firm* ceases to comply with the requirements of the *IRB approach*, it must either present to the *FSA* a plan for a timely return to compliance or demonstrate that the effect of non-compliance is immaterial.

[Note BCD Article 84(5)]

- 4.1.26 G If a *firm* ceases to comply with the requirements of the *IRB approach*, the *FSA* may revoke the *IRB permission* or take other appropriate supervisory action.
- 4.1.27 G For the purposes of *BIPRU 4.1.25R*, the *FSA* will expect a *firm* to demonstrate that, taking into account all instances where the *firm* has not complied with the requirements of the *IRB approach*, the effect of non-compliance is immaterial.
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4.2 The IRB approach: High level material

Application

4.2.1 R This section applies to all *exposures* treated under the *IRB approach*.

General approach to granting an IRB permission

4.2.2 R A *firm's* systems for the management and rating of credit risk *exposures* must be sound and implemented with integrity and, in particular, they must meet the following standards in accordance with the *minimum IRB standards*:

- (1) the *firm's rating systems* provide for a meaningful assessment of obligor and transaction characteristics, a meaningful differentiation of risk and accurate and consistent quantitative estimates of risk;
- (2) internal ratings and *default* and *loss* estimates used in the calculation of capital requirements and associated systems and processes play an essential role in the risk management and decision-making process, and in the credit approval, internal capital allocation and corporate governance functions of the *firm*;
- (3) the *firm* has a credit risk control unit responsible for its *rating systems* that is appropriately independent and free from undue influence;
- (4) the *firm* collects and stores all relevant data to provide effective support to its credit risk measurement and management process; and
- (5) the *firm* documents its *rating systems*, the rationale for their design and validates its rating systems.

[Note: BCD Article 84(2) (part)]

4.2.3 R Where an *EU parent credit institution* and its *subsidiary undertakings* or an *EU parent financial holding company* and its *subsidiary undertakings* use the *IRB approach* on a unified basis, the question whether the *minimum IRB standards* are met is answered by considering the *parent undertaking* and its *subsidiary undertakings* together unless the *firm's IRB permission* specifies otherwise.

[Note: BCD Article 84(2) (part)]

Outsourcing

- 4.2.4 G
- (1) This *guidance* sets out the basis on which a *firm* may rely upon a *rating system* or data provided by another member of its *group*.
 - (2) A *firm* may rely upon a *rating system* or data provided by another member of its *group* if the following conditions are satisfied:
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- (a) the *firm* only does so to the extent that it is appropriate, given the nature and scale of the *firm's* business and portfolios and the *firm's* position within the *group*;
 - (b) the *group* is an *EEA banking and investment group*;
 - (c) the integrity of the *firm's* systems and controls is not adversely affected;
 - (d) the outsourcing of these functions meets the requirements of *SYSC*; and
 - (e) (if the provision of the *rating system* or data is not carried out in the *United Kingdom* or in the jurisdiction of the *competent authority* that is the lead regulator of the *group*) the *firm* can demonstrate to the *FSA* that the ability of the *FSA* and that lead regulator to carry out their responsibilities under the *Handbook*, the *Banking Consolidation Directive* and the *Capital Adequacy Directive* are not adversely affected.
- (3) If a *firm* does use a *rating system* or data provided by another member of its *group*, the requirements in *BIPRU 4* continue to apply to that *firm* in respect of that *rating system* and data. A *firm* cannot absolve itself of the responsibility for complying with those requirements by claiming that any breach is caused by the actions of a third party to which the *firm* has delegated tasks. The *rating system* and data provision are still those of the *firm*, even though personnel elsewhere in the *firm's* group are carrying out these functions on its behalf. So any references in *BIPRU* to what a *firm*, its personnel and its management should and should not do still apply.
- (4) If a *firm* does use a *rating system* or data provided by another *group* member, the *firm's governing body* should formally delegate those functions to the *persons* or bodies that are to carry them out.
- (5) Before delegating the provision of a *rating system* or data to another *group* member, the *firm's governing body* should have explicitly considered the arrangement and decided that it is appropriate and that it enables the *firm* to meet the conditions in (2).

Assessment and estimation

- 4.2.5 G (1) This paragraph provides *guidance* on *BIPRU 4.2.2R* and in particular *BIPRU 4.2.2R(1)*.
- (2) The information that a *firm* produces or uses for the purpose of the *IRB approach* should be reliable and take proper account of the different users of the information produced (customers, shareholders, regulators and other market participants).
- (3) A *firm* should establish quantified and documented targets and standards, against which it should test the accuracy of data used in its *rating systems*.
- (4) Tests under (3) might include:
-

- (a) report and accounts reconciliation, including completeness in relation to (b);
 - (b) whether every *exposure* has a *PD*, *LGD* and, if applicable, *conversion factor* for reporting purposes;
 - (c) whether the *firm's* risk control environment has key risk indicators for the purpose of monitoring and ensuring data accuracy;
 - (d) whether the *firm* has an adequate business and information technology infrastructure with fully documented processes;
 - (e) whether the *firm* has clear and documented standards on ownership of data (including inputs and manipulation) and timeliness of current data (daily, monthly, real time); and
 - (f) whether the *firm* has a comprehensive quantitative audit programme.
- (5) The reconciliation referred to in 4(a) should be reasonably fit for purpose. In particular it should meet the standards in (6) and (7).
- (6) For data inputs, testing for accuracy of data, including the reconciliation referred to in 4(a), should be sufficiently detailed so that, together with other available evidence, it gives reasonable assurance that data input into the *rating system* is accurate, complete and appropriate. Input data fails the required standard if it gives rise to a serious risk of material misstatement in the capital requirement either immediately or subsequently.
- (7) For data outputs, the *firm*, as part of the reconciliation referred to in 4(a), should be able to identify and explain material differences between the outputs produced under accounting standards and those produced under the requirements of the *IRB approach*, including in relation to areas that address similar concepts in different ways (for example *expected loss* on the one hand and accounting provisions on the other).
- (8) A *firm* should have clear and documented standards and policies about the use of data in practice (including information technology standards) which should in particular cover the *firm's* approach to the following:
- (a) data access and security;
 - (b) data integrity, including the accuracy, completeness, appropriateness and testing of data; and
 - (c) data availability.

Further requirements concerning the use test

- 4.2.6 R If a *firm* uses separate models for the purpose of the *IRB approach* and for its internal purposes as referred to in *BIPRU* 4.2.2R(2) it must be able to demonstrate the reasonableness of any differences between those models.
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- 4.2.7 G (1) This paragraph provides *guidance* on *BIPRU* 4.2.2R and in particular *BIPRU* 4.2.2R(2).
- (2) The *IRB approach* as applicable to a *firm* should be an integral part of its business and risk management processes and procedures to the extent that credit risk is relevant to them. It should also have a substantial influence on its decision-making and actions. ~~In particular, the *FSA* would expect a *firm* to have regard to the following areas~~
- (a) particular regard should be had to the use of the *IRB approach* in:
- (i) credit approval;
 - (ii) individual and portfolio limit setting;
 - (iii) reporting of credit risk information; and
 - (iv) provisioning; ~~and~~
 - ~~(v) the setting and use of the significant criteria by reference to which other decisions to incur or maintain credit risk are taken or by reference to which credit risk is otherwise assessed;~~
- (b) other relevant aspects include ~~assessment of~~:
- (vi) assessment of economic capital;
 - (vii) internal capital allocation so far as related to credit risk;
 - (viii) risk appetite;
 - (ix) strategy and acquisitions;
 - (x) profitability and performance; and
 - (xi) performance-related remuneration;
- (c) the carrying out of the *firm's* obligations under the *overall Pillar 2 rule*; and
- (d) matters relating to the *firm's* infrastructure, including information technology, skills and resources and organisational culture.
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- 4.2.8 G This paragraph provides further *guidance* on *BIPRU 4.2.2R* and in particular *BIPRU 4.2.2R(2)*. In the *FSA's* view risk management has an essential role in informing risk decisions. However, an essential role does not necessarily mean an exclusive role or even always a primary role. There may be justifiable differences between the *IRB approach* and the *firm's* use of *rating systems* for its internal purposes as referred to in *BIPRU 4.2.2R(2)*. For example, internal standards and policies may refer to estimates of *PD* and *LGD* for the length of the asset rather than to estimates based on a one-year period (in the case of *PD* estimates) or on an economic downturn (in the case of *LGD* estimates) required by the *IRB approach*.
- 4.2.9 G If a *firm* uses scorecards for its internal credit approval process and the models it uses for the purpose of the *IRB approach* are fundamentally different from those scorecards, a *firm's* demonstration of how this is compatible with *BIPRU 4.2.2R(2)* might include demonstrating that estimates calculated under the *IRB approach* are used to change sanctioning decisions at an individual or portfolio level. Examples of this might include amending cut-offs, the application of policy rules, the revision of an existing scorecard or the introduction of a new one or taking strategic decisions on which segments of the market to target.
- 4.2.10 G To the extent that a *firm* uses *LGD* estimates in its internal risk management processes that differ from the downturn *LGDs* used in the calculation of *risk weighted assets* (see *BIPRU 4.3.103R*), the reasons for the difference should be documented in accordance with *BIPRU 4.3.109R*.

Requirements concerning the experience requirement

- 4.2.11 R A *firm* must be able to demonstrate that it has been using for the *IRB exposure classes* in question *rating systems* that were broadly in line with the *minimum IRB standards* for internal risk measurement and management purposes for at least three years prior to the date of its *IRB permission*.

[**Note:** *BCD* Article 84(3)]

- 4.2.12 G In meeting the experience requirement under *BIPRU 4.2.11R*, the *FSA* would expect a *firm* to be able to demonstrate that it has been:
- (1) operating an internal *rating system* with estimates of *PD*;
 - (2) meeting the standards in *BIPRU 4* for senior management knowledge and reporting; and
 - (3) meeting the standards in *BIPRU 4* relating to the use of *rating systems* in its business;

for the required minimum 3 year period.

4.2.13 R A *firm* that has applied for the use of own estimates of *LGDs* and/or *conversion factors* must be able to demonstrate to the *FSA* that it has been estimating and employing own estimates of *LGDs* and/or *conversion factors* in a manner that was broadly consistent with the *minimum IRB standards* for use of own estimates of those parameters for at least three years prior to the date of its *IRB permission* or of a variation of its *IRB permission* that, in either case, entitled the *firm* to use own estimates of *LGDs* and/or *conversion factors*.

[**Note:** *BCD* Article 84(4)]

4.2.14 G In meeting the experience requirement under *BIPRU* 4.2.13R, the *FSA* would expect a *firm* to be able to demonstrate that it has been:

(1) operating an internal *rating system* with estimates of *LGD* and with *conversion factors*; and

(2) compliant with *BIPRU* 4.2.11R as applied to the *advanced IRB approach*.

for the required minimum 3 year period.

4.2.15 G In the *FSA's* view the standard required by *BIPRU* 4.2.11R and *BIPRU* 4.2.13R is for a *rating system* to be improved in the light of experience during the three year period so that it meets the minimum requirements more fully for the last year than for the two prior years, provided that the *rating system* has not changed so profoundly that experience from the first or second years becomes of marginal relevance in assessing the reliability of the changed *rating system*.

Implementation of the internal ratings based approach

4.2.16 R A *firm* must comply with any requirements in its *IRB permission* relating to the matters described in 4.2.17R – *BIPRU* 4.2.35G.

4.2.17 R Without prejudice to *BIPRU* 4.2.26R, a *firm* and any *parent undertaking* and its *subsidiary undertakings* must implement the *IRB approach* for all *exposures*.

[**Note:** *BCD* Article 85(1) (part)]

4.2.18 R To the extent that a *firm's IRB permission* permits this, implementation may be carried out sequentially across the different *IRB exposure classes* within the same business unit, across different business units in the same group or for the use of own estimates of *LGDs* or *conversion factors* for the calculation of *risk weights* for the *sovereign, institutional and corporate IRB exposure class*.

[**Note:** *BCD* Article 85(1) (part)]

4.2.19 R In the case of the *retail exposures*, implementation may (but only to the extent provided for in the *firm's IRB permission*) be carried out sequentially across the categories of *exposures* to which the different correlations in *BIPRU* 4.6.41R–*BIPRU* 4.6.44R correspond.

[Note: BCD Article 85(1) (part)]

- 4.2.20 R (1) Implementation of the *IRB approach* as referred to in *BIPRU 4.2.18R* must be carried out within a reasonable period of time as set out in the *IRB permission*.
- (2) The implementation must be carried out subject to strict conditions determined by the *FSA* and set out in the *IRB permission*.
- (3) A *firm* must not use the flexibility under *BIPRU 4.2.18R* selectively with the purpose of achieving reduced minimum capital requirements in respect of those *IRB exposure classes* or business units that are yet to be included in the *IRB approach* or in the use of own estimates of *LGDs* and *conversion factors*.

[Note: BCD Article 85(2)]

- 4.2.21 G (1) A *firm* should achieve full roll-out of the *IRB approach* to all its *exposures*, subject to the exemptions outlined in *BIPRU 4.2.26R*, within the period specified in its *IRB permission*. A *firm* should not retain a permanent mix of portfolios on the *standardised approach* and the *IRB approach*, on the *foundation IRB approach* and the *advanced IRB approach* or on a mixture of all approaches with the exception of portfolios covered by those exemptions.
- (2) This applies to a move:
- (a) from the *standardised approach* to the *IRB approach*;
- (b) from the *foundation IRB approach* to the *advanced IRB approach*; and
- (c) from the transitional *rules and guidance* for *BIPRU* to the *IRB approach*.
- (3) The period referred to in *BIPRU 4.2.20R(1)* will generally be not more than three years of starting use of the *IRB approach* or the *advanced IRB approach* as applicable.

- 4.2.22 R A *firm* using the *IRB approach* for any *IRB exposure class* must at the same time use the *IRB approach* for the *equity exposure class*.

[Note: BCD Article 85(3)]

- 4.2.23 R Subject to *BIPRU 4.2.17R – BIPRU 4.2.20R*, *BIPRU 4.2.22R* and *BIPRU 4.2.26R*, a *firm* that has an *IRB permission* must not use the *standardised approach* for the calculation of *risk-weighted exposure amounts* for the *exposures* to which the *IRB approach* applies under the *IRB permission*.

[Note: BCD Article 85(4)]

4.2.24 R Subject to *BIPRU 4.2.17R – BIPRU 4.2.22R* and *BIPRU 4.2.26R*, a *firm* whose *IRB permission* provides for the use of the *advanced IRB approach* for the calculation of *LGDs* and *conversion factors* for the *sovereign, institution and corporate IRB exposure class* must not use the *LGD values* and *conversion factors* applicable to the *foundation IRB approach* for the exposures to which the *advanced IRB approach* applies under the *IRB permission*.

[Note: BCD Article 85(5)]

4.2.25 G The *FSA* will not agree to a *firm's* request to revoke or vary its *IRB permission* so as to permit the *firm* to revert to the *standardised approach* except for demonstrated good cause. Likewise, the *FSA* will not agree to a *firm's* request to revoke or vary its *IRB permission* so as to permit the *firm* to revert to the *foundation IRB approach* if the *IRB permission* provides for it to use the *advanced IRB approach*, except for demonstrated good cause.

Combined use of methodologies: Basic provisions

- 4.2.26 R
- (1) To the extent that its *IRB permission* permits this, a *firm* permitted to use the *IRB approach* in the calculation of *risk weighted exposure amounts* and *expected loss amounts* for one or more *IRB exposure classes* may apply the *standardised approach* in accordance with this *rule*.
 - (2) A *firm* may apply the *standardised approach* to the *IRB exposure class* referred to in *BIPRU 4.3.2R(1)* (Sovereigns) where the number of material counterparties is limited and it would be unduly burdensome for the *firm* to implement a *rating system* for these counterparties. A *firm* may include in this treatment an *exposure* of the type described in *BIPRU 3.4.18R* (Exposures to churches or religious communities) that would fall within *BIPRU 3.4.15R* or *BIPRU 3.4.17R* (Exposure to a regional government or local authority) if those provisions had not been excluded by *BIPRU 3.4.18R*.
 - (3) A *firm* may apply the *standardised approach* to the *IRB exposure class* referred to in *BIPRU 4.3.2R(2)* (Institutions), where the number of material counterparties is limited and it would be unduly burdensome for the *firm* to implement a *rating system* for these counterparties.
 - (4) A *firm* may apply the *standardised approach* to exposures in non-significant business units as well as *IRB exposure classes* that are immaterial in terms of size and perceived risk profile.
 - (5) A *firm* may apply the *standardised approach* to exposures to the central government of the *United Kingdom* and to its regional governments, local authorities and administrative bodies, provided that:
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- (a) there is no difference in risk between the *exposures* to the central government and those other *exposures* because of specific public arrangements; and
 - (b) *exposures* to the central government are assigned a 0% *risk weight* under the *standardised approach*.
- (6) A *firm* may apply the *standardised approach* to *exposures* of a *firm* to a counterparty which is its *parent undertaking*, its *subsidiary undertaking* or a *subsidiary undertaking* of its *parent undertaking* provided that the counterparty is an *institution*, a *financial holding company*, a *financial institution*, an *asset management company* or an *ancillary services undertaking* subject to appropriate prudential requirements.
 - (7) A *firm* may apply the *standardised approach* to *equity exposures* to entities whose credit obligations qualify for a 0% *risk weight* under the *standardised approach* (including those publicly sponsored entities where a zero *risk weight* can be applied).
 - (8) A *firm* may apply the *standardised approach* to *equity exposures* incurred under legislative programmes to promote specified sectors of the economy that provide significant subsidies for the investment to the *firm* and involve some form of government oversight and restrictions on the *equity* investments. This exclusion is limited to an aggregate of 10% of *capital resources*.
 - (9) A *firm* may apply the *standardised approach* to the *exposures* identified in *BIPRU* 3.4.48R (Exposures in the form of minimum reserves required by the European Central Bank or by the central bank of an EEA State) meeting the conditions specified therein.
 - (10) A *firm* may apply the *standardised approach* to state and state-reinsured guarantees pursuant to *BIPRU* 5.7.12R (Conditions for state and state-reinsured guarantees).

[Note: BCD Article 89(1)]

Combined use of methodologies: Documentation

- 4.2.27 G As part of the application for an *IRB permission*, a *firm* should have a well documented policy explaining the basis on which *exposures* are to be selected for permanent exemption from the *IRB approach* and for treatment under the *standardised approach*. The *firm's* roll out plan should also contain provisions for the continuing application of that policy on a consistent basis over time.

Combined use of methodologies: Sovereign and institutional, exposures

4.2.28 G A *firm* intending to make use of *BIPRU* 4.2.26R(2) or (3) should demonstrate to the *FSA* when applying for an *IRB permission* that it meets the requirements of those provisions with respect to its sovereign or, as the case may be, institutional, *exposures*.

Combined use of methodologies: Meaning of non-significance and immateriality

4.2.29 R For the purposes of *BIPRU* 4.2.26R(4), the *equity exposure IRB exposure class* of a *firm* must be considered material if its aggregate value, excluding *equity exposures* incurred under legislative programmes as referred to in *BIPRU* 4.2.26R(8), exceeds, on average over the preceding year, 10% of the *firm's capital resources*. If the number of those *equity exposures* is less than 10 individual holdings, that threshold is 5% of the *firm's capital resources*.

[Note: *BCD* Article 89(2)]

4.2.30 R (1) This *rule* sets out what must be treated as being non-significant business or immaterial for the purposes of *BIPRU* 4.2.26R(4), for *exposures* that do not fall within the *equity exposure IRB exposure class*.

(2) A *firm* may elect permanently to exclude *exposures* from the *IRB approach* and apply the *standardised approach*. However a *firm* may only make use of this exemption to the extent that:

(a) the *consolidated credit risk requirement* (adjusted under (6)) so far as it is attributable to the excluded *exposures*;

would be no more than 15% of:

(b) the *consolidated credit risk requirement* (adjusted under (6)) with respect to all *exposures* (including the ones dealt with under (a)).

(3) *Exposures* excluded under *BIPRU* 4.2.29R or *BIPRU* 4.2.26R(2), (3) and (5)-(7) must not be included in (a) or (b).

(4) The calculation in (2)(a) is based on the *standardised approach*.

(5) The calculation in (2)(b) is based on whichever of the *standardised approach* and the *IRB approach* would apply to the *exposures* referred to in (2)(b) at the time when the calculation is being made.

(6) The *consolidated credit risk requirement* is adjusted for the purposes of this *rule* as follows:

(a) the element based on the *concentration risk capital component* is excluded, with only the elements based on the *credit risk capital component* and the *counterparty risk capital component* being taken into account; and

(b) the calculation is carried out with respect to the group of *undertakings* referred to in *BIPRU* 4.2.17R.

(7) If a group with respect to which the calculation in this *rule* is being carried out is not required to calculate the *consolidated credit risk requirement*, the calculations in this *rule* must be carried out as if it were.

4.2.31 R If a *firm* applies to use the *advanced IRB approach* for the *sovereign, institution and corporate IRB exposure class*, BIPRU 4.2.26R(4) also applies with respect to *exposures* in that class. For these purposes, to the extent permitted in the *firm's IRB permission*, a *firm* may:

- (1) exclude some *exposures* from the *IRB approach* and apply the *standardised approach* to those *exposures*; and
- (2) exclude other *exposures* from the *advanced IRB approach* and apply the *foundation IRB approach* to those *exposures*.

4.2.32 G Where BIPRU 4.2.31R applies:

- (1) the 15% limit in BIPRU 4.2.30R(2) is a combined limit for excluded *exposures* remaining on the *standardised approach* and excluded *exposures* remaining on the *foundation IRB approach*; and
- (2) the calculation in BIPRU 4.2.30R(2)(a) is carried out under whichever method of calculation would be applicable to the *exposure* in question.

Combined use of methodologies: Territorial aspects

- 4.2.33 G
- (1) This *guidance* sets out at what level the tests in BIPRU 4.2.30R- BIPRU 4.2.32R will be applied in the case of a *firm* that is a member of a group that is part of a bigger group.
 - (2) If an *EEA banking and investment group* for which the *FSA* is the lead regulator is part of a wider *EEA banking and investment group* for which the *FSA* is also lead regulator then BIPRU 4.2.30R- BIPRU 4.2.32R apply with respect to that wider group.
 - (3) If an *EEA banking and investment group* for which the *FSA* is the lead regulator is part of a wider *EEA banking and investment group* for which another *competent authority* is lead regulator then BIPRU 4.2.26R(4) applies with respect to that wider group but the requirements of that lead regulator will generally apply in place of BIPRU 4.2.30R- BIPRU 4.2.32R.
 - (4) If an *EEA banking and investment group* for which the *FSA* is the lead regulator is part of a wider *third-country banking and investment group* that is subject to equivalent supervision by a regulatory authority outside the *EEA*, then BIPRU 4.2.26R(4) applies with respect to both that wider group and the sub-group of which the *FSA* is lead regulator. However the requirements of that third country regulator apply in place of BIPRU 4.2.30R- BIPRU 4.2.32R. The question of whether supervision is equivalent is decided in accordance with GENPRU 3.2 (Third country groups).
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- (5) If an *EEA banking and investment group* for which the *FSA* is the lead regulator is part of a wider *third-country banking and investment group* that is not subject to equivalent supervision by a regulatory authority outside the *EEA*, then *BIPRU 4.2.30R- BIPRU 4.2.32R* will apply. *BIPRU 4.2.30R- BIPRU 4.2.32R* will apply to the whole group if *GENPRU 3.2.9R* (Supervision by analogy) applies. If *GENPRU 3.2.4G* (Alternative measures) applies, *BIPRU 4.2.30R- BIPRU 4.2.32R* will apply to the *EEA banking and investment group*.
- (6) In the case of a group described in (2) or (3) in respect of which the *Article 129 procedure* applies then *BIPRU 4.2.26R(4)* applies with respect to that wider group. The detailed requirements that apply will be decided in accordance with that procedure.

Combined use of methodologies: Intra-group exposures

- 4.2.34 G (1) Generally, the *FSA* will consider excluding, through a *firm's IRB permission*, exposures falling into *BIPRU 4.2.26R(6)* from the *IRB approach*. The degree to which this exclusion applies will be set out in the *firm's IRB permission*.
- (2) Exposures excluded under (1) will be eligible for a 0% *risk weight* under the *standardised approach* if they satisfy the conditions in *BIPRU 3.2.25R* to *BIPRU 3.2.27R* (Zero risk weight for certain intra-group exposures).
 - (3) Exposures to or holdings in any non-financial *undertakings* in a *firm's group* are not eligible for permanent exemption from the *IRB approach* under *BIPRU 4.2.26R(6)*, as they are not subject to consolidated supervision. It is also the *FSA's* policy that exposures to or holdings in any *insurance undertaking* are ineligible. Such exposures should remain on the *IRB approach* unless excluded under another part of *BIPRU 4.2.26R*.
 - (4) If a *firm* uses the exemption in (1) it should have a policy that:
 - (a) provides for the identification of connected counterparties excluded under (1);
 - (b) identifies exposures that would be permanently exempted from the *IRB approach* under (1); and
 - (c) identifies the connected counterparty exposures that are not permitted to be permanently exempted from the *IRB approach* under (1).
 - (5) The policy in (4) should be applied consistently to all exposures excluded under (1).

Combined use of methodologies: Purchase of a new businesses

- 4.2.35 G (1) This *guidance* deals with some possible effects of acquiring a major new business after the grant of an *IRB permission*.
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- (2) A *firm* should if possible ensure that the *exposures* arising through the acquisition are dealt with in accordance with the *firm's IRB permission*.
 - (3) If the acquisition is made during the currency of a roll out plan under *BIPRU 4.2.18R*, a *firm* should ensure that the *exposures* arising through the acquisition are dealt with in accordance with that plan. For these purposes the existing and the acquired business should be considered together. The whole of the *firm's* business, including the newly acquired business, should be included in both the denominator and numerator of the fraction in *BIPRU 4.2.30R*.
 - (4) If a *firm* cannot comply with (2) the *FSA* will consider an application to vary the *firm's IRB permission* in order to deal with the acquisition. For example the *FSA* may agree to extend the time by which the roll out should be completed (see *BIPRU 4.2.20R*). However any such variation should be consistent with the provisions of *BIPRU 4.2* that would have applied if the acquisition had been included in the *firm's* original application for an *IRB permission*.
 - (5) If the acquisition is made after a *firm* has completed its roll out under *BIPRU 4.2.18R* the *FSA* will not in general agree to an application to treat an *exposure*:
 - (a) under the *standardised approach* if it would otherwise be treated under the *IRB approach* under the *firm's IRB permission*; or
 - (b) under the *foundation IRB approach* if it would otherwise be treated under the *advanced IRB approach* under the *firm's IRB permission*.
 - (6) Any application to disapply the policy in (5) will be treated in accordance with the approach set out in *BIPRU 4.2.25G*.
 - (7) The *FSA* will also adopt the approach in (5) while a roll out plan is in progress if, in relation to an *exposure* of a particular type, the period for completion of the roll out for those *exposures* under that plan has ended.
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4.3 The IRB approach: Provisions common to different exposure classes

Application

4.3.1 R This section applies to all *exposures* treated under the *IRB approach*.

Exposure classes

4.3.2 R Each *exposure* must be assigned to one of the following *exposure* classes:

- (1) claims or contingent claims on central governments and *central banks*;
- (2) claims or contingent claims on *institutions*;
- (3) claims or contingent claims on corporates;
- (4) retail claims or contingent retail claims;
- (5) equity claims;
- (6) *securitisation* positions; and
- (7) *non credit-obligation assets*.

[**Note:** BCD Article 86(1)]

4.3.3 R The methodology used by a *firm* for assigning *exposures* to different *IRB exposure classes* must be appropriate and consistent over time.

[**Note:** BCD Article 86(9)]

Calculation of risk weighted exposure amounts

4.3.4 R The *risk weighted exposure amounts* for credit risk for *exposures* belonging to one of the *exposure* classes referred to in (1) to (4) must, unless deducted from *capital resources*, be calculated in accordance with the following provisions:

- (1) for *exposures* in the *sovereign, institution and corporate IRB exposure class*, BIPRU 4.4.57R to BIPRU 4.4.60R, BIPRU 4.4.79R, BIPRU 4.5.8R to BIPRU 4.5.10R (for *specialised lending exposures*), BIPRU 4.9.3R and BIPRU 4.8.16R to BIPRU 4.8.17R (for purchased *corporate exposure* receivables);
 - (2) for *exposures* in the *retail exposure class*, BIPRU 4.6.41R to BIPRU 4.6.44R, BIPRU 4.6.57R and BIPRU 4.8.18R to BIPRU 4.8.20R (for purchased *retail exposure* receivables);
 - (3) for *exposures* in the *equity exposure class*, BIPRU 4.7.5R to BIPRU 4.7.6R, BIPRU 4.7.9R to BIPRU 4.7.11R, BIPRU 4.7.14R to BIPRU 4.7.16R and BIPRU 4.7.24R to BIPRU 4.7.25R; and
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- (4) for *exposures* in the *non credit-obligation assets exposure class*, BIPRU 4.9.6R.

[Note: BCD Article 87(1)]

- 4.3.5 R The calculation of *risk weighted exposure* amounts for credit risk and *dilution risk* must be based on the relevant parameters associated with the *exposure* in question. These include *probability of default (PD)*, *loss given default (LGD)*, maturity (M) and the *exposure* value of the *exposure*. *PD* and *LGD* may be considered separately or jointly, in accordance with the provisions relating to *PD* and *LGD* in BIPRU 4.4, 4.6 4.7 and 4.8 at:
- (1) for *exposures* in the *sovereign, institution and corporate IRB exposure class*, BIPRU 4.4.34R - BIPRU 4.4.35R, BIPRU 4.4.42R to 4.4.43R, BIPRU 4.4.63R - BIPRU 4.4.66R, BIPRU 4.4.80R and, for *PD* and *LGD* for *dilution risk* of purchased *corporate exposure* receivables, BIPRU 4.8.23R and BIPRU 4.8.26R;
 - (2) for *exposures* in the *retail exposure class*, BIPRU 4.6.50R - BIPRU 4.6.54R, BIPRU 4.6.58R, and, for *PD* and *LGD* for *dilution risk* of purchased *retail exposure* receivables, BIPRU 4.8.24R and BIPRU 4.8.27R; and
 - (3) for *exposures* in the *equity exposure class*, BIPRU 4.7.18R and BIPRU 4.7.20R - BIPRU 4.7.21R.

[Note: BCD Article 87(3)]

Calculation of expected loss amounts

- 4.3.6 R The *expected loss* amounts for *exposures* belonging to one of the *IRB exposure classes* referred to in (1) to (3) must be calculated in accordance with the methods set out in the following provisions:
- (1) for *exposures* in the *sovereign, institution and corporate IRB exposure class*, BIPRU 4.4.61R to BIPRU 4.4.62R and (for *specialised lending exposures*) BIPRU 4.5.13R to BIPRU 4.5.15R;
 - (2) for *exposures* in the *retail exposure class*, BIPRU 4.6.47R to 4.6.48R;
 - (3) for *exposures* in the *equity exposure class*, BIPRU 4.7.12R, BIPRU 4.7.17R and BIPRU 4.7.26R; and
 - (4) (for purchased receivables falling into one of the *IRB exposure classes* in (1) to (3)) BIPRU 4.8.30R.

[Note: BCD Article 88(1)]

- 4.3.7 R The calculation of *expected loss* amounts in accordance with *BIPRU 4.3.6R* must be based on the same input figures of *PD*, *LGD* and the *exposure* value for each *exposure* as being used for the calculation of *risk weighted exposure amounts* in accordance with *BIPRU 4*. For *defaulted exposures*, where a *firm* uses its own estimate of *LGDs*, *EL* must be the *firm's* best estimate of expected loss (*EL_{BE}*), for the *defaulted exposure* in accordance with *BIPRU 4.3.122R*.

[**Note:** *BCD* Article 88(2)]

Treatment of expected loss amounts

- 4.3.8 R The *expected loss* amounts calculated in accordance with *BIPRU 4.3.6R*(1), (2) and (4) must be subtracted from the sum of value adjustments and provisions related to these *exposures*. Discounts on balance sheet *exposures* purchased when in *default* according to *BIPRU 4.4.71R* must be treated in the same manner as value adjustments. *Expected loss* amounts for *securitised exposures* and value adjustments and provisions related to these *exposures* must not be included in this calculation.

[**Note:** *BCD* Annex VII Part 1 point 36]

Corporate governance

- 4.3.9 R All material aspects of the rating and estimation processes must be approved by the *firm's governing body* or a designated committee thereof and senior management. These parties must possess a general understanding of the *firm's rating systems* and detailed comprehension of its associated management reports.

[**Note:** *BCD* Annex VII Part 4 point 124]

- 4.3.10 G (1) A *firm's governing body* or *designated committee* may choose to approve only material aspects of the *firm's rating systems* and material changes to the *firm's rating systems*.
- (2) Where a *firm's governing body* or *designated committee* chooses to approve only material aspects of the *firm's rating systems* and material changes to the *firm's rating systems*:
- (a) the *firm's governing body* or *designated committee* should define the *firm's* overall approach to material aspects of rating and estimation processes for all *rating systems*, including non-material *rating systems* and approve a policy statement defining that approach; and
- (b) the *firm* should define and document the process for approval of non-material aspects of the *firm's rating systems*.

- 4.3.11 R Senior management must provide notice to the *governing body* or a designated committee thereof of material changes or exceptions from established policies that will materially impact the operations of the *firm's rating systems*.

[**Note:** *BCD* Annex VII Part 4 point 125]

- 4.3.12 G Where the *firm's rating systems* are used on a unified basis for the *parent undertaking* and its *subsidiary undertakings* under *BIPRU 4.2.3R*, and approval and reporting of the *ratings systems* are carried out at the group level, the governance requirements in *BIPRU 4.3.9R* and *BIPRU 4.3.11R* may be met if:
- (1) the *subsidiary undertakings* have delegated to the *governing body* or *designated committee* of the *EEA parent institution* or *EEA parent financial holding company* responsibility for approval of the *firm's rating systems*;
 - (2) the *governing body* or *designated committee* of the *EEA parent institution* or *EEA parent financial holding company* approves either:
 - (a) all aspects of the *firm's rating systems*, and material changes; or
 - (b) all aspects of the *firm's rating systems* that are material in the context of the group, and material changes to those, and a policy statement defining the overall approach to material aspects of rating and estimation processes for all *rating systems*, including non-material *rating systems*.

- 4.3.13 R Senior management must have a good understanding of the *rating system's* designs and operations. Senior management must ensure on an ongoing basis that the *rating systems* are operating properly. Senior management must be regularly informed by the credit risk control units about the performance of the rating process, areas needing improvement, and the status of efforts to improve previously identified deficiencies.

[Note: *BCD Annex VII Part 4 point 126*]

- 4.3.14 R Internal ratings-based analysis of the *firm's* credit risk profile must be an essential part of the management reporting required under *BIPRU 4.3.9R*, *BIPRU 4.3.11R* and *BIPRU 4.3.13R*. Reporting must include at least risk profile by grade, migration across grades, estimation of the relevant parameters per grade, and comparison of realised *default* rates and, to the extent that own estimates are used, of realised *LGDs* and realised *conversion factors* against expectations and stress-test results. Reporting frequencies must depend on the significance and type of information and the level of the recipient.

[Note: *BCD Annex VII Part 4 point 127*]

Credit risk control

- 4.3.15 R The credit risk control unit must be independent from the personnel and management functions responsible for originating or renewing *exposures* and report directly to senior management. The unit must be responsible for the design or selection, implementation, oversight and performance of the *rating systems*. It must regularly produce and analyse reports on the output of the *rating systems*.

[Note: *BCD Annex VII Part 4 point 128*]

- 4.3.16 R The areas of responsibility for the credit risk control unit(s) must include the following.
- (1) testing and monitoring grades and pools;
 - (2) production and analysis of summary reports from the *firm's rating systems*;
 - (3) implementing procedures to verify that grade and pool definitions are consistently applied across departments and geographic areas;
 - (4) reviewing and documenting any changes to the rating process, including the reasons for the changes;
 - (5) reviewing the rating criteria to evaluate if they remain predictive of risk (and changes to the rating process, criteria or individual rating parameters must be documented and retained);
 - (6) active participation in the design or selection, implementation and validation of models used in the rating process;
 - (7) oversight and supervision of models used in the rating process; and
 - (8) ongoing review and alterations to models used in the rating process.

[**Note:** *BCD Annex VII Part 4 point 129*]

- 4.3.17 R Notwithstanding *BIPRU 4.3.16R*, a *firm* using pooled data according to *BIPRU 4.3.92R – BIPRU 4.3.94R* (Overall requirements for estimation) may outsource the following tasks:
- (1) production of information relevant to testing and monitoring grades and pools;
 - (2) production of summary reports from the *firm's rating systems*;
 - (3) production of information relevant to review of the rating criteria to evaluate if they remain predictive of risk;
 - (4) documentation of changes to the rating process, criteria or individual rating parameters; and
 - (5) production of information relevant to ongoing review and alterations to models used in the rating process.

[**Note:** *BCD Annex VII Part 4 point 130 (part)*]

- 4.3.18 R A *firm* making use of *BIPRU 4.3.17R* must ensure that the *FSA* has access to all relevant information from the third party that is necessary for examining compliance with the *minimum IRB standards* and the *firm's IRB permission* and that the *FSA* may perform on-site examinations to the same extent as within the *firm*.
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[Note: BCD Annex VII Part 4 point 130 (part)]

Documentation of rating systems

- 4.3.19 R A *firm* must document the design and operational details of its *rating systems*. The documentation must evidence compliance with the *minimum IRB standards* and the *firm's IRB permission*, and address topics including portfolio differentiation, rating criteria, responsibilities of parties that rate obligors and *exposures*, frequency of assignment reviews, and management oversight of the rating process.

[Note: BCD Annex VII Part 4 point 31]

- 4.3.20 R A *firm* must ensure that all documentation relating to its *rating systems* or otherwise required by the *rules* governing the *IRB approach* are stored, arranged and indexed in such a way that the *firm* would be able to make them all available to the *FSA*, or to make any class or description of them specified by the *FSA* available to the *FSA*, immediately on demand or within a short time thereafter.

- 4.3.21 R A *firm* must document the rationale for and analysis supporting its choice of rating criteria. A *firm* must document all major changes in the risk rating process, and such documentation must support identification of changes made to the risk rating process subsequent to the last review by the *FSA*. The organisation of rating assignment including the rating assignment process and the internal control structure must also be documented.

[Note: BCD Annex VII Part 4 point 32]

- 4.3.22 R A *firm* must document the specific definitions of default and loss used internally and demonstrate consistency with the definitions of *default* and *loss* set out in the *glossary* and *BIPRU 4*.

[Note: BCD Annex VII Part 4 point 33]

- 4.3.23 G A *firm's* documentation relating to data should include clear identification of responsibility for data quality. A *firm* should set standards for data quality and aim to improve them over time. A *firm* should measure its performance against those standards. A *firm* should ensure that its data is of high enough quality to support its risk management processes and the calculation of its capital requirements.

- 4.3.24 R Where a *firm* employs statistical models in the rating process, the *firm* must document its methodologies. This material must:
- (1) provide a detailed outline of the theory, assumptions and/or mathematical and empirical basis of the assignment of estimates to grades, individual obligors, *exposures*, or pools, and the data source(s) used to estimate the model;
 - (2) establish a rigorous statistical process (including out-of-time and out-of-sample performance tests) for validating the model; and
 - (3) indicate any circumstances under which the model does not work effectively.
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[**Note:** BCD Annex VII Part 4 point 34]

Rating systems

- 4.3.25 R A *rating system* comprises all of the methods, processes, controls, data collection and IT systems that support the assessment of credit risk, the assignment of *exposures* to grades or pools (rating), and the quantification of *default* and *loss* estimates for a certain type of *exposure*.

[**Note:** BCD Annex VII Part 4 point 1]

- 4.3.26 R If a *firm* uses multiple *rating systems*, the rationale for assigning an obligor or a transaction to a *rating system* must be documented and applied in a manner that appropriately reflects the level of risk.

[**Note:** BCD Annex VII Part 4 point 2]

- 4.3.27 R Assignment criteria and processes must be periodically reviewed to determine whether they remain appropriate for the current portfolio and external conditions.

[**Note:** BCD Annex VII Part 4 point 3]

- 4.3.28 R Where a *firm* uses direct estimates of risk parameters these may be seen as the outputs of grades on a continuous rating scale.

[**Note:** BCD Annex VII Part 4 point 4]

Validation of internal estimates

- 4.3.29 R A *firm* must have robust systems in place to validate the accuracy and consistency of *rating systems*, processes, and the estimation of all relevant risk parameters (*PD*, *LGD*, *conversion factors* and *EL*). A *firm* must be able to demonstrate to the *FSA* that the internal validation process enables it to assess the performance of internal rating and risk estimation systems consistently and meaningfully.

[**Note:** BCD Annex VII Part 4 point 110]

- 4.3.30 R (1) A *firm* must validate its *rating systems*. Its validation process must include, as a minimum, the elements set out in (2) – (8).
- (2) A *firm* must establish and define standards of objectivity, accuracy, stability and conservatism that it designs its *ratings systems* to meet. It must have processes that establish whether its *rating systems* meet those standards.
- (3) A *firm* must establish and define standards of accuracy of calibration (i.e. whether outcomes are consistent with estimate) and discriminative power (i.e. the ability to rank-order risk) that it designs its *rating systems* to meet. It must have processes that establish whether its *rating systems* meet those standards.
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- (4) A *firm* must have policies and standards that specify the actions to be taken when a *rating system* fails to meet the standards of accuracy and discriminative power referred to in (2) and (3).
- (5) A *firm*'s validation process must include a mix of developmental evidence, benchmarking and process verification. A *firm*'s validation process must include policies on how this mixture varies between different *rating systems*.
- (6) A *firm*'s validation process must include the use of both quantitative and qualitative techniques.
- (7) A *firm*'s validation process must include policies on how validation procedures are expected to vary over time.
- (8) A *firm*'s validation process must include independent input into and review of its *rating systems*.
- (9) The standards set under (2) and (3) must meet the *minimum IRB standards*.
- (10) For the purpose of (5):
 - (a) developmental evidence means evidence that substantiates whether the logic and quality of a *rating system* (including the quantification process) adequately discriminates between different levels of, and delivers accurate estimates of, *PD*, *EL*, *LGD* and *conversion factors* (as applicable); and
 - (b) process verification means the process of establishing whether the methods used in a *rating system* to discriminate between different levels of risk and to quantify *PD*, *EL*, *LGD* and *conversion factors* are being used, monitored and updated in the way intended in the design of the *rating system*.

- 4.3.31 G A *firm* should have regard to the involvement of management at an appropriately senior level in the validation process.
- 4.3.32 G The approach to validation may vary with the significance of the *exposures* covered by a *rating system*.
- 4.3.33 R A *firm* must regularly compare realised *default* rates with estimated *PDs* for each grade and where realised *default* rates are outside the expected range for that grade a *firm* must specifically analyse the reasons for the deviation. A *firm* using its own estimates of *LGDs* and/or *conversion factors* must also perform analogous analysis for own estimates of *LGDs* and *conversion factors*. Such comparisons must make use of historical data that cover as long a period as possible. A *firm* must document the methods and data used in such comparisons. This analysis and documentation must be updated at least annually.

[Note: BCD Annex VII Part 4 point 111]

- 4.3.34 G (1) This paragraph sets out *guidance* on assessing the adequacy of a *rating system's* discriminative power (see *BIPRU* 4.3.30R(3) on the meaning of discriminative power).
- (2) A *firm* should be able to explain the performance of its *rating systems* against its chosen measure (or measures) of discriminative power. In making this comparison a *firm* should rely primarily on actual historic *default* experience where this is available. In particular, a *firm* should be able to explain:
- (a) the extent of any potential inaccuracy in these measures, caused in particular by small sample size; and
- (b) the potential for divergence in the future, whether caused by changing economic conditions or other factors.
- (3) The assessment of discriminative power should include appropriate use of external benchmarks where available.
- (4) The *FSA* will, in assessing the *firm's* performance, take into consideration the sophistication of the measure of discrimination chosen.
- (5) In the case of a portfolio for which there is insufficient *default* experience to provide any confidence in statistical measures of discriminative power a *firm* need not carry out the procedure in (2) and may instead use other methods. For example, it may make use of comparison with an external measurement approach by analysing whether the *firm's rating systems* and the external approach rank common obligors in broadly similar ways. A *firm* should be able to explain the methodology it uses and the rationale for its use.
- 4.3.35 R A *firm* must also use other appropriate quantitative validation tools and comparisons with relevant external data sources. The analysis must be based on data that is appropriate to the portfolio, is updated regularly, and covers a relevant observation period. A *firm's* internal assessments of the performance of its *rating systems* must be based on as long a period as possible.
- [**Note:** *BCD* Annex VII Part 4 point 112]
- 4.3.36 R The methods and data used for quantitative validation must be consistent through time. Changes in estimation and validation methods and data (both data sources and periods covered) must be documented.
- [**Note:** *BCD* Annex VII Part 4 point 113]
- 4.3.37 R A *firm* must have sound internal standards for situations where deviations in realised *PDs*, *LGDs*, *conversion factors* and, where *EL* is used, total *losses*, from expectations become significant enough to call the validity of the estimates into question. These standards must take account of business cycles and similar systematic variability in *default* and *loss* experience. Where realised values continue to be higher than expected values, a *firm* must revise estimates upward to reflect its *default* and *loss* experience.
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[Note: BCD Annex VII Part 4 point 114]

Internal audit

- 4.3.38 R Internal audit or another comparable independent auditing unit must review at least annually the *firm's rating systems* and its operations, including the operations of the *firm* and the estimation of *PDs, LGDs, ELs* and *conversion factors*. Areas of review must include adherence to all applicable minimum requirements.

[Note: BCD Annex VII Part 4 point 131]

Stress tests used in assessment of capital adequacy

- 4.3.39 R A *firm* must have in place sound stress testing processes for use in the assessment of its capital adequacy. Stress testing must involve identifying possible events or future changes in economic conditions that could have unfavourable effects on the *firm's* credit *exposures* and assessment of the *firm's* ability to withstand such changes.

[Note: BCD Annex VII Part 4 point 40]

- 4.3.40 R
- (1) A *firm* must regularly perform a credit risk stress test to assess the effect of certain specific conditions on its total capital requirements for credit risk. The test to be employed must be one chosen by the *firm*. The test to be employed must be meaningful and reasonably conservative. Stressed portfolios must contain the vast majority of a *firm's* total *exposures* covered by the *IRB approach*.
 - (2) The stress test must be designed to assess the *firm's* ability to meet its capital requirements for credit risk under *GENPRU 2.1* during all stages of the economic cycle and during an economic recession such as might be experienced once in 25 years.
 - (3) In particular the stress test must address the impact (including by ratings migration) of changes in the credit quality of its credit risk counterparties including its protection providers. A *firm* using the treatment set out in *BIPRU 4.4.79R* must in particular consider the impact of protection providers falling outside the eligibility criteria.
 - (4) The stress test must be conducted on the basis of the *firm's exposures* (on- and off-balance sheet) as they stand at the time of the stress test.
 - (5) The stress test must be carried out at least annually and also in the event of a significant change in the state of the economy.
 - (6) A *firm* need not assume that the recession referred to in (2) will occur in the 12 months immediately following the stress test. Instead, the stress test must incorporate a plausible time horizon for the occurrence of the cyclical deterioration of the severity tested for. A *firm* need not assume that the downturn will occur for all portfolios in all jurisdictions simultaneously.
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[**Note:** *BCD* Annex VII Part 4 points 41 and 42]

4.3.41 G To the extent that the economic conditions assumed in the stress tests required under *BIPRU* 4.3.39R or *BIPRU* 4.3.40R coincide with the conditions assumed in the production of economic downturn *LGDs* (see *BIPRU* 4.3.103R), the *LGDs* to be used might be expected to be similar.

4.3.42 G The requirement in *BIPRU* 4.3.40R(2) is to identify, in a forward-looking manner, severe but plausible downturn conditions relevant to business lines and jurisdictions and to determine the likely impact of those conditions on a *firm's* credit risk regulatory capital requirements. The description of the economic recession contained in *BIPRU* 4.3.40R(2) should not be taken as stipulating one approach (e.g. statistical) over other approaches (e.g. scenario analysis) in the identification of the relevant recessionary circumstances.

Rating systems: Assignment to grades or pools

4.3.43 R A *firm* must have specific definitions, processes and criteria for assigning *exposures* to grades or pools within a *rating system*.

[**Note:** *BCD* Annex VII Part 4 point 17 (part)]

4.3.44 R The grade or pool definitions and criteria must be sufficiently detailed to allow those charged with assigning ratings consistently to assign obligors or facilities posing similar risk to the same grade or pool. This consistency must exist across lines of business, departments and geographic locations within each *rating system*.

[**Note:** *BCD* Annex VII Part 4 point 17 (part)]

4.3.45 G In meeting *BIPRU* 4.3.44R a *firm* should have regard to its application to each *rating system*.

4.3.46 R The documentation of the rating process must allow third parties to understand the assignments of *exposures* to grades or pools, to replicate grade and pool assignments and to evaluate the appropriateness of the assignments to a grade or a pool.

[**Note:** *BCD* Annex VII Part 4 point 17 (part)]

4.3.47 R The criteria referred to in *BIPRU* 4.3.43R must also be consistent with the *firm's* internal lending standards and its policies for handling troubled obligors and facilities.

[**Note:** *BCD* Annex VII Part 4 point 17 (part)]

- 4.3.48 R A *firm* must take all relevant information into account in assigning obligors and facilities to grades or pools. Information must be current and must enable the *firm* to forecast the future performance of the *exposure*. The less information a *firm* has, the more conservative must be its assignments of *exposures* to obligor and *facility grades* or pools. If a *firm* uses an external rating as a primary factor determining an internal rating assignment, the *firm* must ensure that it considers other relevant information.

[**Note:** BCD Annex VII Part 4 point 18]

Rating systems: General governance

- 4.3.49 G
- (1) This paragraph contains *guidance* on BIPRU 4.3.43R and more general *guidance* about the governance of *rating systems*.
 - (2) In determining the assignment referred to in BIPRU 4.3.43R, a *firm* should have regard to the sensitivity of the rating to movements in fundamental risk drivers.
 - (3) A *firm* should, for any *rating system*, be able to demonstrate that it acts appropriately or has an appropriate policy, as applicable, with respect to:
 - (a) any deficiencies caused by its not being sensitive to movements in fundamental risk drivers or for any other reason;
 - (b) periodic review and action in the light of such review;
 - (c) provision of appropriate internal guidance to staff to ensure consistency in the use of the *rating system*, including the assignment of *exposures* or facilities to pools or grades;
 - (d) dealing with potential weaknesses of the *rating system*;
 - (e) identifying appropriate and inappropriate uses of the *rating system* and acting on that identification;
 - (f) novel or narrow rating approaches; and
 - (g) ensuring the appropriate level of stability over time of the *rating system*.

Rating systems: Overrides

- 4.3.50 R For grade and pool assignments a *firm* must document the situations in which human judgement may override the inputs or outputs of the assignment process and the personnel responsible for approving these overrides. A *firm* must document these overrides and the personnel responsible. A *firm* must analyse the performance of the *exposures* whose assignments have been overridden. This analysis must include assessment of the performance of *exposures* whose rating has been overridden by a particular *person*, accounting for all the responsible personnel.
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[**Note:** BCD Annex VII Part 4 point 25]

Rating systems: Use of models

- 4.3.51 R
- (1) This paragraph applies to the use of statistical models and/or other mechanical methods to assign *exposures* to *obligor grades*, obligor pools, *facility grades* or facility pools.
 - (2) A *firm* must be able to demonstrate to the *FSA* that the model has good predictive power and that capital requirements are not distorted as a result of its use.
 - (3) The input variables to the model must form a reasonable and effective basis for the resulting predictions. The model must not have material biases.
 - (4) A *firm* must have in place a process for vetting data inputs into the model, which includes an assessment of the accuracy, completeness and appropriateness of the data.
 - (5) A *firm* must be able to demonstrate to the *FSA* that the data used to build the model is representative of the population of the *firm*'s actual obligors or *exposures*.
 - (6) A *firm* must have a regular cycle of model validation that includes monitoring of model performance and stability, review of model specification and testing of model outputs against outcomes.
 - (7) A *firm* must complement the statistical model by human judgement and human oversight to review model-based assignments and to ensure that the models are used appropriately. Review procedures must aim at finding and limiting errors associated with model weaknesses. Human judgements must take into account all relevant information not considered by the model. A *firm* must document how human judgement and model results are to be combined.
 - (8) Use of a model obtained from a third-party vendor that claims proprietary technology is not a justification for exemption from documentation or any other of the requirements in *BIPRU 4* or a *firm's IRB permission* for *rating systems*. A *firm* must be able to satisfy the *FSA* that all those requirements are satisfied if it uses such a model.

[**Note:** BCD Annex VII Part 4 points 30 and 35 (part)]

- 4.3.52 G
- (1) This paragraph contains guidance on *BIPRU 4.3.51R(7)*.
 - (2) *BIPRU 4.3.51R(7)* does not require that each individual assignment of an *exposure* to a pool or grade should be the subject of an open-ended review by reference to factors not covered by the model if:
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- (a) that is not necessary in order to meet the requirements of *BIPRU 4* about the ability of the *rating system* to predict and to discriminate (as referred to in *BIPRU 4.3.29R* to *BIPRU 4.3.30R* (Validation of internal estimates)); and
- (b) the outputs of the model are not designed to be supplemented by such a review.
- 4.3.53 G (1) This paragraph contains *guidance* on *BIPRU 4.3.51R* for the use of external models.
- (2) *BIPRU 4.3.51R(2) - (8)* also apply to mechanical methods to assign *exposures* or obligors to facility grades or pools and to a combination of models and mechanical methods.
- (3) The standards which a *firm* applies to an external model should not be lower than those for internal models.
- (4) The *FSA* will not accredit any individual model or vendor. The burden is on a *firm* to satisfy itself that external models are fit for purpose and meet the relevant requirements of the *IRB approach*.
- (5) Notwithstanding that commercial confidentiality may limit the willingness of vendors of external models to disclose all details, a *firm* should ensure that it is able to obtain sufficiently detailed information to be able to satisfy the requirements of the *IRB approach*.
- (6) A *firm* should have a clear understanding of responsibilities for support and maintenance of external models. This should include how new developments will be brought in and what entitlement the *firm* has to receive and/or request specific enhancements. A *firm* should ensure that the requirements of *BIPRU 4.3.51R* and other provisions of the *IRB approach* are complied with on an ongoing basis.
- (7) If a *firm* uses an external model it should have regard to the following:
- (a) the adequacy of the information it has about the population on which the model is built;
- (b) the comparability of the population referred to in (a) to the *exposures* with respect to which it is using that model;
- (c) what the drivers of the model are and their relevance to the *exposures* with respect to which it is using the model; and
- (d) how the *firm* satisfies itself that the standards required by the *IRB approach* for an internal model are met by the external model.

Rating systems: Data maintenance

4.3.54 R A *firm* must collect and store data on aspects of its internal ratings as required under *BIPRU* 11 (Disclosure).

[**Note:** *BCD* Annex VII Part 4 point 36]

Rating systems: IT systems

4.3.55 G A *firm* should ensure that IT systems relevant to the operation of its *rating systems* are sound and robust. A *firm's* IT systems should provide rapid availability of databases and appropriate archiving. Adequate controls should be in place to prevent unauthorised changes to data being made. Contingency processes and plans should be in place to deal with events of system failure. A *firm* should document work-flows and procedures related to data collection and storage.

Definition of default: Main provisions

4.3.56 R A *default* must be considered to have occurred with regard to a particular obligor when either or both of the two following events has taken place:

- (1) the *firm* considers that the obligor is unlikely to pay its credit obligations to the *firm*, the *parent undertaking* or any of its *subsidiary undertakings* in full, without recourse by the *firm* to actions such as realising security (if held); and
- (2) the obligor is past due more than 90 days on any material credit obligation to the *firm*, the *parent undertaking* or any of its *subsidiary undertakings*.

[**Note:** *BCD* Annex VII Part 4 point 44 (part)]

4.3.57 R The following provisions also apply with respect to the definition of *default*:

- (1) for overdrafts, days past due commence once an obligor has breached an advised limit, has been advised a limit smaller than current outstandings, or has drawn credit without authorisation and the underlying amount is material;
 - (2) an advised limit means a limit which has been brought to the knowledge of the obligor;
 - (3) days past due for credit cards commence on the minimum payment due date;
 - (4) in the case of *retail exposures* and *exposures to public sector entities* the number of days past due is as set out in *BIPRU* 4.4.22R and *BIPRU* 4.6.20R; and
 - (5) in all cases for the purposes of the definition of *default*, a credit obligation or, for overdrafts, the underlying amount, is material if, when added to the other *exposures* of the obligor, the total exceeds the amount which the *firm* treats as a material default for its internal risk measurement and management purposes.
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[**Note:** BCD Annex VII Part 4 point 44 (part)]

Definition of default: Materiality

- 4.3.58 R Where a *firm* applies the definition of *default* at facility level in accordance with *BIPRU* 4.6.21R, it should define materiality for the purposes of *BIPRU* 4.3.57R(5) by reference to the facility amount only, disregarding other *exposures* of the obligor.
- 4.3.59 R A *firm* must have a policy which sets out how it will determine whether a credit obligation or, for overdrafts, the underlying amount, is material for the purposes of the definition of *default* in *BIPRU* 4.3.56R(2) and *BIPRU* 4.3.57R(5).

Definition of default: Identification of obligor

- 4.3.60 G (1) This paragraph contains *guidance* on the definition of *default*.
- (2) If:
- (a) a *firm* ordinarily assigns *exposures* in the *sovereign, institution and corporate IRB exposure class* to a member of a group substantially on the basis of membership of that group and a common group rating; and
- (b) the *firm* does so in the case of a particular group;
- (3) the *firm* should consider whether members of that group should be treated as a single obligor for the purpose of the definition of *default*.
- (4) The *FSA* would not expect a *firm* to treat an obligor as part of a single obligor under (2) if the *firm* rates its *exposures* on a stand alone basis or if its rating is notched. A rating is notched if it takes into account individual risk factors or otherwise reflects risk factors that are not applied on a common group basis.
- (5) Accordingly if a group has two members who are separately rated the *default* of one does not necessarily imply the *default* of the other.

Definition of default: Days past due

- 4.3.61 G (1) This paragraph contains *guidance* on the meaning of days past due for the purposes of the definition of *default*.
- (2) If an amount is overdue by the relevant number of days past due because of administrative oversight on the part of the obligor or the *firm*, a *firm* with sufficient information may, retrospectively if necessary, treat that as not involving a *default* if:
- (a) that failure is not associated with any increase in the risk referred to in *BIPRU* 4.3.56R(1); and

- (b) treating it as not being in *default* is consistent with the way that the *firm* treated the failure in its relationship with the obligor.
- (3) If a *firm* takes advantage of this provision it should have a policy about the circumstances in which it can apply the treatment in (2). That policy should be documented and consistently applied.
- 4.3.62 G Days past due is only one part of the definition of *default* and should be treated as a back-stop. A *firm* should not rely solely on the number of days past due set by *BIPRU* 4 but should also consider all other indicators of unlikelihood to pay when assessing whether a *default* has occurred.

Definition of default: Unlikelihood to pay

- 4.3.63 R
- (1) Elements to be taken as indications of unlikelihood to pay must include the items set out in this *rule*.
 - (2) The *firm* putting the credit obligation on non-accrued status must be taken as an indication of unlikelihood to pay.
 - (3) The *firm* making a value adjustment resulting from a significant perceived decline in credit quality subsequent to the *firm* taking on the *exposure* must be taken as an indication of unlikelihood to pay.
 - (4) The *firm* selling the credit obligation at a material credit-related economic loss must be taken as an indication of unlikelihood to pay.
 - (5) The *firm* consenting to a distressed restructuring of the credit obligation must be taken as an indication of unlikelihood to pay where this is likely to result in a diminished financial obligation caused by the material forgiveness, or postponement, of principal, interest or (where relevant) fees. This includes in the case of *equity exposures* assessed under a *PD/LGD approach*, distressed restructuring of the equity itself.
 - (6) The *firm* having filed for the obligor's bankruptcy or a similar order in respect of an obligor's credit obligation to the *firm*, the *parent undertaking* or any of its *subsidiary undertakings* must be taken as an indication of unlikelihood to pay.
 - (7) The obligor seeking or having been placed in bankruptcy or similar protection where this would avoid or delay repayment of a credit obligation to the *firm*, the *parent undertaking* or any of its *subsidiary undertakings* must be taken as an indication of unlikelihood to pay.

[**Note:** *BCD* Annex VII Part 4 point 45]

- 4.3.64 G A *firm* may use the amount overdue as an additional indication of unlikelihood to pay. If a *firm* uses this approach, the days past due element of the definition of *default* continues to apply, including the provisions relating to the fixed number of days past due referred to in *BIPRU* 4.3.57R(4). A *firm* might make the use of a definition of *default* that takes into account the amount overdue consistent with the days past due element of the definition by setting the amount overdue at such a level that, taking into account:
- (1) the order in which payments are applied against overdue payments; and
 - (2) the number of payment dates, the time between them, the amount of the overdue payments that results in a *default* under the definition used by the *firm* and other relevant factors;

it is not possible for any payment to be past due by a number of days exceeding the maximum amount specified in *BIPRU* for the purposes of the definition of *default* without there being a *default* under the part of the definition of *default* based on the amount overdue.

- 4.3.65 G In the case of a *retail exposure*, a value adjustment resulting from significant perceived decline in credit quality falling within *BIPRU* 4.3.63R(3) need not necessarily be taken as an indication of unlikelihood to pay if a *firm* employs formulaic portfolio provisioning based on a number of days overdue for its *retail exposures*. However, if such an *exposure* reaches the compulsory days past due indicator for the purposes of the definition of *default* it should automatically be deemed to be in *default*, regardless of the provisioning situation.
- 4.3.66 G An obligation should be considered a distressed restructuring under *BIPRU* 4.3.63R(5) if an independent third party, with expertise in the relevant area, would not be prepared to provide financing on substantially the same terms and conditions.
- 4.3.67 G
- (1) The realisation or forfeiture of collateral may be taken as an indication of unlikelihood to pay for the purposes of the definition of *default*.
 - (2) However, the realisation or forfeiture of collateral may not indicate unlikelihood to pay:
 - (a) in the case of an *exposure* in a market (such as one that involves *retail exposures* involving margin lending) in which it is established practice for collateral to be sold if its value falls below a certain percentage of the *exposure* and the obligor does not restore the margin (but this exception does not apply if the value of the collateral has fallen below the amount outstanding); or
 - (b) if the *firm* is able to demonstrate that for some other reason the realisation or forfeiture of collateral is not a meaningful indication of unlikelihood to pay.
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- 4.3.68 G (1) If an obligor approach is being taken with respect to *retail exposures* (that is, the application of the definition of *default* at an obligor level rather than at a facility level as set out in *BIPRU* 4.6.21R,) a *firm* should ensure that the *PD* associated with unsecured *exposures* is not understated as a result of the presence of any collateralised *exposures*. A *firm* should be able to explain to the *FSA*, if asked, how it has ensured that its estimate of *PD* is appropriate for both secured and unsecured *exposures* covered by an obligor rating approach.
- (2) In the view of the *FSA*, *firms* typically find that the *PD* of a residential mortgage is lower than the *PD* of an unsecured loan to the same borrower.

- 4.3.69 G A *firm* may, but without prejudice to *BIPRU* 4.4.22R and *BIPRU* 4.6.20R (Fixed numbers of days past due), use additional, or stricter, indicators of unlikeliness to pay if it uses these indicators for internal purposes in accordance with *BIPRU* 4.2.2R(2) (Use tests) and if the disclosures under *BIPRU* 11 (Disclosure) are on this basis.

Risk quantification: Definition of default: Other provisions

- 4.3.70 R A *firm* must (if it uses external data that is not itself consistent with the definition of *default*) be able to demonstrate to the *FSA* that appropriate adjustments have been made that achieve broad equivalence with the definition of *default*.

[Note: *BCD* Annex VII Part 4 point 46]

- 4.3.71 R If a *firm* considers that a previously *defaulted exposure* is such that no trigger of *default* continues to apply, the *firm* must rate the obligor or facility as it would for a non-*defaulted exposure*. Should the definition of *default* subsequently be triggered, another *default* must be deemed to have occurred.

[Note: *BCD* Annex VII Part 4 point 47]

- 4.3.72 G A *firm* should have a clear and documented policy for determining whether an *exposure* that has been in *default* should subsequently be returned to performing status.

Risk quantification: Overall requirements for estimation: General

- 4.3.73 R *BIPRU* 4.3.74R to *BIPRU* 4.3.131R apply to a *firm's* own estimates of risk parameters used in the *IRB approach*.

[Note: *BCD* Annex VII Part 4 point 43]

- 4.3.74 R A *firm's* own estimates of the risk parameters *PD*, *LGD*, *conversion factor* and *EL* must incorporate all relevant data, information and methods. The estimates must be derived using both historical experience and empirical evidence, and must not be based purely on judgemental considerations. The estimates must be plausible and intuitive and must be based on the material drivers of the respective risk parameters. The less data a *firm* has, the more conservative it must be in its estimation.

[Note: BCD Annex VII Part 4 point 49]

- 4.3.75 G (1) This paragraph provides guidance on BIPRU 4.3.73R.
- (2) Relevant data and information under BIPRU 4.3.73R includes external data.
- (3) Where internal *default* and *loss* experience is scarce, a *firm* should consider using material relevant external information. When using external information such as industry averages when determining *LGD* or *conversion factors*, a *firm* should consider whether this data is appropriate to its own experience and whether adjustments are necessary.
- 4.3.76 R (1) In calculating estimates of *PD*, *LGD* and *conversion factors* a *firm* must adjust the averages of historical experience referred to in the *historical averages rules* in order to ensure that those estimates are accurate estimates of the *default rate*, *loss rate* or *conversion factor* over the long-run.
- (2) The *historical average rules* means the requirements in BIPRU 4 relating to the calculation of *PD*, *LGD* and *conversion factors* using historical averages (and in particular BIPRU 4.4.24R, BIPRU 4.4.30R, BIPRU 4.8.7R, BIPRU 4.8.8R, BIPRU 4.6.24R, BIPRU 4.6.27R, BIPRU 4.3.99R and BIPRU 4.3.125R).
- 4.3.77 G Where a *firm* is able to demonstrate that the effect is immaterial in accordance with BIPRU 4.1.25R (Compliance), it may estimate average *LGDs* and *conversion factors* under the *historical average rules* in a way that does not strictly comply with BIPRU 4.3.94R (Default weighted average), provided the final estimates of *LGD* and *conversion factors* following the adjustments to averages of historical experience are made on the basis of *default* weighted averages for the *facility grade* or *pool* in question.
- 4.3.78 G A *firm* may carry out the adjustments under BIPRU 4.3.76R (Adjustments to averages of historical experience) by adjusting the data from which estimates are made rather than by adjusting the estimates themselves if it can demonstrate that capital requirements are not underestimated as a result.
- 4.3.79 G While the qualitative requirements in BIPRU 4 are important for all portfolios, they are of even greater importance in those cases where a *firm* lacks sufficient historical data to calibrate or validate its estimates of *PD*, *LGD* or *conversion factors* on the basis of proven statistical significance, sometimes referred to as low default portfolios.
- 4.3.80 R (1) A *firm* must collect data on what it considers to be the main drivers of the risk parameters *PD*, *LGD*, *conversion factor* and *EL* for each group of obligors or facilities.
- (2) A *firm* must document its identification of the main drivers of risk parameters.
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(3) A *firm* must be able to demonstrate that its process of identification is reasonable and appropriate.

- 4.3.81 R In its processes for identifying the main drivers of risk parameters, a *firm* must set out its reasons for concluding that the data sources chosen provide in themselves sufficient discriminative power and accuracy and why additional potential data sources do not provide relevant and reliable information that would be expected materially to improve the discriminative power and accuracy of its estimates of the risk parameter in question. This does not require an intensive analysis of all factors.
- 4.3.82 G If a *firm* uses a rating model to assign exposures to the borrower or facility grades, it may reflect the data on main drivers of risk parameters by its inclusion in the model as a risk driver or as part of a subsequent process that adjusts the output of that model to calculate the risk parameters *PD*, *LGD*, *conversion factor* and *EL*.
- 4.3.83 R A *firm* must be able to provide a breakdown of its loss experience in terms of *default* frequency, *LGD*, *conversion factor*, or *loss* where *EL* estimates are used, by the factors it sees as the drivers of the respective risk parameters. A *firm* must be able to demonstrate to the *FSA* that its estimates are representative of long-run experience.

[**Note:** *BCD* Annex VII Part 4 point 50]

- 4.3.84 R Any changes in lending practice or the process for pursuing recoveries over the observation periods referred to in *BIPRU* 4.4.31R (Observation period for sovereigns, institutions and corporates for *PDs*), *BIPRU* 4.6.28R (Observation period for retail exposures for *PDs*), *BIPRU* 4.4.54R (Observation period for sovereigns, institutions and corporates for *LGDs*), *BIPRU* 4.6.33R (Observation period for retail exposures for *LGDs*), *BIPRU* 4.4.55R (Observation period for sovereigns, institutions and corporates for *conversion factors*) and *BIPRU* 4.6.38R (Observation period for retail exposures for *conversion factors*) must be taken into account. A *firm*'s estimates must reflect the implications of technical advances and new data and other information, as it becomes available. A *firm* must review its estimates when new information comes to light but at least on an annual basis.

[**Note:** *BCD* Annex VII Part 4 point 51]

- 4.3.85 R The population of *exposures* represented in the data used for estimation, the lending standards used when the data was generated and other relevant characteristics must be comparable with those of a *firm*'s *exposures* and standards. A *firm* must also be able to demonstrate to the *FSA* that the economic or market conditions that underlie the data are relevant to current and foreseeable conditions. The number of *exposures* in the sample and the data period used for quantification must be sufficient to provide a *firm* with confidence in the accuracy and robustness of its estimates.

[**Note:** *BCD* Annex VII Part 4 point 52]

- 4.3.86 G It may be reasonable for a *firm* to treat foreseeable in *BIPRU* 4.3.85R as referring to the most distant date to which it carries out detailed capital planning.

- 4.3.87 G A *firm* should be able to demonstrate to the *FSA*:
- (1) how, with respect to each *rating system*, both assignment of ratings and estimates of *PD*, *LGD* and *conversion factors* are affected by:
 - (a) movements in the economic cycle; and
 - (b) other cyclical effects which are material to levels of *default*, *loss* or the amount of *exposures* at *default* for the *exposures* covered by the *rating system*; and
 - (2) the level of conservatism inherent in its ratings, as provided for by *BIPRU*.
- 4.3.88 R A *firm* must add to its estimates a margin of conservatism that is related to the expected range of estimation errors. Where methods and data are less satisfactory and the expected range of errors is larger, the margin of conservatism must be larger.
- [**Note:** *BCD* Annex VII Part 4 point 54]
- 4.3.89 G Estimation of *PD* through the use of a technique set out in *BIPRU* does not remove the need to make conservative adjustments, where necessary, related to the expected range of estimation errors so that capital requirements produced by the relevant model or other *rating system* are not understated.
- 4.3.90 R If a *firm* uses different estimates for the calculation of *risk weights* and internal purposes it must be documented. The *firm* must be able to demonstrate to the *FSA* the reasonableness of such estimates.
- [**Note:** *BCD* Annex VII Part 4 point 55]
- 4.3.91 G If a *firm* can demonstrate to the *FSA* that for data that have been collected prior to 31 December 2006, appropriate adjustments have been made to achieve broad equivalence with the definitions of *default* or *loss*, the *FSA* may in the *IRB permission* allow the *firm* some flexibility in the application of the required standards for data.
- [**Note:** *BCD* Annex VII Part 4 point 56]
- Risk quantification: Overall requirements for estimation: Pooled data
- 4.3.92 R If a *firm* uses data that is pooled across *institutions* it must be able to demonstrate to the *FSA* that:
- (1) the *rating systems* and criteria of other firms in the pool are similar to its own;
 - (2) the pool is representative of the portfolio for which the pooled data is used; and
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- (3) the pooled data is used consistently over time by the *firm* for its permanent estimates; and

[Note: BCD Annex VII Part 4 point 57]

4.3.93 G *BIPRU* 4.3.92R(1) is intended to ensure that data entering a pool is consistent and does not contain distortions as a result of different contributors' practices. It is not intended to constrain the use of pooled data by one *firm* that is contributed by a second *firm* where the differences do not affect the data being contributed.

4.3.94 R If a *firm* uses data that is pooled across *institutions* it remains responsible for the integrity of its *rating systems*. If a *firm* uses such data it must be able to demonstrate to the *FSA* that it has sufficient in-house understanding of its *rating systems*, including effective ability to monitor and audit the rating process.

[Note: BCD Annex VII Part 4 point 58]

Risk quantification: Overall requirements for estimation: Requirements specific to PD estimates

- 4.3.95 R (1) If:
- (a) a *firm's* internal experience of *exposures* of a type covered by a model or other *rating system* is 20 *defaults* or fewer; and
 - (b) in the *firm's* view, reliable estimates of *PD* cannot be derived from external sources of *default* data, including the use of market price related data, for all the *exposures* covered by the *rating system*;

the *firm* must estimate *PD* for *exposures* covered by that *rating system* in accordance with this *rule*.

- (2) A *firm* must use a statistical technique to derive the distribution of *defaults* implied by the *firm's* experience, estimating *PDs* (the "statistical *PD*") from the upper bound of a confidence interval set by the *firm* in order to produce conservative estimates of *PDs* in accordance with *BIPRU* 4.3.88R.
 - (3) The techniques chosen for the purposes of (2) must take account, as a minimum, of the following modelling issues:
 - (a) the number of *defaults* and number of obligor years in the sample;
 - (b) the number of years from which the sample was drawn;
 - (c) the interdependence between *default* events for individual obligors;
 - (d) the interdependence between *default* rates for different years; and
 - (e) the choice of the statistical estimators and the associated distributions and confidence intervals.
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- (4) The *firm* must further adjust the statistical PD to the extent necessary to take account of the following:
- (a) any likely differences between the observed *default* rates over the period covered by the *firm's default* experience and the long-run PD for each grade in accordance with BIPRU 4.4.24R and BIPRU 4.6.24R; and
 - (b) any other information that indicates (taking into account the robustness and cogency of that information) that the statistical PD is likely to be an inaccurate estimate of PD.
- (5) This *rule* is in addition to the other requirements in BIPRU about the calculation of PD.
- (6) When a *firm* calculates whether it has 20 *defaults* or fewer under the calculation in (1)(a), it must only take into account *defaults* that occurred during periods that are relevant to the validation under BIPRU 4 of the model or other *rating system* in question.
- 4.3.96 G A *firm* may if appropriate also choose to use the approach in BIPRU 4.3.91R if the internal experience on *exposures* covered by a *rating system* is greater than 20 *defaults*.
- 4.3.97 G If a *firm* excludes defaulted exposures that have been cured (as referred to in BIPRU 4.3.71R) or restructured (as referred to in BIPRU 4.3.63R(5)) from estimates of LGD in accordance with BIPRU 4.3.110G, it may also exclude cures from estimates of PD for these exposures.
- Risk quantification: Overall requirements for estimation: Requirements specific to own-LGD estimates
- 4.3.98 R BIPRU 4.3.98R to BIPRU 4.3.123R set out requirements specific to own-LGD estimates.
- 4.3.99 R A *firm* must estimate LGDs by *facility grade* or pool on the basis of the average realised LGDs by *facility grade* or pool using all observed *defaults* within the data sources (*default weighted average*).
- [Note: BCD Annex VII Part 4 point 73]
- 4.3.100 R A *firm* must calculate the *default weighted average* on the basis of the number of *defaults* included in the calculations made under the *historical average rules* so far as they relate to the calculation of PDs and must not be weighted by the size of *exposures*.
- 4.3.101 R (1) A *firm's* estimates of LGDs must take into account:
- (a) data in respect of relevant incomplete workouts; and
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- (b) the possibility that the proportion of *defaulted exposures* which are cured (as referred to in *BIPRU 4.3.71R*) or restructured (as referred to in *BIPRU 4.3.63R(5)*) or the length of the period over which a *firm* makes recoveries under a *defaulted exposure* may be different from the *firm's* observed historic experience.
- (2) An incomplete workout as referred to in (1)(a) means a *defaulted exposure* included in the data set on which the *firm's LGD* estimates are based, but for which the recovery process is still in progress, with the result that the final realised *losses* in respect of that *exposure* are not yet certain.
- 4.3.102 G The changes referred to in *BIPRU 4.3.101R(1)(b)* may be caused by external factors, such as the economic environment, as well as factors specific to the obligor, the transaction or the policies of the *firm*.
- 4.3.103 R A *firm* must use *LGD* estimates that are appropriate for an economic downturn if those are more conservative than the long-run average. To the extent a *rating system* is expected to deliver constant realised *LGDs* by grade or pool over time, a *firm* must make adjustments to its estimates of risk parameters by grade or pool to limit the capital impact of an economic downturn.

[Note: *BCD Annex VII Part 4 point 74*]

- 4.3.104 R (1) A *firm* must have a rigorous and well documented process for:
- (a) assessing the effects, if any, of economic downturn conditions on recovery rates; and
 - (b) producing *LGD* estimates consistent with downturn conditions as referred to in *BIPRU 4.3.103R*.
- (2) That process must include the following, which may be included in an integrated manner:
- (a) identification of appropriate downturn conditions for each *IRB exposure class* within each jurisdiction;
 - (b) identification of adverse dependencies, if any, between *default* rates and recovery rates; and
 - (c) incorporation of adverse dependencies, if identified, between *default* rates and recovery rates in the *firm's* estimates of *LGD* in a manner that meets the requirements in *BIPRU 4.3.103R* relating to an economic downturn.
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- 4.3.105 G A *firm* may derive the *LGD* in accordance with *BIPRU* 4.3.104R(2)(c) either by directly assigning to the *facility grade* or pool an estimate of *LGD* appropriate for downturn conditions, or alternatively by estimating a *default* weighted average *LGD* in accordance with *BIPRU* 4.3.99 and *BIPRU* 4.3.76 and converting it into an *LGD* appropriate for downturn conditions by the use of a formula. It should be able to demonstrate that that formula produces well-founded estimates of *LGDs* consistent with downturn conditions for the *exposures* in question.
- 4.3.106 G A *firm* may combine *IRB exposure classes*, jurisdictions or both for the purpose of *BIPRU* 4.3.104R(2)(a) if it can demonstrate that the downturn conditions to which the portfolios are subject will be similar.
- 4.3.107 G The adverse dependencies referred to in *BIPRU* 4.3.104R(2)(b) will not always exist. However, if a *firm* uses *LGDs* that do not allow for such adverse dependencies, it should be able to justify its decision.
- 4.3.108 G Data relating to economic downturn conditions is likely to be scarce. Accordingly, a *firm* should use internal data, external data or a combination of data sources in order to produce appropriate downturn *LGD* estimates in accordance with *BIPRU* 4.3.103R.
- 4.3.109 R A *firm* must retain sufficient data on both *LGDs* calculated on a economic downturn basis and calculated on a long-run average basis (as referred to in *BIPRU* 4.3.103R) to be able to demonstrate to the *FSA* (if asked) that its estimates based on an economic downturn are no less conservative than the long-run average as referred to in that *rule*.
- 4.3.110 G Where a *firm* is able to demonstrate that the effect is immaterial in accordance with *BIPRU* 4.1.25R (Compliance), it may exclude *defaulted exposures* that have been cured (as referred to in *BIPRU* 4.3.671R) or restructured (as referred to in *BIPRU* 4.3.63R(5)) from the data about *default* and *loss* experience on which *LGDs* are calculated provided it can demonstrate that its calculation of capital requirements (including capital requirements resulting from the application of capital floors under the transitional *rules* and *guidance* in *BIPRU*) are not reduced as a result of this approximation.
- 4.3.111 R Irrespective of whether calculated on an economic downturn or long-run average basis, each *LGD* estimate must be at least zero.
- 4.3.112 G In order to support an *LGD* estimate which is very low or zero, a *firm* should be able to demonstrate that the estimate adequately reflects the expected experience on a *default* weighted average basis or in a downturn as appropriate, taking into account the costs and discount rate associated with realisations and the operation of *BIPRU* 4.3.118R.
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- 4.3.113 R The methods that a *firm* uses for discounting cash flows for the purposes of estimating *LGDs* must take account of the uncertainties associated with the receipt of recoveries with respect to a *defaulted exposure*. If a *firm* intends to use a discount rate that does not take full account of the uncertainty in recoveries, it must be able to explain by what other process it has taken into account that uncertainty for the purposes of calculating *LGDs*.
- 4.3.114 G The uncertainty referred to in *BIPRU* 4.3.113R can be addressed by adjusting cash flows to certainty-equivalents or by using a discount rate that embodies an appropriate risk premium; or by a combination of the two.
- 4.3.115 G A *firm* may exclude from its calculation of *loss* indirect costs that it incurs for the purpose of making recoveries with respect to a *defaulted exposure* if it would also have incurred those costs if there had not been a *default*.
- 4.3.116 R A *firm* must consider the extent of any dependence between the risk of the obligor with that of the collateral or collateral provider. Cases where there is a significant degree of dependence must be addressed in a conservative manner.
- [Note: *BCD* Annex VII Part 4 point 75]
- 4.3.117 R Currency mismatches between the underlying obligation and the collateral must be treated conservatively in the *firm*'s assessment of *LGD*.
- [Note: *BCD* Annex VII Part 4 point 76]
- 4.3.118 R To the extent that *LGD* estimates take into account the existence of collateral, these estimates must not solely be based on the collateral's estimated market value. *LGD* estimates must take into account the effect of the potential inability of the *firm* expeditiously to gain control of its collateral and liquidate it.
- [Note: *BCD* Annex VII Part 4 point 77]
- 4.3.119 G (1) A *firm* may comply with *BIPRU* 4.3.118R by reducing the amount of the collateral taken into account for the purposes of calculating *LGD* (applying a haircut to the collateral), basing that reduction on validated realisation experience and using conservatism to reflect the uncertainties.
- (2) If collateral is used to reduce the *LGD*, a *firm* should be able to demonstrate how the risk in *BIPRU* 4.3.118R has been accounted for. To the extent that it is adequately accounted for in that way it need not be reflected again as part of the residual risk in relation to collateral under the *overall Pillar 2 rule*.
- 4.3.120 R To the extent that *LGD* estimates take into account the existence of collateral, a *firm* must establish internal requirements for collateral management, legal certainty and risk management that are generally consistent with those set out in *BIPRU* 5 (Credit risk mitigation) as modified by *BIPRU* 4.10.
- [Note: *BCD* Annex VII Part 4 point 78]
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- 4.3.121 R To the extent that a *firm* recognises collateral for determining the exposure value for *counterparty credit risk* according to the *CCR standardised method* or the *CCR internal model method*, any amount expected to be recovered from the collateral must not be taken into account in the *LGD* estimates.
- [Note: BCD Annex VII Part 4 point 79]
- 4.3.122 R For the specific case of *exposures* already in *default*, a *firm* must use the sum of its best estimate of *expected loss* for each *exposure* given current economic circumstances and *exposure* status and the possibility of additional unexpected *losses* during the recovery period.
- [Note: BCD Annex VII Part 4 point 80]
- 4.3.123 R To the extent that unpaid late fees have been capitalised in a *firm's* income statement, they must be added to the *firm's* measure of *exposure* and *loss*.
- [Note: BCD Annex VII Part 4 point 81]
- Risk quantification: Overall requirements for estimation: Requirements specific to own-conversion factor estimates
- 4.3.124 R *BIPRU* 4.3.125R - *BIPRU* 4.3.131R set out requirements specific to own-*conversion factor* estimates.
- 4.3.125 R A *firm* must estimate *conversion factors* by *facility grade* or pool on the basis of the average expected *conversion factors* by *facility grade* or pool using all observed *defaults* within the data sources (*default* weighted average).
- [Note: BCD Annex VII Part 4 point 87]
- 4.3.126 G (1) A *firm* using own estimates of *conversion factors* should take into account all facility types that may result in an *exposure* when an obligor *defaults*, including uncommitted facilities.
- (2) A *firm* should treat a facility as an *exposure* from the earliest date at which a customer is able to make drawings under it.
- (3) To the extent that a *firm* makes available multiple facilities, it should be able to demonstrate:
- (a) how it deals with the fact that *exposures* on one may become *exposures* under another on which the *losses* are ultimately incurred; and
- (b) the impact of its approach on its capital requirements.
- 4.3.127 R A *firm* must use *conversion factor* estimates that are appropriate for an economic downturn if those are more conservative than the long-run average. To the extent a *rating system* is expected to deliver realised *conversion factors* at a constant level by grade or pool over time, a *firm* must make adjustments to its estimates of risk parameters by grade or pool to limit the capital impact of an economic downturn.
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[Note: BCD Annex VII Part 4 point 88]

- 4.3.128 R A *firm's* estimates of *conversion factors* must reflect the possibility of additional drawings by the obligor up to and after the time a *default* event is triggered. The *conversion factor* estimate must incorporate a larger margin of conservatism where a stronger positive correlation can reasonably be expected between the *default* frequency and the magnitude of *conversion factor*.

[Note: BCD Annex VII Part 4 point 89]

- 4.3.129 R In arriving at estimates of *conversion factors* a *firm* must consider its specific policies and strategies adopted in respect of account monitoring and payment processing. A *firm* must also consider its ability and willingness to prevent further drawings in circumstances short of payment *default*, such as covenant violations or other technical *default* events.

[Note: BCD Annex VII Part 4 point 90]

- 4.3.130 R A *firm* must have adequate systems and procedures in place to monitor facility amounts, current outstandings against committed lines and changes in outstandings per obligor and per grade. A *firm* must be able to monitor outstanding balances on a daily basis.

[Note: BCD Annex VII Part 4 point 91]

- 4.3.131 R If a *firm* uses different estimates of *conversion factors* for the calculation of *risk weighted exposure amounts* and internal purposes it must be documented. The *firm* must be able to demonstrate their reasonableness to the FSA.

[Note: BCD Annex VII Part 4 point 92]

Risk quantification: Overall requirements for estimation: Comparability

- 4.3.132 G (1) This paragraph contains *guidance* about the interpretation of the requirements relating to comparability in BIPRU 4.3.85R. It is also relevant to the requirement for representative data in BIPRU 4.3.51R(5), to the references to comparability in the additional *guidance* in BIPRU 4.3.53G(7)(b) and to the requirements for similarity in BIPRU 4.3.92R.
- (2) In general, comparability should be based on analyses of the population of *exposures* represented in the data, the lending standards used when the data was generated (where relevant) and other relevant characteristics in relation to the corresponding properties of the *firm's* own portfolio. Other relevant characteristics could include the distribution of the obligors across industries, the size distribution of the *exposures* and similarity with respect to the geographic or demographic distribution of the *exposures*.
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4.4 The IRB approach: Exposures to corporates, institutions and sovereigns

Application

- 4.4.1 R (1) This section applies with respect to the *sovereign, institution and corporate IRB exposure class*.
- (2) The *sovereign, institution and corporate IRB exposure class* includes *specialised lending exposures*.
- (3) Both *BIPRU 4.4* and *BIPRU 4.5* (Specialised lending exposures) apply to *specialised lending exposures*. A firm may calculate *risk weighted exposure amounts* for a *specialised lending exposure* either:
- (a) (if it is able to do so) in accordance with *BIPRU 4.4*; or
- (b) in accordance with *BIPRU 4.4* as modified by *BIPRU 4.5*.

Definition

- 4.4.2 R The following *exposures* must be treated as *exposures* to central governments and *central banks*:
- (1) *exposures* to regional governments, local authorities or *public sector entities* which are treated as *exposures* to central governments under the *standardised approach*; and
- (2) *exposures* to *multilateral development banks* and international organisations which attract a *risk weight* of 0% under the *standardised approach*.

[**Note:** *BCD* Article 86(2)]

- 4.4.3 R The following *exposures* must be treated as *exposures* to *institutions*:
- (1) *exposures* to regional governments and local authorities which are not treated as *exposures* to central governments under the *standardised approach*;
- (2) *exposures* to *public sector entities* which are treated as *exposures* to *institutions* under the *standardised approach*;
- (3) *exposures* to *multilateral development banks* which do not attract a 0% *risk weight* under the *standardised approach*; and
- (4) without prejudice to *BIPRU 13.3.13R* and *BIPRU 13.8.10R* (*Exposures* to a central counterparty) *exposures* to *recognised third-country investment firms* and *exposures* to *recognised clearing houses* and *designated investment exchanges*.

[Note: BCD Article 86(3) and CAD Article 40]

- 4.4.4 R Any credit obligation not assigned to the *IRB exposure classes* referred to in *BIPRU 4.3.2R(1)* (Sovereigns), *BIPRU 4.3.2R(2)* (Institutions) and *BIPRU 4.3.2R(4)-BIPRU 4.3.2R(6)* (Retail, equity and securitisations) must be assigned to the *corporate exposure class*.

[Note: BCD Article 86(7)]

Rating system: Structure of rating system

- 4.4.5 R *BIPRU 4.4.6R - BIPRU 4.4.21R* apply in addition to *BIPRU 4.3.25R - BIPRU 4.3.28R* (Rating systems).

- 4.4.6 R A *rating system* must take into account obligor and transaction risk characteristics.

[Note: BCD Annex VII Part 4 point 5]

- 4.4.7 R A *rating system* must have an obligor rating scale which reflects exclusively quantification of the risk of obligor *default*. The obligor rating scale must have a minimum of seven grades for non-*defaulted* obligors and one for *defaulted* obligors.

[Note: BCD Annex VII Part 4 point 6]

- 4.4.8 R An *obligor grade* means for the purpose of *BIPRU 4* as it applies to the *sovereign, institution and corporate IRB exposure class* a risk category within a *rating system's* obligor rating scale, to which obligors are assigned on the basis of a specified and distinct set of rating criteria, from which estimates of *PD* are derived. A *firm* must document both the relationship between *obligor grades* in terms of the level of *default* risk each grade implies and the criteria used to distinguish that level of *default* risk.

[Note: BCD Annex VII Part 4 point 7]

- 4.4.9 R A *firm* with portfolios concentrated in a particular market segment and range of *default* risk must have enough *obligor grades* within that range to avoid undue concentrations of obligors in a particular grade. Significant concentrations within a single grade must be supported by convincing empirical evidence that the *obligor grade* covers a reasonably narrow *PD* band and that the *default* risk posed by all obligors in the grade falls within that band.

[Note: BCD Annex VII Part 4 point 8]

Rating system: Assignment to grades or pools

- 4.4.10 G Material on assignment to grades or pools can be found in *BIPRU 4.3.43R - BIPRU 4.3.48R*.

Rating system: Assignment of exposures

- 4.4.11 R Each obligor must be assigned to an *obligor grade* as part of the credit approval process.
- [Note: BCD Annex VII Part 4 point 19]
- 4.4.12 R Each separate legal entity to which a *firm* is exposed must be separately rated. A *firm* must be able to demonstrate to the *FSA* that it has acceptable policies regarding the treatment of individual obligor clients and *groups of connected clients*.
- [Note: BCD Annex VII Part 4 point 22]
- 4.4.13 R Separate *exposures* to the same obligor must be assigned to the same *obligor grade*, irrespective of any differences in the nature of each specific transaction. Exceptions, where separate *exposures* are allowed to result in multiple grades for the same obligor are:
- (1) country transfer risk, this being dependent on whether the *exposures* are denominated in local or foreign currency;
 - (2) where the treatment of associated guarantees to an *exposure* may be reflected in an adjusted assignment to an *obligor grade*; and
 - (3) where consumer protection, bank secrecy or other legislation prohibit the exchange of client data.
- [Note: BCD Annex VII Part 4 point 23]
- Rating system: Overrides
- 4.4.14 G Material on overrides can be found in *BIPRU* 4.3.50R.
- Rating system: Integrity of assignment process
- 4.4.15 R Assignments and periodic reviews of assignments must be completed or approved by an independent party that does not directly benefit from decisions to extend the credit.
- [Note: BCD Annex VII Part 4 point 26]
- 4.4.16 R A *firm* must update assignments at least annually. High risk obligors and problem *exposures* must be subject to more frequent review. A *firm* must undertake a new assignment if material information on the obligor or *exposure* becomes available.
- [Note: BCD Annex VII Part 4 point 27]
- 4.4.17 G Although it will not usually be the case that facility ratings and *conversion factors* will have to be updated more frequently than annually, *LGDs* and *exposure* values are subject to more frequent recalculation due to their connection to drawn balances, which can vary on a daily basis.

4.4.18 R A *firm* must have an effective process to obtain and update relevant information on obligor characteristics that affect *PDs*, and on transaction characteristics that affect *LGDs* and *conversion factors*.

[**Note:** *BCD* Annex VII Part 4 point 28]

Rating system: Use of models

4.4.19 G Material on the use of models can be found in *BIPRU* 4.3.51R - *BIPRU* 4.3.53G.

Rating system: Documentation of rating systems

4.4.20 G Material on the documentation of rating systems can be found in *BIPRU* 4.3.19R - *BIPRU* 4.3.24R.

Rating system: Data maintenance

4.4.21 R In addition to complying with the material in *BIPRU* 4.3.54R (Data maintenance) a *firm* must collect and store:

- (1) complete rating histories on obligors and recognised guarantors;
- (2) the dates the ratings were assigned;
- (3) the key data and methodology used to derive the rating;
- (4) the person responsible for the rating assignment;
- (5) the identity of obligors and *exposures* that *defaulted*;
- (6) the date and circumstances of such *defaults*;
- (7) data on the *PDs* and realised *default* rates associated with rating grades and ratings migration; and
- (8) (in the case of a *firm* not using the *advanced IRB approach* in the calculation of *LGDs* and/or *conversion factors*) data on comparisons of realised *LGDs* to the values as set out in *BIPRU* 4.4.34R and *BIPRU* 4.8.25R and realised *conversion factors* to the values as set out in *BIPRU* 4.4.37R, *BIPRU* 4.4.45R and *BIPRU* 4.6.44R.

[**Note:** *BCD* Annex VII Part 4 point 37]

Risk quantification: Definition of default

- 4.4.22 R
- (1) This *rule*, in accordance with *BIPRU* 4.3.57R(4) (Definition of default), sets the exact number of days past due that a *firm* should abide by in the case of *exposures* to *PSEs*.
 - (2) For counterparts that are *PSEs* situated within the *United Kingdom* the number of days past due is 180.

- (3) For counterparts that are *PSEs* situated in another *EEA State* the number of days past due is the lower of:
- (a) 180; and
 - (b) the number of days past due fixed under the *CRD implementation measure* with respect to point 48 of Part 4 of Annex VII of the *Banking Consolidation Directive* for that *EEA State* for such *exposures*.
- (4) For counterparts that are *PSEs* in a state outside the *EEA* the number of days past due is the lower of:
- (a) 180; and
 - (b) (if a number of days past due for such *exposures* has been fixed under any law of that state applicable to *undertakings* in the *banking sector* or the *investment services sector* that implements the *IRB approach*) that number.

[**Note:** *BCD* Annex VII Part 4 point 44 (part) and point 48 (part)]

Risk quantification: Overall requirements for estimation: Requirements specific to PD estimation

4.4.23 R *BIPRU* 4.4.24R - *BIPRU* 4.4.31R apply to both the *foundation IRB approach* and the *advanced IRB approach*.

4.4.24 R A *firm* must estimate *PDs* by *obligor grade* from long run averages of one-year *default rates*.

[**Note:** *BCD* Annex VII Part 4 point 59]

4.4.25 R A *firm* must use *PD* estimation techniques only with supporting analysis. A *firm* must recognise the importance of judgmental considerations in combining results of techniques and in making adjustments for limitations of techniques and information.

[**Note:** *BCD* Annex VII Part 4 point 62]

4.4.26 G Where rating agency experience or the output of a statistical default model are the primary component of *PD* estimation, a *firm* should consider whether it needs to make adjustments for other relevant information, such as internal experience, conservatism and cyclical effects. In making these adjustments, a *firm* should consider the extent to which it needs to take account of the potential for both under-recording of actual *defaults* experienced and divergence of actual experience from the true underlying average *PD*.

- 4.4.27 R To the extent that a *firm* uses data on internal *default* experience for the estimation of *PDs* it must be able to demonstrate in its analysis that the estimates are reflective of underwriting standards and of any differences in the *rating system* that generated the data and the current *rating system*. Where underwriting standards or *rating systems* have changed, a *firm* must add a greater margin of conservatism in its estimate of *PD*.

[**Note:** BCD Annex VII Part 4 point 63]

- 4.4.28 R To the extent that a *firm* associates or maps its internal grades to the scale used by an *ECAI* or similar organisations and then attributes the *default* rate observed for the external organisation's grades to the *firm's* grades, mappings must be based on a comparison of internal rating criteria to the criteria used by the external organisation and on a comparison of the internal and external ratings of any common obligors. Biases or inconsistencies in the mapping approach or underlying data must be avoided. The external organisation's criteria underlying the data used for quantification must be oriented to *default* risk only and not reflect transaction characteristics. The *firm's* analysis must include a comparison of the *default* definitions used, subject to the requirements in *BIPRU* 4.3.56R to *BIPRU* 4.3.71R and *BIPRU* 4.4.22R (Definition of default). The *firm* must document the basis for the mapping.

[**Note:** BCD Annex VII Part 4 point 64]

- 4.4.29 G It is unlikely that a *firm* will be able to convince the FSA that it had considered all relevant and available information, as required by *BIPRU* 4.3.74R, if it used only data from one *ECAI* or similar organisation, where other relevant information is available.

- 4.4.30 R To the extent that a *firm* uses statistical *default* prediction models it may estimate *PDs* as the simple average of *default*-probability estimates for individual obligors in a given grade. The *firm's* use of *default* probability models for this purpose must meet the standards specified in *BIPRU* 4.3.51R.

[**Note:** BCD Annex VII Part 4 point 65]

- 4.4.31 R Irrespective of whether a *firm* is using external, internal, or pooled data sources, or a combination of the three, for its *PD* estimation, the length of the underlying historical observation period used must be at least five years for at least one source. If the available observation period spans a longer period for any source, and this data is relevant, this longer period must be used. A *firm* not permitted to use own estimates of *LGDs* or *conversion factors* may have, when it implements the *IRB approach*, relevant data covering a period of two years. The period to be covered must increase by one year each year until relevant data cover a period of five years.

[**Note:** BCD Annex VII Part 4 point 66 (part)]

IRB foundation approach: General

- 4.4.32 R *BIPRU* 4.4.33R - *BIPRU* 4.4.39R set out requirements specific to the *foundation IRB approach*.

4.4.33 R Under the *foundation IRB approach* a *firm* must apply the *LGD* values set out in *BIPRU 4.4.34R* and *BIPRU 4.8.25R* and the *conversion factors* set out in *BIPRU 4.4.37*.

[**Note:** *BCD Article 87(8)*]

IRB foundation approach: LGDs

4.4.34 R A *firm* must use the following *LGD* values:

- (1) senior *exposures* without eligible collateral, 45%;
- (2) subordinated *exposures* without eligible collateral, 75%;
- (3) a *firm* may recognise funded and *unfunded credit protection* in the *LGD* in accordance with *BIPRU 5* (Credit risk mitigation), as modified by *BIPRU 4.10*;
- (4) *covered bonds* may be assigned an *LGD* value of 12.5%; and
- (5) for certain senior *corporate exposure* purchased receivables, for certain subordinated *corporate exposure* purchased receivables and for *dilution risk of corporate* purchased receivables the provisions of *BIPRU 4.8.25R* (LGDs for corporate receivables) apply.

[**Note:** *BCD Annex VII Part 2 point 8 (part)*]

4.4.35 R Until 31 December 2010, *covered bonds* as set out in *BIPRU 3.4.107R* to *BIPRU 3.4.110R* may be assigned an *LGD* value of 11.25% if:

- (1) assets as set out in *BIPRU 3.4.107R(1)(a)* to (c) collateralising the *covered bonds* all qualify for *credit quality assessment step one* as set out in *BIPRU 3*;
- (2) where assets set out in *BIPRU 3.4.107R(1)(d)* and (e) are used as collateral, the respective upper limits laid down in each of those points is 10% of the nominal amount of the outstanding issue;
- (3) assets as set out in *BIPRU 3.4.107R(1)(f)* are not used as collateral; or
- (4) the *covered bonds* are the subject of a credit assessment by a *nominated ECAI*, and the *ECAI* places them in the most favourable category of credit assessment that the *ECAI* could make in respect of *covered bonds*.

[**Note:** *BCD Annex VII Part 2 point 8 (part)*]

Foundation IRB approach: Exposure value and conversion factors

4.4.36 R *BIPRU 4.4.37R - BIPRU 4.4.39R* apply in addition to *BIPRU 4.4.71R - BIPRU 4.4.78R*.

- 4.4.37 R (1) The *exposure* value for the items set out in this *rule* must be calculated as the committed but undrawn amount multiplied by the applicable *conversion factor* set out in this *rule*.
- (2) For credit lines which are uncommitted, that are unconditionally cancellable at any time by the *firm* without prior notice, or that effectively provide for automatic cancellation due to deterioration in a borrower's credit worthiness, a *conversion factor* of 0 % applies. To apply a *conversion factor* of 0% a *firm* must actively monitor the financial condition of the obligor, and its internal control systems must enable it immediately to detect a deterioration in the credit quality of the obligor.
- (3) For short-term letters of credit arising from the movement of goods, a *conversion factor* of 20% applies for both the issuing and confirming *firms*.
- (4) For other credit lines, note issuance facilities (NIFs), and revolving underwriting facilities (RUFs), a *conversion factor* of 75% applies.
- (5) For undrawn purchase commitments for revolving purchased receivables falling under *BIPRU* 4.8.29R, the *conversion factor* set out in that *rule* applies.

[**Note:** *BCD* Annex VII Part 3 point 9 (part)]

- 4.4.38 R Where a commitment refers to the extension of another commitment, the lower of the two *conversion factors* associated with the individual commitment must be used.

[**Note:** *BCD* Annex VII Part 3 point 10]

- 4.4.39 R For all off-balance sheet items other than mentioned in *BIPRU* 4.4.37R, *BIPRU* 4.4.45R, *BIPRU* 4.4.71R - *BIPRU* 4.4.78R, *BIPRU* 4.6.44R *BIPRU* 4.8.28R and *BIPRU* 4.8.29R, the *exposure* value must be the following percentage of its value:

- (1) 100% if it is a full risk item;
- (2) 50% if it is a medium risk item;
- (3) 20% if it is a medium/low risk item; and
- (4) 0% if it is a low risk item.

For the purposes of this *rule* the off-balance sheet items must be assigned to risk categories as indicated in *BIPRU* 3.7 (Classification of off-balance sheet items).

[**Note:** *BCD* Annex VII Part 3 point 11]

Advanced IRB approach: General

- 4.4.40 R *BIPRU* 4.4.41R - *BIPRU* 4.4.55R set out requirements specific to the *advanced IRB approach*.

4.4.41 R Under the *advanced IRB approach* a firm must use its own estimates of *LGDs* and *conversion factors* in accordance with *BIPRU 4*.

[**Note:** *BCD Article 87(9)*]

Advanced IRB approach: *LGDs* and *PDs*

4.4.42 R A firm using own *LGD* estimates under the *advanced IRB approach* may recognise *unfunded credit protection* by adjusting *PDs* subject to *BIPRU 4.4.43R*.

[**Note:** *BCD Annex VII Part 2 point 6*]

4.4.43 R Notwithstanding *BIPRU 4.4.34R* and *BIPRU 4.8.25R*, if a firm's *IRB permission* permits it to use own *LGD* estimates under the *advanced IRB approach* for *exposures* to which *BIPRU 4* applies and permits it to use the approach in this rule, *unfunded credit protection* may be recognised by adjusting *PD* and/or *LGD* estimates subject to the *minimum IRB standards*. A firm must not assign guaranteed exposures an adjusted *PD* or *LGD* such that the adjusted *risk weight* would be lower than that of a comparable, direct *exposure* to the guarantor.

[**Note:** *BCD Annex VII Part 2 point 10*]

4.4.44 G A firm using the *advanced IRB approach* may only recognise *unfunded credit protection* in accordance with *BIPRU 4.4.43R*. The other methods for recognising *unfunded credit risk mitigation* under the *standardised approach* and *foundation IRB approach* are not available to a firm on the *advanced IRB approach*.

Advanced IRB approach: *Conversion factors*

4.4.45 R If a firm uses its own estimates of *conversion factors* under the *advanced IRB approach* it must calculate the *exposure* value of off-balance sheet *exposures* calculated with the use of *conversion factors* by using its own estimates of *conversion factors* across different product types as mentioned in *BIPRU 4.4.37R* and *BIPRU 4.4.39R(2) to (4)*.

[**Note:** *BCD Annex VII Part 3 point 9 (part)*]

4.4.46 G Under *BIPRU 4.4.45R*, a firm may calculate *exposure* values by calculating the amount expected to be claimed, instead of the maximum possible amount of the potential claim. The figure for the amount expected to be claimed should not be less than the current outstandings from time to time.

Advanced IRB approach: *Structure of the rating system*

4.4.47 R *BIPRU 4.4.48R - BIPRU 4.4.50R* are in addition to *BIPRU 4.3.25R - BIPRU 4.3.28R* and *BIPRU 4.4.6R - BIPRU 4.4.9R*.

4.4.48 R If a firm's *IRB permission* provides for it to use the *advanced IRB approach* for the calculation of *LGDs*, its *rating system* must incorporate a distinct facility rating scale which exclusively reflects *LGD* related transaction characteristics.

[Note: BCD Annex VII Part 4 point 9]

- 4.4.49 R A *facility grade* means for the purpose of the *advanced IRB approach* a risk category within a *rating system*'s facility scale to which *exposures* are assigned on the basis of a specified and distinct set of rating criteria from which own estimates of *LGDs* are derived. The grade definition must include both a description of how *exposures* are assigned to the grade and of the criteria used to distinguish the level of risk across grades.

[Note: BCD Annex VII Part 4 point 10]

- 4.4.50 R Significant concentrations within a single *facility grade* must be supported by convincing empirical evidence that the *facility grade* covers a reasonably narrow *LGD* band, respectively, and that the risk posed by all *exposures* in the grade falls within that band.

[Note: BCD Annex VII Part 4 point 11]

Advanced IRB approach: Assignment of exposures

- 4.4.51 R For a *firm* permitted to use own estimates of *LGDs* or *conversion factors* under the *advanced IRB approach*, each *exposure* must be assigned to a *facility grade* as part of the credit approval process. This is in addition to the requirements in *BIPRU* 4.4.11R - *BIPRU* 4.4.13R.

[Note: BCD Annex VII Part 4 point 20]

- 4.4.52 G *BIPRU* 4.4.50R and *BIPRU* 4.4.51R should be read in the light of *BIPRU* 4.3.28R.

Advanced IRB approach: Data maintenance

- 4.4.53 R As well as complying with *BIPRU* 4.3.54R and *BIPRU* 4.4.21R (Data maintenance), a *firm* using own estimates of *LGDs* and/or *conversion factors* under the *advanced IRB approach* must collect and store:

- (1) complete histories of data on the facility ratings and *LGD* and *conversion factor* estimates associated with each *rating scale*;
- (2) the dates the ratings were assigned and the estimates were done;
- (3) the key data and methodology used to derive the facility ratings and *LGD* and *conversion factor* estimates;
- (4) the person who assigned the facility rating and the person who provided *LGD* and *conversion factor* estimates;
- (5) data on the estimated and realised *LGDs* and *conversion factors* associated with each *defaulted exposure*;

- (6) data on the *LGD* of the *exposure* before and after evaluation of the effects of a guarantee or credit derivative, for a *firm* that reflects the credit risk mitigating effects of guarantees or credit derivatives through *LGD*; and
- (7) data on the components of *loss* for each *defaulted exposure*.

[**Note:** *BCD* Annex VII Part 4 Point 38]

Advanced IRB approach: Requirements specific to own-LGD estimates

- 4.4.54 R In addition to the requirements in *BIPRU* 4.3.74R - *BIPRU* 4.3.94R (General requirements about risk quantification) and *BIPRU* 4.3.98R - *BIPRU* 4.3.123R (Requirements for risk quantification specific to own-LGD estimates), estimates of *LGD* must be based on data over a minimum of five years, increasing by one year each year after implementation until a minimum of seven years is reached, for at least one data source. If the available observation period spans a longer period for any source, and the data is relevant, this longer period must be used.

[**Note:** *BCD* Annex VII Part 4 point 82]

Advanced IRB approach: Requirements specific to own-conversion factor estimates

- 4.4.55 R In addition to the requirements in *BIPRU* 4.3.124R - *BIPRU* 4.3.131R (Requirements specific to own-conversion factor estimates), estimates of *conversion factors* must be based on data over a minimum of five years, increasing by one year each year after implementation until a minimum of seven years is reached, for at least one data source. If the available observation period spans a longer period for any source, and the data is relevant, this longer period must be used.

[**Note:** *BCD* Annex VII Part 4 point 93]

Calculations: General

- 4.4.56 R The remainder of this section applies to both the *foundation IRB approach* and the *advanced IRB approach*.

Calculations: Risk-weighted exposure amounts

- 4.4.57 R Subject to *BIPRU* 4.4.59R to *BIPRU* 4.4.60R, *BIPRU* 4.5.6R, *BIPRU* 4.5.8R - *BIPRU* 4.5.10R (Risk weights for specialised lending), *BIPRU* 4.8.16R, *BIPRU* 4.8.17R (Risk weights for corporate exposure purchased receivables) and *BIPRU* 4.9.3R (Securitisation: provision of credit protection), *risk weighted exposure amounts* must be calculated according to the formulae in the table in *BIPRU* 4.4.58R and the adjustment formula in *BIPRU* 4.4.79R (Double default).

[**Note:** *BCD* Annex VII Part 1 point 3]

- 4.4.58 R Table: Formulae for the calculation of *risk weighted exposure amounts*
This table belongs to *BIPRU* 4.4.57R

Correlation (R)	$0.12 \times (1 - \text{EXP}(-50*PD))/(1-\text{EXP}(-50)) + 0.24*$ $[1-(1-\text{EXP}(-50*PD))/(1-\text{EXP}(-50))]$	
Maturity factor (b)	$(0.11852-0.05478*1n(PD))^2$	
	$(LGD*N[(1-R)^{-0.5}*G(PD)+(R/(1-R))^{0.5} *G(0.999)]-PD*LGD)*$ $(1-1.5*b)^{-1}*(1+(M-2.5)*b)*12.5*1.06$	
N(x)	denotes the cumulative distribution function for a standard normal random variable (i.e. the probability that a normal random variable with mean zero and variance of one is less than or equal to x). G(z) denotes the inverse cumulative distribution function for a standard normal random variable (i.e. the value x such that N(x) = z).	
PD = 0	For PD = 0, RW shall be: 0	
PD = 1	For PD = 1:	
	(i)	for <i>defaulted exposures</i> where a <i>firm</i> applies the LGD values set out in BIPRU 4.4.32R and BIPRU 4.8.25R RW shall be: 0;
	(ii)	for <i>defaulted exposures</i> where a <i>firm</i> uses its own estimates of LGDs, RW shall be: Max {0, 12.5 *(LGD- <u>EL_{BE}</u>)};
	where <u>EL_{BE}</u> must be the <i>firm</i> 's best estimate of <i>expected loss</i> for the <i>defaulted exposure</i> according to BIPRU 4.3.122R.	

[Note: BCD Annex VII Part 1 point 3]

- 4.4.59 R For *exposures* to companies where the total annual sales for the consolidated group of which the firm is a part is less than EUR 50 million a *firm* may use the following correlation formula for the calculation of *risk weights* for *corporate exposures*. In this formula S is expressed as total annual sales in millions of Euros with EUR 5 million <= S <= EUR 50 million. Reported sales of less than EUR 5 million must be treated as if they were equivalent to EUR 5 million. In accordance with BIPRU 4.8.21R, for purchased receivables the total annual sales are the weighted average by individual *exposures* of the pool. The formula for the calculation of correlation (R) is:

$$0.12 \times (1 - \text{EXP}(-50*PD))/(1-\text{EXP}(-50)) + 0.24*$$

$$[1-(\text{EXP}(-50*PD))/(1-\text{EXP}(-50))]$$

$$-0.04*(1-(S-5)/45)$$

[Note: BCD Annex VII Part 1 point 5 (part)]

- 4.4.60 R A *firm* must for the purpose of BIPRU 4.4.59R substitute total assets of the consolidated group for total annual sales when total annual sales are not a meaningful indicator of firm size and total assets are a more meaningful indicator than total annual sales.

[Note: BCD Annex VII Part 1 point 5 (part)]

Calculations: Expected loss amounts

- 4.4.61 R *Expected loss* amounts must be calculated according to the formulae in the table in BIPRU 4.4.62R.

[Note: BCD Annex VII Part 1 point 30 (part)]

- 4.4.62 Table: Formulae for the calculation of *expected loss* amounts
This table belongs to BIPRU 4.4.61R

<i>Expected loss (EL)</i>	equals $PD \times LGD$
<i>Expected loss amount</i>	equals $EL \times exposure$ value
For <i>defaulted exposures</i> ($PD = 1$) where a <i>firm</i> uses its own estimates of <i>LGDs</i> , <i>EL</i> must be EL_{BE} , the <i>firm's</i> best estimate of <i>expected loss</i> for the <i>defaulted exposure</i> according to BIPRU 4.3.122R.	
For exposures subject to the treatment set out in BIPRU 4.4.79R (Double default) <i>EL</i> must be 0.	

[Note: BCD Annex VII Part 1 point 30 (part)]

Calculations: PD

- 4.4.63 R A *firm* must provide its own estimates of *PDs* in accordance with its *IRB permission* and the *minimum IRB standards*.

[Note: BCD Article 87(6) (part)]

- 4.4.64 R The *PD* of a *corporate exposure* or an *exposure* in the *IRB exposure class* referred to in BIPRU 4.3.2R(2) (Institutions) must be at least 0.03%.

[Note: BCD Annex VII Part 2 point 2]

4.4.65 R The *PD* of obligors in *default* must be 100%.

[Note: BCD Annex VII Part 2 point 4]

4.4.66 R Subject to BIPRU 4.4.42R (*Advanced IRB approach: LGDs and PDs*) a *firm* may recognise *unfunded credit protection* in the *PD* in accordance with the provisions of BIPRU 5 (Credit risk mitigation), as modified by BIPRU 4.10. For *dilution risk*, however, a *firm* may also recognise *unfunded credit protection* providers which are specified in its *IRB permission* in addition to those indicated in the *CRM eligibility conditions*.

[Note: BCD Annex VII Part 2 point 5]

Calculations: Maturity

4.4.67 R A *firm* must calculate maturity (M) for each of the *exposures* referred to in this *rule* in accordance with this *rule* and subject to BIPRU 4.4.68R to BIPRU 4.4.70R. In all cases, M must be no greater than 5 years.

(1) For an instrument subject to a cash flow schedule M must be calculated according to the following formula:

$$M = \text{MAX}\{1; \text{MIN}\{\sum_t t * CF_t / \sum_t CF_t ; 5\}\}$$

where CF_t denotes the cash flows (principal, interest payments and fees) contractually payable by the obligor in period t .

(2) For derivatives subject to a master netting agreement M must be the weighted average remaining maturity of the *exposure*, where M must be at least 1 year. The notional amount of each *exposure* must be used for weighting the maturity.

(3) For *exposures* arising from fully or nearly-fully collateralised *financial derivative instruments* transactions and fully or nearly-fully collateralised *margin lending transactions* which are subject to a master netting agreement M must be the weighted average remaining maturity of the transactions where M must be at least 10 days. The notional amount of each transaction must be used for weighting the maturity.

- (5) Where a *firm* uses the *CCR internal model method* to calculate the *exposure* values, M must be calculated for *exposures* to which a *firm* applies this method and for which the maturity of the longest-dated contract contained in the *netting set* is greater than one year according to the following formula:

$$M = \text{MIN} \left(\frac{\sum_{k=1}^{tk \leq 1 \text{ year}} \text{Effective} EE_k * \Delta t_k * df_k + \sum_{tk > 1 \text{ year}}^{\text{maturity}} EE_k * \Delta t_k * df_k}{\sum_{k=1}^{tk \leq 1 \text{ year}} \text{Effective} EE_k * \Delta t_k * df_k} ; 5 \right)$$

where:

df_k = the risk-free discount factor for future time period t_k and the remaining symbols are defined in BIPRU 13.6.

- (6) Notwithstanding (7), a *firm* that uses a *CCR internal model method* model to calculate a one-sided credit valuation adjustment (CVA) may use the effective credit duration estimated by the model as M if permitted to do so by its *CCR internal model method permission*.
- (7) Subject to BIPRU 4.4.68R, for *netting sets* in which all contracts have an original maturity of less than one year the formula in (2) must be applied
- (8) If a *firm* is permitted under its *IRB permission* to use own *PD* estimates for *corporate exposure* purchased receivables, for drawn amounts M must equal the purchased receivables *exposure* weighted average maturity, where M must be at least 90 days. This same value of M must also be used for undrawn amounts under a committed purchase facility provided the facility contains effective covenants, early amortisation triggers, or other features that protect the purchasing *firm* against a significant deterioration in the quality of the future receivables it is required to purchase over the facility's term. Absent such effective protections, M for undrawn amounts must be calculated as the sum of the longest-dated potential receivable under the purchase agreement and the remaining maturity of the purchase facility, where M must be at least 90 days
- (9) For any other instrument than mentioned in this *rule* or when a *firm* is not in a position to calculate M as set out in (2), M must be the maximum remaining time (in years) that the obligor is permitted to take fully to discharge its contractual obligations, where M must be at least 1 year.

[**Note:** BCD Annex VII Part 2 point 13 (part)]

4.4.68 R Notwithstanding BIPRU 4.4.67R(2)-(3) and (8)-(9), M must be at least one-day for:

- (1) fully or nearly-fully collateralised *financial derivative instruments*;

- (2) fully or nearly-fully collateralised *margin lending transactions*; and
- (3) *repurchase transactions, securities or commodities lending or borrowing transactions*,

provided the documentation requires daily remargining and daily revaluation and includes provisions that allow for the prompt liquidation or setoff of collateral in the event of *default* or failure to re-margin.

[**Note:** BCD Annex VII Part 2 point 14 (part)]

- 4.4.69 G The last paragraph of paragraph 14 of Part 2 of Annex VII of the *Banking Consolidation Directive* says: “In addition, for other short-term exposures specified by the competent authorities which are not part of the credit institution’s ongoing financing of the obligor, M shall be at least one-day. A careful review of the particular circumstances shall be made in each case.” The FSA has not at this stage specified any such short-term exposure.

[**Note:** BCD Annex VII Part 2 point 14 (part)]

- 4.4.70 R Maturity mismatches must be treated as specified in *BIPRU 4.10* and *BIPRU 5* (Credit risk mitigation).

[**Note:** BCD Annex VII Part 2 point 16]

Calculations: Exposure value

- 4.4.71 R Unless provided otherwise in *BIPRU 4* the *exposure* value of on-balance sheet *exposures* must be measured gross of value adjustments. This also applies to assets purchased at a price different than the amount owed. For purchased assets, the difference between the amount owed and the net value recorded on the balance-sheet of the firm is denoted discount if the amount owed is larger, and premium if it is smaller.

[**Note:** BCD Annex VII Part 3 point 1]

- 4.4.72 R A *firm* must not treat the *exposure* value of a facility as being less than current drawings under it. Interest accrued to date on an *exposure* under a facility must be included in current drawings or an allowance for it must be built into the *conversion factor*.

- 4.4.73 R Where a *firm* uses master netting agreements in relation to *repurchase transactions or securities or commodities lending or borrowing transactions* the *exposure* value must be calculated in accordance with *BIPRU 5* (Credit risk mitigation), as modified by *BIPRU 4.10*, and *BIPRU 13.8*.

[**Note:** BCD Annex VII Part 3 point 2]

- 4.4.74 R For on-balance sheet netting of loans and deposits a *firm* must apply for the calculation of the *exposure* value the methods set out in *BIPRU 5* (Credit risk mitigation), as modified by *BIPRU 4.10*.

[Note: BCD Annex VII Part 3 point 3]

- 4.4.75 R The *exposure* value for leases must be the discounted minimum lease payments. Minimum lease payments are the payments over the lease term that the lessee is or can be required to make and any bargain option (i.e. option the exercise of which is reasonably certain). Any guaranteed residual value fulfilling the set of conditions in *BIPRU 5.7.1R* (Eligibility), as modified by *BIPRU 4.10.38R* and *BIPRU 4.10.39R* (Unfunded credit protection: Eligibility of providers) regarding the eligibility of protection providers as well as the minimum requirements for recognising other types of guarantees provided in *BIPRU 5.7.6R* (Minimum requirements: General) to *BIPRU 5.7.12R* (Additional requirements for guarantees) should also be included in the minimum lease payments.

[Note: BCD Annex VII Part 3 point 4]

- 4.4.76 R Where an *exposure* takes the form of *securities* or *commodities* sold, posted or lent under *repurchase transactions* or *securities or commodities lending or borrowing transactions*, *long settlement transactions* and *margin lending transactions*, the *exposure* value must be the value of the *securities* or *commodities* determined in accordance with *GENPRU 1.3* (Valuation). Where the *financial collateral comprehensive method* is used, the *exposure* value must be increased by the volatility adjustment appropriate to such *securities* or *commodities* as set out in *BIPRU 4.10* and *BIPRU 5* (Credit risk mitigation). The *exposure* value of *repurchase transactions*, *securities or commodities lending or borrowing transactions*, *long settlements transactions* and *margin lending transactions* must be determined in accordance with *BIPRU 13*.

[Note: BCD Annex VII Part 3 point 7]

- 4.4.77 R Notwithstanding *BIPRU 4.4.76R*, the *exposure* value of credit risk *exposures* outstanding, as determined by the *firm*, with a *central counterparty* must be determined in accordance with *BIPRU 13.3.3R* and *BIPRU 13.8.8R* (Exposure to central counterparty), provided that the *central counterparty's CCR exposures* with all participants in its arrangements are fully collateralised on a daily basis.

[Note: BCD Annex VII Part 3 point 8]

- 4.4.78 R In the case of any *financial derivative instrument*, the *exposure* value must be determined by the methods set out in *BIPRU 13*.

[Note: BCD Annex VII Part 3 point 5]

Double default

- 4.4.79 R The *risk weighted exposure amount* for each *exposure* which meets the requirements set out in *BIPRU 5.7.2R* and *BIPRU 4.4.83R* (Double default) may be adjusted according to the following formula:

$$(1) \quad \text{Risk weighted exposure amount} = \text{RW} * \text{exposure value} * (0.15 + 160 * \text{PD}_{pp})$$

- (2) $PD_{pp} = PD$ of the protection provider
- (3) RW must be calculated using the relevant *risk weight* formula set out in *BIPRU 4.4.57R* for the *exposure*, the *PD* of the obligor and the *LGD* of a comparable direct *exposure* to the protection provider. The maturity factor (b) must be calculated using the lower of the *PD* of the protection provider and the *PD* of the obligor.

[**Note:** *BCD Annex VII Part 1 point 4*]

- 4.4.80 R Notwithstanding *BIPRU 4.4.34R* and *BIPRU 4.4.43R*, for the purposes of *BIPRU 4.4.79R*, the *LGD* of a comparable direct *exposure* to the protection provider shall either be the *LGD* associated with an unhedged facility to the guarantor or the unhedged facility of the obligor, depending upon whether in the event both the guarantor and the obligor *default* during the life of the hedged transaction available evidence and the structure of the guarantee indicate that the amount recovered would depend on the financial condition of the guarantor or obligor, respectively

[**Note:** *BCD Annex VII Part 2 point 11*]

- 4.4.81 R For the purposes of *BIPRU 4.4.79R*, M must be the effective maturity of the credit protection but at least 1 year.

[**Note:** *BCD Annex VII Part 2 point 13 (part)*]

- 4.4.82 R *BIPRU 4.4.83R* applies to the eligibility of protection providers under the *IRB approach* which qualify for the treatment set out in *BIPRU 4.4.79R*.

- 4.4.83 R An *institution*, an *insurance undertaking* (including an *insurance undertaking* that carries out *reinsurance*) or an export credit agency which fulfils the following conditions may be recognised as an eligible provider of *unfunded credit protection* which qualifies for the treatment set out in *BIPRU 4.4.79R*:

- (1) the protection provider has sufficient expertise in providing *unfunded credit protection*;
- (2) the protection provider is regulated in a manner equivalent to the rules laid down in the *Banking Consolidation Directive* or had, at the time the credit protection was provided, a credit assessment by a *recognised ECAI* which is associated with *credit quality step 3* or above under the *rules* for the *risk weighting* of *exposures to corporates* under the *standardised approach*;
- (3) the protection provider had, at the time the credit protection was provided, or for any period of time thereafter, an internal rating with a *PD* equivalent to or lower than that associated with *credit quality step 2* or above under the *rules* for the *risk weighting* of *exposures to corporates* under the *standardised approach*;

- (4) the protection provider has an internal rating with a *PD* equivalent to or lower than that associated with *credit quality step 3* or above under the *rules* for the *risk weighting* of *exposures* to *corporates* under the *standardised approach*;

For the purpose of this *rule*, credit protection provided by an export credit agency must not benefit from any explicit central government counter-guarantee.

[**Note:** *BCD* Annex VIII Part 1 point 29]

- 4.4.84 R *BIPRU* 4.4.85R applies to the requirements to qualify for the treatment set out in *BIPRU* 4.4.79R.
- 4.4.85 R To be eligible for the treatment set out in *BIPRU* 4.4.79R, credit protection deriving from a guarantee or credit derivative must meet the following conditions:
- (1) the underlying obligation must be to:
 - (a) a *corporate exposure*, excluding an *exposure* to an *insurance undertaking* (including an *insurance undertaking* that carries out *reinsurance*); or
 - (b) an *exposure* to a regional government, local authority or *public sector entity* which is not treated as an *exposure* to a central government or a central bank according to *BIPRU* 4.4.2R; or
 - (c) an *exposure* to *retail SME*, classified as a *retail exposure* according to *BIPRU* 4.6.2R;
 - (2) the underlying obligors must not be members of the same *group* as the protection provider;
 - (3) the *exposure* must be hedged by one of the following instruments:
 - (a) single name unfunded credit derivatives or single name guarantees;
 - (b) first to *default* basket products, with these the treatment must be applied to the asset within the basket with the lowest *risk weighted exposure amount*;
 - (c) n^{th} to *default* basket products, with these the protection obtained is only eligible for consideration under this framework if eligible $(n-1)^{\text{th}}$ *default* protection has also been obtained or where $(n-1)$ of the assets within the basket has/have already *defaulted* and where this is the case the treatment must be applied to the asset within the basket with the lowest *risk weighted exposure amount*;
 - (4) the credit protection must meet the requirements set out in *BIPRU* 5.7.6R-*BIPRU* 5.7.8R (Minimum requirements: Operational requirements), *BIPRU* 5.7.11R (Additional requirements for guarantees) and *BIPRU* 5.7.13R-*BIPRU* 5.7.14R (Additional requirements for credit derivatives);

- (5) the *risk weight* that is associated with the *exposure* prior to the application of the treatment in *BIPRUI* 4.4.79R does not already factor in any aspect of the credit protection;
- (6) a *firm* must have the right and expectation to receive payment from the protection provider without having to take legal action in order to pursue the counterparty for payment;
- (7) the purchased credit protection must absorb all credit losses incurred on the hedged portion of an *exposure* that arise due to the occurrence of credit events outlined in the contract;
- (8) if the payout structure provides for physical settlement, then there must be legal certainty with respect to the deliverability of a loan, bond or contingent liability and if a *firm* intends to deliver an obligation other than the underlying *exposure*, it must ensure that the deliverable obligation is sufficiently liquid so that the *firm* would have the ability to purchase it for delivery in accordance with the contract;
- (9) the terms and conditions of credit protection arrangements must be legally confirmed in writing by both the protection provider and the *firm*;
- (10) a *firm* must have a process in place to detect excessive correlation between the creditworthiness of a protection provider and the obligor of the underlying *exposure* due to their performance being dependent on common factors beyond the systematic risk factor;
- (11) in the case of protection against *dilution risk*, the seller of purchased receivables must not be a member of the same *group* as the protection provider; and
- (12) with reference to (6), to the extent possible, a *firm* must take steps to satisfy itself that the protection provider is willing to pay promptly should a credit event occur.

[**Note:** *BCD* Annex VIII Part 2 point 22]

4.5 The IRB approach: Specialised lending exposures

Application

4.5.1 R *BIPRU 4.5* applies with respect to the *exposures* referred to in *BIPRU 4.5.3R*.

4.5.2 R Except for *BIPRU 4.5.1R* and *BIPRU 4.5.3R*, *BIPRU 4.5* only applies to the extent that a *firm* applies the method in *BIPRU 4.5.8R* (slotting).

Definition of specialised lending

4.5.3 R Within the *corporate exposure IRB exposure class*, a *firm* must separately identify as *specialised lending exposures*, *exposures* which possess the following characteristics:

- (1) the *exposure* is to an entity which was created specifically to finance and/or operate physical assets;
- (2) the contractual arrangements give the lender a substantial degree of control over the assets and the income that they generate; and
- (3) the primary source of repayment of the obligation is the income generated by the assets being financed, rather than the independent capacity of a broader commercial enterprise.

[**Note:** *BCD Article 86(6)*]

Treatment of specialised lending

4.5.4 R If a *firm* is using or is applying to use the *advanced IRB approach* for some or all of its *exposures* in the *sovereign, institution and corporate IRB exposure class*, then *specialised lending exposures* treated under *BIPRU 4.5.8R* (Slotting) must be treated as being dealt with under the *advanced IRB approach* for the purposes of the calculations in *BIPRU 4.2.30R* and *BIPRU 4.2.31R*. If a *firm* is not using or applying to use the *advanced IRB approach* for any of its *exposures* in the *sovereign, institution and corporate IRB exposure class*, in the cases in which it is necessary to distinguish between the *advanced IRB approach* and the *foundation IRB approach*, then *specialised lending exposures* treated under *BIPRU 4.5.8R* must be treated as being dealt with under the *foundation IRB approach* for the purposes of the calculations in *BIPRU 4.2.30R* and *BIPRU 4.2.31R*.

Structure of rating system

- 4.5.5 R A *firm* using the methods set out in *BIPRU* 4.5.8R (Slotting) for assigning *risk weights* for *specialised lending exposures* is exempt from the requirement to have an obligor rating scale which reflects exclusively quantification of the risk of obligor *default* for these *exposures*. Notwithstanding *BIPRU* 4.4.7R (Seven grades for exposures to sovereigns, institutions and corporates), a *firm* must have for these *exposures* four grades for non-*defaulted* obligors and one grade for *defaulted* obligors.

[**Note:** *BCD* Annex VII Part 4 point 12 and point 21]

Assignment of exposures

- 4.5.6 R (1) A *firm* using the methods set out in *BIPRU* 4.5.8R (Slotting) for assigning *risk weights* for *specialised lending exposures* must assign each of these *exposures* to a grade in accordance with *BIPRU* 4 Annex 1R, taking into account the following factors:
- (a) financial strength;
 - (b) political and legal environment;
 - (c) transaction and/or asset characteristics;
 - (d) strength of the sponsor and developer including any public private partnership income stream; and
 - (e) security package.
- (2) A *firm* must slot *exposures* into the five columns in the tables in *BIPRU* 4.5.9R and *BIPRU* 4.5.13R as follows:
- (a) a *firm* must slot an *exposure* categorised as strong under Annex X into column 1;
 - (b) a *firm* must slot an *exposure* categorised as good under the Annex X into column 2;
 - (c) a *firm* must slot an *exposure* categorised as satisfactory under Annex X into column 3;
 - (d) a *firm* must slot an *exposure* categorised as weak under Annex X into column 4;
 - (e) in accordance with *BIPRU* 4.5.5R a *firm* must slot an *exposure* in *default* into column 5.

[**Note:** *BCD* Annex VII Part 1 point 6 (part)]

Calculation of risk-weighted exposure amounts

4.5.7 R Notwithstanding *BIPRU 4.3.5R* (Use of relevant parameters for calculating risk weighted exposure amounts), the calculation of *risk weighted exposure amounts* for credit risk for *specialised lending exposures* may be calculated in accordance with *BIPRU 4.5.8R*.

[**Note:** *BCD Article 87(5)*]

4.5.8 R For *specialised lending exposures* in respect of which a *firm* cannot demonstrate that its *PD* estimates meet the *minimum IRB standards* it must assign *risk weights* to these *exposures* according to the table in *BIPRU 4.5.9R*.

[**Note:** *BCD Annex VII Part 1 point 6 (part)*]

4.5.9 R Table: Risk weights for specialised lending
This table belongs to *BIPRU 4.5.9R*

Remaining maturity	Category 1 (Strong)	Category 2 (Good)	Category 3 (Satisfactory)	Category 4 (Weak)	Category 5
Less than 2.5 years	50%	70%	115%	250%	0%
Equal or more than 2.5 years	70%	90%	115%	250%	0%

The coverage of each of the categories is set out in *BIPRU 4.5.6R*

[**Note:** *BCD Annex VII Part 1 point 6 (part)*]

4.5.10 R A *firm* may generally assign preferential *risk weights* of 50% to *exposures* in category 1, and a 70% *risk weight* to *exposures* in category 2 if:

- (1) its *IRB permission* allows this; and
- (2) the *firm's* underwriting characteristics and other risk characteristics are substantially strong for the relevant category.

[**Note:** *BCD Annex VII Part 1 point 6 (part)*]

4.5.11 G (1) If a *firm* applies for an *IRB permission* or for a variation of an *IRB permission* that permits the treatment in *BIPRU 4.5.10R* it should demonstrate that its standards exceed those of the slotting criteria provided for in *BIPRU 4.5* and result in ratings that are stronger than the benchmarks referred to in (3).

- (2) If a *firm* has an *IRB permission* that permits the treatment in *BIPRU 4.5.10R* it should continue to be able to demonstrate the matters in (1) to the *FSA* if asked.
- (3) Although a *firm* should map its internal ratings to the supervisory categories set out in the table in *BIPRU 4.5.9R* using the slotting criteria provided in *BIPRU 4.5.6R*, each supervisory category broadly corresponds to a range of external credit assessments of BBB- or better, BB+ or BB, BB- or B+ and B to C- (or their equivalents). The fifth category covers *default*.

Calculation of expected loss amounts

- 4.5.12 R The *EL* values for *specialised lending exposures* where a *firm* uses the methods set out in *BIPRU 4.5.8R* for assigning *risk weights* must be assigned according to the table in *BIPRU 4.5.13R*.

[**Note:** *BCD* Annex VII Part 1 point 31 (part)]

- 4.5.13 R Table: Expected loss values for specialised lending
This table belongs to *BIPRU 4.5.12R*

Remaining maturity	Category 1 (Strong)	Category 2 (Good)	Category 3 (Satisfactory)	Category 4 (Weak)	Category 5
Less than 2.5 years	0%	0.4%	2.8%	8%	50%
Equal or more than 2.5 years	0.4%	0.8%	2.8%	8%	50%

The coverage of each of the categories is set out in *BIPRU 4.5.6R*

[**Note:** *BCD* Annex VII Part 1 point 31 (part)]

- 4.5.14 R Where a *firm's IRB permission* authorises it generally to assign preferential *risk weights* as outlined in *BIPRU 4.5.10R* of 50% to *exposures* in category 1, and 70% to *exposures* in category 2, the *EL* value for *exposures* in category 1 must be 0%, and for *exposures* in category 2 must be 0.4%.

[**Note:** *BCD* Annex VII Part 1 point 31 (part)]

4.6 The IRB approach: Retail exposures

Application

4.6.1 R *BIPRU* 4.6 applies with respect to the *exposures* referred to in *BIPRU* 4.6.2R.

Definition of retail exposures

4.6.2 R To be eligible to be treated as a *retail exposure*, *exposures* must meet the following criteria:

- (1) they must be either to an individual person or persons, or to a small or medium sized entity, provided in the latter case that the total amount owed to the *firm* and *parent undertaking* and its *subsidiary undertakings*, including any past due *exposure*, by the obligor client or *group of connected clients*, but excluding claims or contingent claims secured on residential real estate collateral, must not, to the knowledge of the *firm*, which must have taken reasonable steps to confirm the situation, exceed EUR 1 million;
- (2) they are treated by the *firm* in its risk management consistently over time and in a similar manner;
- (3) they are not managed just as individually as *exposures* in the *corporate exposure IRB exposure class*; and
- (4) they each represent one of a significant number of similarly managed *exposures*.

[**Note:** *BCD* Article 86(4) (part)]

4.6.3 R The present value of retail minimum lease payments is eligible to be treated as a *retail exposure*.

[**Note:** *BCD* Article 86(4) (part)]

- 4.6.4 G
- (1) This paragraph sets out *guidance* on *BIPRU* 4.6.2R so far as it relates to the boundary between *retail exposures* and *corporate exposures*.
 - (2) In deciding what steps are reasonable for the purposes of *BIPRU* 4.6.2R(1), a *firm* may take into account complexity and cost, as well as the materiality of the impact upon its capital calculation. A *firm* should be able to demonstrate to the *FSA* that it has complied with the obligation to take reasonable steps under *BIPRU* 4.6.2R(1) in the way it takes these factors into account.

- (3) If a *firm* has *exposures* to an owner of a *retail SME* in his personal capacity and *exposures* to the *retail SME* the *firm* should aggregate the two types of *exposure* for the purpose of *BIPRU* 4.6.2R(1), although it should not include claims secured on residential real estate collateral. In deciding what steps are reasonable for the purposes of *BIPRU* 4.6.2R(1) in aggregating these two types of *exposure*, a *firm* may take into account the materiality of those personal *exposures*. A *firm* should be able to demonstrate to the *FSA* that it has complied with the obligation to take reasonable steps under *BIPRU* 4.6.2R(1) when taking into account materiality in this way..
- (4) The definition of *group of connected clients* is set out in the *glossary*. Paragraph (2) of that definition is "two or more *persons* ... who are to be regarded as constituting a single risk because they are so interconnected that, if one of them were to experience financial problems, the other or all of the others would be likely to encounter repayment difficulties". Say that a *firm* has *exposures* to A and B. When deciding whether A and B come within paragraph (2) of the definition two conditions should be satisfied. Firstly the connections between A and B should mean that if A experiences financial problems, B should be likely to encounter repayment difficulties. Secondly, the connections between A and B should mean that if B experiences financial problems, A should be likely to encounter repayment difficulties
- (5) A *firm* should have its own documented policy on the types of *exposures* that, in accordance with *BIPRU* 4.6, qualify as *retail SME exposures*. The *FSA* would not expect that a definition based on the EUR 1m *exposure* limit would be adequate on its own.
- (6) The purpose of the definition of *retail exposure* is to separate a non-granular retail and small and medium sized business portfolio from other business so that a separate capital calculation may be applied to that portfolio that takes into account its non-granularity. Where *retail exposures* are assigned to pools it is the statistical characteristics of these pools which are used to derive the *IRB approach* estimates. Therefore pools should be reasonably homogenous and subject to consistent risk management practices.
- (7) A *firm* should have sufficient controls to ensure that any inadvertent assignment of non-eligible *exposures* to the *retail exposure IRB exposure class* is sufficiently immaterial that it does not result in any significant distortion of the overall statistical characteristics of the sub-sets of that *IRB exposure class* which arise when the *exposures* are assigned to grades or pools. Cost considerations do not justify inclusion of non-eligible *exposures* if the effect would be material. Sample testing could be one method of demonstrating that the impact would be immaterial. *BIPRU* 4.1.25R applies to *exposures* treated in accordance with this sub-paragraph (7).
- (8) If an *exposure* to a small or medium sized business crosses the *retail exposure* size boundary it should be treated as a *corporate*, unless, in accordance with *BIPRU* 4.1.25R, the excess is immaterial because of its size or because it is temporary.

- (9) *BIPRU 4.6.2R* does not require that *exposures to retail SMEs* should never be individually managed. In deciding whether the frequency and extent of individual management does or does not make *exposures* ineligible for the *retail exposure IRB exposure class*, a *firm* should consider whether that individual management is:
- (a) sufficiently insignificant not to disrupt the homogeneity of the pool;
 - (b) consistent with the management of other *exposures* in the same *retail exposure* pool; and
 - (c) significantly different in extent from the individual management that occurs for *corporate exposures*, looked at as a whole.
- (10) Where an *exposure* is denominated in other currencies, a *firm* may calculate the Euro equivalent for the purposes of *BIPRU 4.6.2R(1)* using any appropriate set of exchange rates provided its choice has no obvious bias and that the *firm* is consistent in its approach to choosing rates.
- (11) A *firm* may monitor compliance with the €1m threshold in *BIPRU 4.6.2R(1)* on the basis of approved limits provided that it has internal control procedures that are sufficient to ensure that amounts owed cannot diverge from those approved limits to such an extent as to give rise to a breach of the €1m threshold or, if the *firm* is relying on provisions relating to reasonable steps in *BIPRU 4.6.2R(1)*, any material breach of that threshold.

Rating system: Structure of rating system

- 4.6.5 G Further material on the structure of rating systems can be found in *BIPRU 4.3.25R - BIPRU 4.3.28R*.

Rating system: Assignment to grades or pools

- 4.6.6 R *Rating systems* must reflect both obligor and transaction risk, and must capture all relevant obligor and transaction characteristics.

[**Note:** *BCD Annex VII Part 4 point 13*]

- 4.6.7 R The level of risk differentiation must ensure that the number of *exposures* in a given grade or pool is sufficient to allow for meaningful quantification and validation of the *loss* characteristics at the grade or pool level. The distribution of *exposures* and obligors across grades or pools must be such as to avoid excessive concentrations.

[**Note:** *BCD Annex VII Part 4 point 14*]

- 4.6.8 G (1) This paragraph contains *guidance* on the level of differentiation referred to in *BIPRU 4.6.7R*.

- (2) It is important that a *firm* achieves adequate segmentation to deliver robust estimates of *LGD* and *conversion factors*, as well as *PD*. Whether the focus should be more on *exposure* size or collateral type is a question of fact for the particular circumstances in which the assignment of *exposures* to grades or pools occurs. Typically the *FSA* would expect both to be important.
- (3) A *firm* may allocate *retail exposures* to pools based on direct estimates of *PD*, *LGD* and *conversion factors* as well as using an approach under which the *firm* segments first and attributes *PD*, *LGD* and *conversion factors* afterwards. However the result should in either case be that the pools are sufficiently homogenous.
- (4) The number and size of pools should be determined in relation to the objective of establishing homogeneous risk. Pools should be of sufficient size to permit the production of robust risk estimates but should not be so large as to obscure variations in quality.

4.6.9 R A *firm* must be able to demonstrate to the *FSA* that the process of assigning *exposures* to grades or pools provides for a meaningful differentiation of risk, provides for a grouping of sufficiently homogenous exposures, and allows for accurate and consistent estimation of *loss* characteristics at grade or pool level.

[**Note:** *BCD* Annex VII Part 4 point 15 (part)]

4.6.10 G For purchased receivables, *BIPRU* 4.8 contains material about assignment to grades or pools.

- 4.6.11 R
- (1) A *firm* must consider the following risk drivers when assigning *exposures* to grades or pools:
 - (a) obligor risk characteristics;
 - (b) transaction risk characteristics, including product or collateral types or both; and
 - (c) delinquency.
 - (2) In the case of (1)(b) a *firm* must explicitly address cases where several *exposures* benefit from the same collateral.
 - (3) However:
 - (a) a *firm* need not consider delinquency if this is compatible with its *IRB permission*; and
 - (b) (in the case of a *firm* with an *IRB permission* that permits the *firm* not to consider delinquency) it should be able to demonstrate to the *FSA* that delinquency is not a material risk driver for the *exposures* treated in this way.

[**Note:** *BCD* Annex VII Part 4 Point 16]

Rating system: Assignment of exposures

- 4.6.12 R Each *exposure* must be assigned to a grade or a pool as part of the credit approval process.

[**Note:** BCD Annex VII Part 4 point 24]

Rating system: Overrides

- 4.6.13 G Material on overrides can be found in *BIPRU* 4.3.50R.

Rating system: Integrity of assignment process

- 4.6.14 R A *firm* must at least annually update obligor and facility assignments or review the *loss* characteristics and delinquency status of each identified risk pool whichever is applicable. A *firm* must also at least annually review in a representative sample the status of individual *exposures* within each pool as a means of ensuring that *exposures* continue to be assigned to the correct pool.

[**Note:** BCD Annex VII Part 4 point 29]

- 4.6.15 G Annual rescore is one method of meeting the requirement in *BIPRU* 4.6.14R. However a *firm* need not carry out this update by means of a full re-run of a credit scoring model if it is able to demonstrate that its method is appropriate to the portfolio given its materiality and its impact on its capital requirements and that the *firm* still meets the *minimum IRB standards*.

Rating system: Use of models

- 4.6.16 G Material on the use of models can be found in *BIPRU* 4.3.51R - *BIPRU* 4.3.53G.

Rating system: Documentation

- 4.6.17 G Material on documentation can be found in *BIPRU* 4.3.19R - *BIPRU* 4.3.24R.

Rating system: Data maintenance

- 4.6.18 R In addition to complying with *BIPRU* 4.3.54R (Data maintenance) a *firm* must collect and store:

- (1) data used in the process of allocating *exposures* to grades or pools;
- (2) data on the estimated *PDs*, *LGDs* and *conversion factors* associated with grades or pools of *exposures*;
- (3) the identity of obligors and *exposures* that *defaulted*;
- (4) for *defaulted exposures*, data on the grades or pools to which the *exposure* was assigned over the year prior to *default* and the realised outcomes on *LGD* and *conversion factor*; and
- (5) data on *loss rates* for *qualifying revolving retail exposures*.

[**Note:** BCD Annex VII Part 4 point 39]

Risk quantification: Definition of default

- 4.6.19 G Material on the definition of *default* can be found in BIPRU 4.3.56R - BIPRU 4.3.72G.
- 4.6.20 R (1) This *rule*, in accordance with BIPRU 4.3.57R(4) (Definition of default), sets the exact number of days past due that a *firm* must abide by in the case of *retail exposures*.
- (2) For *retail exposures* to counterparts situated within the *United Kingdom* the number of days past due is 180 days with the exception of *retail SME exposures*. For these *exposures* the number is 90 days.
- (3) For *retail exposures* to counterparts situated in another *EEA State* the number of days past due is the lower of:
- (a) 180; and
- (b) the number of days past due fixed under the *CRD implementation measure* in that *EEA State* with respect to paragraph 48 of Part 4 of Annex VII of the *Banking Consolidation Directive* for such *exposures*.
- (4) For *retail exposures* to counterparts in a state outside the *EEA* the number of days past due is the lower of:
- (a) 180; and
- (b) (if a number of days past due for such *exposures* has been fixed under any national law of that state applicable to *undertakings* in the *banking sector* or the *investment services sector* that implements the *IRB approach*) that number.

[**Note:** BCD Annex VII Part 4 point 44 (part) and point 48 (part)]

- 4.6.21 R A *firm* may apply the definition of *default* at a facility level.

[**Note:** BCD Annex VII Part 4 point 44 (part)]

- 4.6.22 G Where a *firm* chooses to apply the definition of *default* at facility level and a customer has *defaulted* on a facility, then *default* on that facility is likely to influence the *PD* assigned to that customer on other facilities and so should be taken into account..

Risk quantification: Overall requirements for estimation

- 4.6.23 G Material on the overall requirements for estimation can be found in BIPRU 4.3.73R - BIPRU 4.3.94R.

Risk quantification: Requirements specific to PD estimation

- 4.6.24 R A *firm* must estimate *PDs* by obligor grade or pool from long run averages of one-year *default* rates.
- [Note: BCD Annex VII Part 4 point 67]
- 4.6.25 R Notwithstanding BIPRU 4.6.24R, *PD* estimates may also be derived from realised *losses* and appropriate estimates of *LGDs*.
- [Note: BCD Annex VII Part 4 point 68]
- 4.6.26 R A *firm* must regard internal data for assigning exposures to grades or pools as the primary source of information for estimating *loss* characteristics. A *firm* may use external data (including pooled data) or statistical models for quantification provided a strong link can be demonstrated between:
- (1) the *firm's* process of assigning *exposures* to grades or pools and the process used by the external data source; and
 - (2) the *firm's* internal risk profile and the composition of the external data.
- [Note: BCD Annex VII Part 4 point 69]
- 4.6.27 R If a *firm* derives long run average estimates of *PD* and *LGD* for *retail exposures* from an estimate of total *losses*, and an appropriate estimate of *PD* or *LGD*, the process for estimating total *losses* must meet the *IRB minimum standards* for estimation of *PD* and *LGD*, and the outcome must be consistent with the concept of *LGD* as set out in BIPRU 4.3.99R (Default weighted average).
- [Note: BCD Annex VII Part 4 point 70]
- 4.6.28 R Irrespective of whether a *firm* is using external, internal, pooled data sources or a combination of the three, for its estimation of *loss* characteristics, the length of the underlying historical observation period used must be at least five years for at least one source. If the available observation spans a longer period for any source, and these data are relevant, this longer period must be used. However:
- (1) a *firm* need not give equal importance to historic data if this is compatible with its *IRB permission*; and
 - (2) (in the case of a *firm* with an *IRB permission* that permits this treatment of historic data) the *firm* must be able to convince the *FSA* that more recent data is a better predictor of *loss* rates.
- [Note: BCD Annex VII Part 4 point 71 (part)]
- 4.6.29 R A *firm* may have, when implementing the *IRB approach*, relevant data covering a period of two years. The period to be covered must increase by one year each year until relevant data cover a period of five years.
- [Note: BCD Annex VII Part 4 point 71 (part)]

- 4.6.30 R A *firm* must identify and analyse expected changes of risk parameters over the life of credit *exposures* (seasoning effects).
- [**Note:** *BCD* Annex VII Part 4 point 72]
- Risk quantification: Requirements specific to own-LGD estimation
- 4.6.31 R Notwithstanding *BIPRU* 4.3.99R (Default weighted average), *LGD* estimates may be derived from realised *losses* and appropriate estimates of *PDs*.
- [**Note:** *BCD* Annex VII Part 4 point 83]
- 4.6.32 R Notwithstanding *BIPRU* 4.3.128R (Additional drawings), a *firm* may reflect future drawings either in its *conversion factor* or in its *LGD* estimates.
- [**Note:** *BCD* Annex VII Part 4 point 84]
- 4.6.33 R Estimates of *LGD* must be based on data over a minimum of five years. Notwithstanding *BIPRU* 4.3.99R (Default weighted average):
- (1) a *firm* need not give equal importance to historic data if this is permitted by its *IRB permission*; and
 - (2) (in the case of a *firm* with an *IRB permission* that permits this treatment of historic data) the *firm* must be able to convince the *FSA* that more recent data is a better predictor of loss rates.
- [**Note:** *BCD* Annex VII Part 4 point 86 (part)]
- 4.6.34 R A *firm* may have, when it implements the *IRB approach*, relevant data covering a period of two years. The period to be covered must increase by one year each year until relevant data cover a period of five years.
- [**Note:** *BCD* Annex VII Part 4 point 86 (part)]
- 4.6.35 G The *FSA* does not assume that all portfolios are sensitive to downturns. The *FSA* also accepts that for some portfolios, particularly in unsecured lending, the impact of the material drivers on *LGD* may be weak. However the burden is on the *firm* to demonstrate that its models are appropriate for the circumstances in which they are applied.
- 4.6.36 G Additional material on requirements specific to own-*LGD* estimation can be found in *BIPRU* 4.3.98R - *BIPRU* 4.3.123R.
- Risk quantification: Requirements specific to own-conversion factor estimates
- 4.6.37 R Notwithstanding *BIPRU* 4.3.128R (Additional drawings), a *firm* may reflect future drawings either in its *conversion factors* or in its *LGD* estimates.
- [**Note:** *BCD* Annex VII Part 4 point 94]

- 4.6.38 R Estimates of *conversion factors* must be based on data over a minimum of five years. Notwithstanding *BIPRU* 4.3.125R :
- (1) a *firm* need not give equal importance to historic data if this is permitted by its *IRB permission*; and
 - (2) (in the case of a *firm* with an *IRB permission* that permits this treatment of historic data) the *firm* must be able to convince the *FSA* if asked that more recent data is a better predictor of loss rates.

[**Note:** *BCD* Annex VII Part 4 point 95 (part)]

- 4.6.39 R A *firm* may have, when it implements the *IRB approach*, relevant data covering a period of two years. The period to be covered must increase by one year each year until relevant data cover a period of five years.

[**Note:** *BCD* Annex VII Part 4 point 95 (part)]

- 4.6.40 G Additional material on requirements specific to own-*conversion factor* estimation can be found in *BIPRU* 4.3.124R - *BIPRU* 4.3.131R.

Calculation of risk weighted exposure amounts for retail exposures: General

- 4.6.41 R Subject to *BIPRU* 4.6.43R and *BIPRU* 4.6.44R, the *risk weighted exposure amounts* for *retail exposures* must be calculated according to the formulae in the table in *BIPRU* 4.6.42R.

[**Note:** *BCD* Annex VII Part 1 point 10 1st sentence]

- 4.6.42 R Table: Risk weighted exposure amounts for retail exposures
This table belongs to *BIPRU* 4.6.41R

Correlation (R)	$0.03 \times (1 - \text{EXP}(-35 \cdot PD)) / (1 - \text{EXP}(-35)) + 0.16 \cdot [1 - (1 - \text{EXP}(-35 \cdot PD)) / (1 - \text{EXP}(-35))]$
Risk weight (RW)	$(LGD \cdot N[(1-R)^{-0.5} \cdot G(PD) + (R/(1-R))^{0.5} \cdot G(0.999)] - PD \cdot LGD) \cdot 12.5 \cdot 1.06$
N(x)	denotes the cumulative distribution function for a standard normal random variable (i.e. the probability that a normal random variable with mean zero and variance of one is less than or equal to x).
G(z)	denotes the inverse cumulative distribution function for a standard normal random variable (i.e. the value x such that N(x) = z).
PD = 1	For PD = 1 (<i>defaulted exposure</i>), RW must be:

	<p>Max $\{0, 12.5 * (LGD - EL_{BE})\}$</p> <p>where EL_{BE} must be the firm's best estimate of <i>expected loss</i> for the <i>defaulted exposure</i> according to BIPRU 4.3.122R.</p>
<i>Risk weighted exposure amount</i>	equals $RW * exposure$ value

[Note: BCD Annex VII Part 1 point 10 (part)]

Calculation of risk weighted exposure amounts for retail exposures: Retail mortgages

- 4.6.43 R For *retail exposures* secured by real estate collateral a correlation (R) of 0.15 must replace the correlation formula in the table in BIPRU 4.6.42R.

[Note: BCD Annex VII Part 1 point 12]

Calculation of risk weighted exposure amounts for retail exposures: Qualifying revolving retail exposures

- 4.6.44 R (1) For *qualifying revolving retail exposures* a correlation (R) of 0.04 must replace the correlation formula in the table in BIPRU 4.6.42R.
- (2) *Retail exposures* qualify as *qualifying revolving retail exposures* if they meet the following conditions:
- (a) the *IRB permission* of the *firm* in question does not disapply this paragraph;
 - (b) the *exposures* are to individuals;
 - (c) the *exposures* are revolving, unsecured, and, to the extent they are not drawn, immediately and unconditionally cancellable by the *firm*;
 - (d) the maximum *exposure* to a single individual in the sub-portfolio is EUR 100,000 or less;
 - (e) the *firm* is able to demonstrate to the *FSA* that the use of the correlation formula in this paragraph is limited to portfolios that have exhibited low volatility of *loss rates*, relative to their average level of *loss rates*, especially within the low *PD* bands; and
 - (f) the *firm* is able to demonstrate to the *FSA* that treatment as a *qualifying revolving retail exposure* is consistent with the underlying risk characteristics of the sub-portfolio.

(3) In the context of this *rule* revolving *exposures* are defined as those where customers' outstanding balances are permitted to fluctuate based on their decisions to borrow and repay, up to a limit established by the *firm* in question. Undrawn commitments may be considered as unconditionally cancellable if the terms permit the *firm* to cancel them to the full extent allowable under consumer protection and related legislation.

[**Note:** BCD Annex VII Part 1 point 13 (part) and Part 3 point 9(a) (part)]

4.6.45 G A *firm* should be able to demonstrate the low volatility of *loss* rates mentioned in BIPRU 4.6.44R(2)(e) at the time of the initial application for an *IRB permission* and thereafter at any time on request. The benchmark level should be the volatility of *loss* rates for the *qualifying revolving retail exposure* portfolio relative to the volatilities of *loss* rates of other relevant types of *retail exposures*. A *firm* should demonstrate low volatility by reference to data on the mean and standard deviation of *loss* rates over a time period that can be regarded as representative of the long-run performance of the portfolios concerned.

4.6.46 G In the *FSA's* view a sub-portfolio consisting of credit card or overdraft obligations will usually meet the condition in BIPRU 4.6.44R(2)(f). In the *FSA's* view it is unlikely that any other type of *retail exposure* will do so. If a *firm* wishes to apply the treatment in BIPRU 4.6.44R(1) to product types other than credit card or overdraft obligations it should first discuss this with the *FSA*.

Calculation of expected loss amounts

4.6.47 R *Expected loss* amounts must be calculated according to the formulae in the table in BIPRU 4.6.48R.

[**Note:** BCD Annex VII Part 1 point 30 (part)]

4.6.48 R Table: Formulae for the calculation of expected loss amounts
This table belongs to BIPRU 4.6.48R

<i>Expected loss (EL)</i>	equals $PD \times LGD$
<i>Expected loss amount</i>	equals $EL \times exposure$ value
<p>For <i>defaulted exposures</i> ($PD = 1$) where a <i>firm</i> uses its own estimates of <i>LGDs</i>, <i>EL</i> must be <u>EL_{BE}</u> the <i>firm's</i> best estimate of <i>expected loss</i> for the <i>defaulted exposure</i> according to BIPRU 4.3.122R.</p> <p>For <i>exposures</i> subject to the treatment set out in BIPRU 4.4.79R (Double default) <i>EL</i> must be 0.</p>	

[Note: BCD Annex VII Part 1 point 30 (part)]

Calculation of PDs

- 4.6.49 R A *firm* must provide its own estimates of *PDs* in accordance with its *IRB permission* and the *minimum IRB standards*.

[Note: BCD Article 87(6) (part)]

- 4.6.50 R The *PD* of an *exposure* must be at least 0.03%.

[Note: BCD Annex VII Part 2 point 17]

- 4.6.51 R The *PD* of obligors in *default* must be 100%. If a *firm* is using the facility level approach described in *BIPRU 4.6.21R*, the *PD* of an *exposure* in *default* must be 100%.

[Note: BCD Annex VII Part 2 point 18]

- 4.6.52 R *Unfunded credit protection* may be recognised by adjusting *PDs* subject to *BIPRU 4.6.54R*. For *dilution risk*, where a *firm* does not use its own estimates of *LGDs*, this must be subject to compliance with *BIPRU 5* (Credit risk mitigation) modified by *BIPRU 4.10* and, for this purpose, a *firm* may recognise *unfunded credit protection* providers other than those indicated in the *CRM eligibility conditions* provided the *firm* is able to demonstrate that the unfunded protection provider giving the undertaking is sufficiently reliable and that the protection agreement is legally effective in accordance with *BIPRU 5.2.7R* (Unfunded credit protection).

[Note: BCD Annex VII Part 2 point 20]

Calculation of LGDs

- 4.6.53 R A *firm* must provide its own estimates of *LGDs* in accordance with its *IRB permission* and the *minimum IRB standards*.

[Note: BCD Article 87(7) (part)]

- 4.6.54 R *Unfunded credit protection* may be recognised as eligible by adjusting *PD* or *LGD* estimates subject to the *minimum IRB standards* as specified in *BIPRU 4.10.43 - BIPRU 4.10.48R* and in accordance with the *IRB permission* either in support of an individual *exposure* or a pool of *exposures*. A *firm* must not assign guaranteed *exposures* an adjusted *PD* or *LGD* such that the adjusted *risk weight* would be lower than that of a comparable, direct *exposure* to the guarantor.

[Note: BCD Annex VII Part 2 point 22]

Calculation of exposure values and own conversion factors

- 4.6.55 R Except where otherwise specified, *BIPRU 4.4.37R - BIPRU 4.4.39R* (Exposure value and conversion factors), *BIPRU 4.4.45R* (AIRB conversion factors) and *BIPRU 4.4.71R - BIPRU 4.4.78R* (Calculation of exposure values for sovereigns, institutions and corporates) also apply to *retail exposures*.
- 4.6.56 R A *firm* must provide its own estimates of *conversion factors* in accordance with its *IRB permission* and the *minimum IRB standards*.
- [**Note:** *BCD Article 87(7) (part)*]
- Double default
- 4.6.57 R The *risk weighted exposure amount* for each *exposure to retail SME* as defined in *BIPRU 4.6.2R* which meets the requirements set out in *BIPRU 4.4.83R* and *BIPRU 4.4.85R* may be calculated according to *BIPRU 4.4.79R* (Double default).
- [**Note:** *BCD Annex VII Part 1 point 11*]
- 4.6.58 R Notwithstanding *BIPRU 4.6.54,R* for the purposes of *BIPRU 4.4.80R* the *LGD* of a comparable direct *exposure* to the protection provider must either be the *LGD* associated with an unhedged facility to the guarantor or the unhedged facility of the obligor, depending upon whether in the event both the guarantor and obligor *default* during the life of the hedged transaction available evidence and the structure of the guarantee indicate that the amount recovered would depend on the financial condition of the guarantor or obligor, respectively.
- [**Note:** *BCD Annex VII Part 2 point 23*]

4.7 The IRB approach: Equity exposures

Application

4.7.1 R *BIPRU 4.7* applies with respect to the *exposures* referred to in *BIPRU 4.7.2R*.

Definition of equity exposures

4.7.2 R The following *exposures* must be classed as *equity exposures*:

- (1) non-debt *exposures* conveying a subordinated, residual claim on the assets or income of the issuer; and
- (2) debt *exposures* the economic substance of which is similar to the *exposures* specified in (1).

[**Note:** *BCD* Article 86(2)]

Calculation of risk-weighted exposure amounts

4.7.3 R Notwithstanding *BIPRU 4.3.5R* (Relevant parameters), the calculation of *risk weighted exposure amounts* for credit risk for all *exposures* belonging to the *equity exposure IRB exposure class* must be calculated in accordance with one of the following ways:

- (1) the simple risk weight approach (see *BIPRU 4.7.8R*);
- (2) the *PD/LGD approach* (see *BIPRU 4.7.13R*); and
- (3) the internal models approach (see *BIPRU 4.7.23R*);

in accordance with *BIPRU 4.7* and subject to the *firm's IRB permission*.

[**Note:** *BCD* Article 87(4) (part)]

4.7.4 R Even if a *firm's IRB permission* would otherwise permit the use of the internal models approach as referred to in *BIPRU 4.7.3R(3)*, it may only use that approach if it meets the minimum requirements in *BIPRU 4.7.27R - BIPRU 4.7.35R*.

[**Note:** *BCD* Article 87(4) (part)]

4.7.5 R A *firm* may employ different approaches to different portfolios where the *firm* itself uses different approaches internally. A *firm* must, if it uses different approaches in accordance with the previous sentence, be able to demonstrate to the *FSA* that the choice is made consistently and is not determined by regulatory arbitrage considerations.

[**Note:** *BCD* Annex VII Part 1 point 17]

- 4.7.6 R Notwithstanding *BIPRU 4.7.5R* a firm may, if its *IRB permission* permits it to do so, attribute the *risk weighted exposure amounts* for *equity exposures* to *ancillary services undertakings* according to the treatment of *non credit-obligation assets*.

[**Note:** *BCD Annex VII Part 1 point 18*]

Exposure value

- 4.7.7 R The *exposure* value must be the value presented in the financial statements. Admissible *equity exposure* measures are the following:

- (1) for investments held at fair value with changes in value flowing directly through income and into *capital resources*, the *exposure* value is the fair value presented in the balance sheet;
- (2) for investments held at fair value with changes in value not flowing through income but into a tax-adjusted separate component of equity, the *exposure* value is the fair value presented in the balance sheet; and
- (3) for investments held at cost or at the lower of cost or market value, the *exposure* value is the cost or market value presented in the balance sheet.

[**Note:** *BCD Annex VII Part 3 point 12*]

The calculation of risk-weighted exposure amounts for equity exposures: The simple risk weight approach: Introduction

- 4.7.8 R *BIPRU 4.7.9R* to *BIPRU 4.7.12R* set out the simple risk weight approach for calculating the *risk weighted exposure amounts* for *equity exposures* as referred to in *BIPRU 4.7.3R(1)*.

The calculation of risk-weighted exposure amounts for equity exposures: The simple risk weight approach: Risk weighted exposure amounts

- 4.7.9 R The *risk weighted exposure amounts* must be calculated according to the following formula:

$$\text{risk-weighted exposure amount} = \text{RW} * \text{exposure value};$$

where:

- (1) *risk weight* (RW) = 190% for private *equity exposures* in sufficiently diversified portfolios;
- (2) *risk weight* (RW) = 290% for exchange traded *equity exposures*; and
- (3) *risk weight* (RW) = 370% for all other *equity exposures*.

[**Note:** *BCD Annex VII Part 1 point 19*]

- 4.7.10 R Short cash positions and derivative instruments held in the *non-trading book* are permitted to offset long positions in the same individual stocks provided that these instruments have been explicitly designated as hedges of specific *equity exposures* and that they provide a hedge for at least another year. Other short positions must be treated as if they are long positions with the relevant *risk weight* assigned to the absolute value of each position. In the context of maturity mismatched positions, the method is that for *corporate exposures* as set out in *BIPRU 4.4.70R*.

[Note: *BCD Annex VII Part 1 point 20*]

- 4.7.11 R A *firm* may recognise *unfunded credit protection* obtained on an *equity exposure* in accordance with the methods set out in *BIPRU 5 (Credit risk mitigation)*, as modified by *BIPRU 4.10*.

[Note: *BCD Annex VII Part 1 point 21*]

The calculation of risk-weighted exposure amounts for equity exposures: The simple risk weight approach: Expected loss

- 4.7.12 R The *expected loss amounts* for *equity exposures* must be calculated according to the following formula:

(1) *expected loss amount* = $EL \times \text{exposure value}$; and

(2) the *EL* values must be the following:

(a) *expected loss (EL)* = 0.8% for private *equity exposures* in sufficiently diversified portfolios;

(b) *expected loss (EL)* = 0.8% for exchange traded *equity exposures*; and

(c) *expected loss (EL)* = 2.4% for all other *equity exposures*.

[Note: *BCD Annex VII Part 1 point 32*]

The calculation of risk-weighted exposure amounts for equity exposures: The PD/LGD approach: Introduction

- 4.7.13 R *BIPRU 4.7.14R* to *BIPRU 4.7.22R* set out the *PD/LGD approach* for calculating the *risk weighted exposure amounts* for *equity exposures*.

The calculation of risk-weighted exposure amounts for equity exposures: The PD/LGD approach: Risk weighted exposure amounts

- 4.7.14 R The *risk weighted exposure amounts* must be calculated according to the formulas in *BIPRU 4.4.58R* (Risk weighted exposure amounts for sovereigns, institutions and corporates). If a *firm* does not have sufficient information to use the definition of *default* a scaling factor of 1.5 must be assigned to the *risk weights*.

[Note: *BCD Annex VII Part 1 point 22*]

- 4.7.15 R At the individual *exposure* level the sum of the *expected loss* amount multiplied by 12.5 and the *risk weighted exposure amount* must not exceed the *exposure* value multiplied by 12.5.

[Note: BCD Annex VII Part 1 point 23]

- 4.7.16 R A *firm* may recognise *unfunded credit protection* obtained on an *equity exposure* in accordance with the methods set out in *BIPRU 5* (Credit risk mitigation) as modified by *BIPRU 4.10*. This must be subject to an *LGD* of 90% on the *exposure* to the provider of the hedge. For private *equity exposures* in sufficiently diversified portfolios an *LGD* of 65% may be used.

[Note: BCD Annex VII Part 1 point 24]

The calculation of risk-weighted exposure amounts for equity exposures: The PD/LGD approach: Calculation of expected loss amounts

- 4.7.17 R The *expected loss* amounts for *equity exposures* must be calculated according to the following formulae:

(1) *expected loss* (EL) = $PD \times LGD$; and

(2) *expected loss* amount = $EL \times exposure\ value$.

[Note: BCD Annex VII Part 1 point 33]

The calculation of risk-weighted exposure amounts for equity exposures: The PD/LGD approach: PDs

- 4.7.18 R *PDs* must be determined according to the methods for *corporate exposures*. The following minimum *PDs* must be applied:

(1) 0.09% for exchange traded *equity exposures* where the investment is part of a long-term customer relationship;

(2) 0.09% for non-exchange traded *equity exposures* where the returns on the investment are based on regular and periodic cash flows not derived from capital gains;

(3) 0.40% for exchange traded *equity exposures* including other short positions as set out in *BIPRU 4.7.10R*; and

(4) 1.25% for all other *equity exposures* including other short positions as set out in *BIPRU 4.7.10R*.

[Note: BCD Annex VII Part 2 point 24]

- 4.7.19 R *BIPRU 4.4.29R* (five year observation period) applies to the *PD/LGD approach*.

[Note: BCD Annex VII Part 4 point 66 (part)]

The calculation of risk-weighted exposure amounts for equity exposures: The PD/LGD approach: LGDs

- 4.7.20 R Private *equity exposures* in sufficiently diversified portfolios may be assigned an *LGD* of 65 %.

[Note: BCD Annex VII Part 2 point 25]

- 4.7.21 R All other *exposures* must be assigned an *LGD* of 90%.

[Note: BCD Annex VII Part 2 point 26]

The calculation of risk-weighted exposure amounts for equity exposures: The PD/LGD approach: Maturity

- 4.7.22 R M (maturity) assigned to all *exposures* must be 5 years.

[Note: BCD Annex VII Part 2 point 27]

The calculation of risk-weighted exposure amounts for equity exposures: The internal models approach: Introduction

- 4.7.23 R *BIPRU 4.7.24R* to *BIPRU 4.7.35R* set out the internal models approach for calculating the *risk weighted exposure amounts* for *equity exposures* as referred to in *BIPRU 4.7.3R(3)*.

The calculation of risk-weighted exposure amounts for equity exposures: The internal models approach: Risk weighted exposure amounts

- 4.7.24 R The *risk weighted exposure amount* is the potential *loss* on the *firm's equity exposures* as derived using internal value-at-risk models subject to the 99th percentile, one-tailed confidence interval of the difference between quarterly returns and an appropriate risk-free rate computed over a long-term sample period, multiplied by 12.5. The *risk weighted exposure amounts* at the individual *exposure* level must not be less than the sum of minimum *risk weighted exposure amounts* required under the *PD/LGD approach* and the corresponding *expected loss amounts* multiplied by 12.5 and calculated on the basis of the *PD* values set out in *BIPRU 4.7.18(1)R* and the corresponding *LGD* values set out *BIPRU 4.7.20R* and *BIPRU 4.7.21R*.

[Note: BCD Annex VII Part 1 point 25]

- 4.7.25 R A *firm* may recognise *unfunded credit protection* obtained on an *equity position*.

[Note: BCD Annex VII Part 1 point 26]

The calculation of risk weighted exposure amounts for equity exposures: The internal models approach: Expected loss amounts

- 4.7.26 R The *expected loss* amounts for *equity exposures* under the internal models approach must be 0%.

[Note: BCD Annex VII Part 1 point 34]

The calculation of risk weighted exposure amounts for equity exposures: The internal models approach: Capital requirements and risk quantification

- 4.7.27 R
- (1) A *firm* must meet the standards set out in (2) to (9) for the purpose of calculating capital requirements.
 - (2) The estimate of potential *loss* must be robust to adverse market movements relevant to the long-term risk profile of the *firm's* specific holdings. The data used to represent return distributions must reflect the longest sample period for which data is available and be meaningful in representing the risk profile of the *firm's* specific *equity exposures*. The data used must be sufficient to provide conservative, statistically reliable and robust loss estimates that are not based purely on subjective or judgmental considerations. A *firm* must be able to demonstrate to the *FSA* that the shock employed provides a conservative estimate of potential *losses* over a relevant long-term market or business cycle.
 - (3) A *firm* must combine empirical analysis of available data with adjustments based on a variety of factors in order to attain model outputs that achieve appropriate realism and conservatism. In constructing Value at Risk (VaR) models estimating potential quarterly losses, a *firm* may use quarterly data or convert shorter horizon period data to a quarterly equivalent using an analytically appropriate method supported by empirical evidence and through a well-developed and documented thought process and analysis. Such an approach must be applied conservatively and consistently over time. Where only limited relevant data is available a *firm* must add appropriate margins of conservatism.
 - (4) The models used must be able to capture adequately all of the material risks embodied in equity returns including both the *general market risk* and *specific risk* exposure of the *firm's equity exposure* portfolio. The internal models must adequately explain historical price variation, capture both the magnitude and changes in the composition of potential concentrations, and be robust to adverse market environments. The population of risk *exposures* represented in the data used for estimation must be closely matched to or at least comparable with those of the *firm's equity exposures*.
 - (5) The internal model must be appropriate for the risk profile and complexity of a *firm's equity exposure* portfolio. Where a *firm* has material holdings with values that are highly non-linear in nature the internal models must be designed to capture appropriately the risks associated with such instruments.
 - (6) Mapping of individual positions to proxies, market indices, and risk factors must be plausible, intuitive, and conceptually sound.

- (7) A *firm* must be able to demonstrate to the *FSA* through empirical analyses the appropriateness of risk factors, including their ability to cover both *general market risk* and *specific risk*.
- (8) The estimates of the return volatility of *equity exposures* must incorporate relevant and available data, information, and methods. Independently reviewed internal data or data from external sources (including pooled data) must be used.
- (9) A rigorous and comprehensive stress-testing programme must be in place.

[Note: *BCD* Annex VII Part 4 point 115]

The calculation of risk-weighted exposure amounts for equity exposures: The internal models approach: Risk management and controls

- 4.7.28 R
- (1) With regard to the development and use of internal models for capital requirement purposes, a *firm* must establish policies, procedures, and controls to ensure the integrity of the model and modelling process. These policies, procedures, and controls must include the ones set out in the rest of this paragraph.
 - (2) There must be full integration of the internal model into the overall management information systems of the *firm* and in the management of the *non-trading book equity exposure* portfolio. In particular they must be used in:
 - (a) measuring and assessing *equity exposure* portfolio performance (including the risk adjusted performance);
 - (b) allocating economic capital to *equity exposures*; and
 - (c) evaluating overall capital adequacy and the investment management process.
 - (3) A *firm* must have established management systems, procedures, and control functions for ensuring the periodic and independent review of all elements of the internal modelling process, including approval of model revisions, vetting of model inputs, and review of model results, such as direct verification of risk computations. These reviews must assess the accuracy, completeness, and appropriateness of model inputs and results and focus on both finding and limiting potential errors associated with known weaknesses and identifying unknown model weaknesses. Such reviews may be conducted by an internal independent unit, or by an independent external third party.
 - (4) There must be adequate systems and procedures for monitoring investment limits and the risk exposures of *equity exposures*.

- (5) The units responsible for the design and application of the model must be functionally independent from the units responsible for managing individual investments.
- (6) Parties responsible for any aspect of the modelling process must be adequately qualified. Management must allocate sufficient skilled and competent resources to the modelling function.

[**Note:** *BCD Annex VII Part 4 point 116*]

The calculation of risk-weighted exposure amounts for equity exposures: The internal models approach: Validation and documentation

- 4.7.29 R A *firm* must have a robust system in place to validate the accuracy and consistency of its internal models and modelling processes. All material elements of the internal models and the modelling process and validation must be documented.

[**Note:** *BCD Annex VII Part 4 point 117*]

- 4.7.30 R A *firm* must use the internal validation process to assess the performance of its internal models and processes in a consistent and meaningful way.

[**Note:** *BCD Annex VII Part 4 point 118*]

- 4.7.31 R The methods and data used for quantitative validation must be consistent through time. Changes in estimation and validation methods and data (both data sources and periods covered) must be documented.

[**Note:** *BCD Annex VII Part 4 point 119*]

- 4.7.32 R A *firm* must regularly compare actual *equity exposure* returns (computed using realised and unrealised gains and losses) with modelled estimates. Such comparisons must make use of historical data that cover as long a period as possible. A *firm* must document the methods and data used in such comparisons. This analysis and documentation must be updated at least annually.

[**Note:** *BCD Annex VII Part 4 point 120*]

- 4.7.33 R A firm must make use of other quantitative validation tools and comparisons with external data sources. The analysis must be based on data that are appropriate to the portfolio, are updated regularly, and cover a relevant observation period. A *firm's* internal assessments of the performance of its models must be based on as long a period as possible.

[**Note:** *BCD Annex VII Part 4 point 121*]

4.7.34 R A *firm* must have sound internal standards for situations where comparison of actual *equity exposure* returns with the models' estimates calls the validity of the estimates or of the models as such into question. These standards must take account of business cycles and similar systematic variability in *equity exposure* returns. All adjustments made to internal models in response to model reviews must be documented and consistent with the *firm's* model review standards.

[**Note:** BCD Annex VII Part 4 point 122]

4.7.35 R The internal model and the modelling process must be documented, including the responsibilities of parties involved in the modelling, and the model approval and model review processes.

[**Note:** BCD Annex VII Part 4 point 123]

- 4.8 The IRB approach: Purchased receivables
- Application
- 4.8.1 R *BIPRU* 4.8 applies with respect to purchased receivables.
- 4.8.2 G Purchased receivables do not form an *IRB exposure class* on their own. For any purchased receivable, the provisions of the sections of *BIPRU* 4 that deal with the *IRB exposure class* to which it belongs also apply, as modified by this section.
- [Note: *BCD* Annex VII Part 4 point 15 (part)]
- Structure of rating systems
- 4.8.3 R For *retail exposure* that are purchased receivables, the grouping referred to in *BIPRU* 4.6.9R must reflect the seller's underwriting practices and the heterogeneity of its customers.
- Risk quantification: Overall requirements for estimation: General
- 4.8.4 G Further general material about the requirements for estimation can be found in *BIPRU* 4.3.73R - *BIPRU* 4.3.94R.
- 4.8.5 R The estimates for determining the risk parameters *PD*, *LGD*, *conversion factor* and *EL* must reflect all relevant information available to the purchasing *firm* regarding the quality of the underlying receivables, including data for similar pools provided by the seller, by the purchasing *firm*, or by external sources. The purchasing *firm* must evaluate any data relied upon which is provided by the seller.
- [Note: *BCD* Annex VII Part 4 point 53]
- Risk quantification: Overall requirements for estimation: Requirements specific to PD estimation
- 4.8.6 R With respect to *BIPRU* 4.6.26R (Internal and external data for PD estimation: retail exposures) a *firm* may use external and internal reference data for *PD* estimation. A *firm* must use all relevant data sources as points of comparison.
- [Note: *BCD* Annex VII Part 4 point 69 (part)]
- 4.8.7 R For *corporate exposure* purchased receivables a *firm* may estimate *ELs* by obligor grade from long run averages of one-year realised *default* rates.
- [Note: *BCD* Annex VII Part 4 point 60]

- 4.8.8 R If a *firm* derives long run average estimates of *PDs* and *LGDs* for *corporate exposure* purchased receivables from an estimate of *EL*, and an appropriate estimate of *PD* or *LGD*, the process for estimating total *losses* must meet the overall standards for estimation of *PD* and *LGD* set out in the *IRB minimum standards*, and the outcome must be consistent with the concept of *LGD* as set out in *BIPRU 4.3.99R*.

[**Note:** *BCD Annex VII Part 4 point 61*]

Risk quantification: Overall requirements for estimation: Requirements specific to own-LGD estimates

- 4.8.9 R A *firm* may use external and internal reference data for its *LGD* estimates in the case of *retail exposures* that are purchased receivables.

[**Note:** *BCD Annex VII Part 4 point 85*]

Risk quantification: Overall requirements for estimation: Minimum requirements for purchased receivables: General

- 4.8.10 R *BIPRU 4.8.11R - BIPRU 4.8.15R* set out minimum requirements specific to the treatment of purchased receivables under the *IRB approach*.

Risk quantification: Overall requirements for estimation: Minimum requirements for purchased receivables: Legal certainty

- 4.8.11 R The structure of the facility must ensure that under all foreseeable circumstances a *firm* has effective ownership and control of all cash remittances from the receivables. When the obligor makes payments directly to a seller or servicer a *firm* must verify regularly that payments are forwarded completely and within the contractually agreed terms. Servicer means an entity that manages a pool of purchased receivables or the underlying credit *exposures* on a day-to-day basis. A *firm* must have procedures to ensure that ownership over the receivables and cash receipts is protected against bankruptcy stays or legal challenges that could materially delay the lender's ability to liquidate or assign the receivables or retain control over cash receipts.

[**Note:** *BCD Annex VII Part 4 point 105*]

Risk quantification: Overall requirements for estimation: Minimum requirements for purchased receivables: Effectiveness of monitoring systems

- 4.8.12 R (1) A *firm* must monitor both the quality of the purchased receivables and the financial condition of the seller and servicer. In particular a *firm* must comply with the remaining provisions of this *rule*.
- (2) A *firm* must assess the correlation among the quality of the purchased receivables and the financial condition of both the seller and servicer, and have in place internal policies and procedures that provide adequate safeguards to protect against such contingencies, including the assignment of an internal risk rating for each seller and servicer.

- (3) A *firm* must have clear and effective policies and procedures for determining seller and servicer eligibility. A *firm* or its agent must conduct periodic reviews of sellers and servicers in order to verify the accuracy of reports from the seller or servicer, detect fraud or operational weaknesses, and verify the quality of the seller's credit policies and servicer's collection policies and procedures. The findings of these reviews must be documented.
- (4) A *firm* must assess the characteristics of the purchased receivables pools including:
 - (a) over-advances;
 - (b) history of the seller's arrears, bad debts, and bad debt allowances;
 - (c) payment terms; and
 - (d) potential contra accounts.
- (4) A *firm* must have effective policies and procedures for monitoring on an aggregate basis single-obligor concentrations both within and across purchased receivables pools.
- (5) A *firm* must ensure that it receives from the servicer timely and sufficiently detailed reports of receivables ageings and dilutions to ensure compliance with the *firm*'s eligibility criteria and advancing policies governing purchased receivables, and provide an effective means with which to monitor and confirm the seller's terms of sale and dilution.

[Note: BCD Annex VII Part 4 point 106]

Risk quantification: Overall requirements for estimation: Minimum requirements for purchased receivables: Effectiveness of work-out systems

- 4.8.13 R A *firm* must have systems and procedures for detecting deteriorations in the seller's financial condition and purchased receivables quality at an early stage, and for addressing emerging problems proactively. In particular a *firm* must have clear and effective policies, procedures, and information systems to monitor covenant violations, and clear and effective policies and procedures for initiating legal actions and dealing with problem purchased receivables.

Risk quantification: Overall requirements for estimation: Minimum requirements for purchased receivables: Effectiveness of systems for controlling collateral, credit availability and cash

[Note: BCD Annex VII Part 4 point 107]

- 4.8.14 R A *firm* must have clear and effective policies and procedures governing the control of purchased receivables, credit, and cash. In particular, written internal policies must specify all material elements of the receivables purchase programme, including the advancing rates, eligible collateral, necessary documentation, concentration limits, and the way cash receipts are to be handled. These elements must take appropriate account of all relevant and material factors, including the seller's and servicer's financial condition, risk concentrations, and trends in the quality of the purchased receivables and the seller's customer base, and internal systems must ensure that funds are advanced only against specified supporting collateral and documentation.

[Note: BCD Annex VII Part 4 point 108]

Risk quantification: Overall requirements for estimation: Minimum requirements for purchased receivables: Compliance with the firm's internal policies and procedures

- 4.8.15 R A *firm* must have an effective internal process for assessing compliance with all internal policies and procedures. The process must include regular audits of all critical phases of the *firm's* receivables purchase programme, verification of the separation of duties between, firstly, the assessment of the seller and servicer and the assessment of the obligor and, secondly, between the assessment of the seller and servicer and the field audit of the seller and servicer and evaluations of back office operations, with particular focus on qualifications, experience, staffing levels, and supporting automation systems.

[Note: BCD Annex VII Part 4 point 109]

Calculation of risk-weighted asset amounts: Eligibility for different treatments: Corporate exposures

- 4.8.16 R For its *corporate exposure* purchased receivables a *firm* must comply with the minimum requirements set out in BIPRU 4.8.11R - BIPRU 4.8.15R. For *corporate exposure* purchased receivables that comply in addition with the conditions set out in BIPRU 4.8.18R, and where it would be unduly burdensome for a *firm* to use the risk quantification standards for *corporate exposures* as set out in the *minimum IRB standards* for these receivables, the risk quantification standards for *retail exposures* as set out in the *minimum IRB standards* may be used.

[Note: BCD Annex VII Part 1 point 7]

- 4.8.17 R For *corporate exposure* purchased receivables, refundable purchase discounts, collateral or partial guarantees that provide first-loss protection for *default losses*, dilution *losses*, or both, may be treated as first-loss positions under the provisions in BIPRU 9 (Securitisation) about the *IRB approach*.

[Note: BCD Annex VII Part 1 point 8]

Calculation of risk weighted asset amounts: Eligibility for different treatments: Retail exposures

- 4.8.18 R To be eligible for the *retail exposure* treatment purchased receivables must comply with the minimum requirements set out in *BIPRU 4.8.11R - BIPRU 4.8.15R* and the following conditions:
- (1) the *firm* has purchased the receivables from unrelated, third party sellers, and its *exposure* to the obligor of the receivable does not include any *exposures* that are directly or indirectly originated by the *firm* itself;
 - (2) the purchased receivables must be generated on an arm's-length basis between the seller and the obligor (and as such, intercompany accounts receivables and receivables subject to contra-accounts between firms that buy and sell to each other are ineligible);
 - (3) the purchasing *firm* has a claim on all proceeds from the purchased receivables or a pro-rata interest in the proceeds; and
 - (4) the portfolio of purchased receivables is sufficiently diversified.

[Note: *BCD Annex VII Part 1 point 14*]

- 4.8.19 R With respect to *retail exposures*, for purchased receivables, refundable purchase discounts, collateral or partial guarantees that provide first-loss protection for *default losses*, *dilution losses*, or both, may be treated as first-loss positions under the provisions in *BIPRU 9 (Securitisation)* about the *IRB approach*.

[Note: *BCD Annex VII Part 1 point 15*]

- 4.8.20 R For hybrid pools of purchased *retail exposure* receivables where the purchasing *firm* cannot separate *exposures* secured by real estate collateral and *qualifying revolving retail exposures* from other *retail exposures*, the *retail risk weight* function producing the highest capital requirements for those *exposures* must apply.

[Note: *BCD Annex VII Part 1 point 16*]

Calculation of risk weighted asset amounts for dilution risk

- 4.8.21 R The *risk weights* for *dilution risk* for purchased receivables (both *corporate exposures* and *retail exposures*) must be calculated according to this *rule*. The *risk weights* must be calculated according to the formula in *BIPRU 4.4.58R*. However, for the purposes of that formula, the total annual sales referred to in *BIPRU 4.4.59R* are the weighted average by individual *exposures* of the pool. The input parameters *PD* and *LGD* and the *exposure* value must be determined under the applicable provisions of *BIPRU 4* as modified by this section. *M* (maturity) must be 1 year. However:

- (1) a *firm* need not recognise *dilution risk* if its *IRB permission* permits this; and
- (2) (in the case of a *firm* with an *IRB permission* that permits the treatment of *dilution risk* in (1)) the *firm* must be able to convince the *FSA* that *dilution risk* is immaterial.

[Note: BCD Article 87(2) (part) and Annex VII Part 1 point 28]

Calculation of risk weighted exposure amounts: PDs

- 4.8.22 R For purchased *corporate exposure* receivables in respect of which a *firm* cannot demonstrate that its *PD* estimates meet the *minimum IRB standards*, the *PDs* for these *exposures* must be determined according to the following methods:
- (1) for senior claims on purchased *corporate exposure* receivables *PD* must be the *firm's* estimate of *EL* divided by *LGD* for these receivables;
 - (2) for subordinated claims on purchased *corporate exposure* receivables *PD* must be the *firm's* estimate of *EL*; and
 - (3) if a *firm* is under its *IRB permission* using the *advanced IRB approach* for *LGD* estimates for *corporate exposures* and it can decompose its *EL* estimates for purchased *corporate exposure* receivables into *PDs* and *LGDs* in a reliable manner, the *LGD* estimate may be used.

[Note: BCD Annex VII Part 2 point 3]

- 4.8.23 R In the case of *corporate exposures*, for *dilution risk* of purchased receivables *PD* must be set equal to *EL* estimate for *dilution risk*. If a *firm* is under its *IRB permission* using the *advanced IRB approach* for *LGD* estimates for *corporate exposures* and it can decompose its *EL* estimates for *dilution risk* of purchased *corporate exposure* receivables into *PDs* and *LGDs* in a reliable manner, the *PD* estimate may be used. A *firm* may recognise *unfunded credit protection* in the *PD* in accordance with the provisions of *BIPRU 9* and *BIPRU 5* as modified by *BIPRU 4.10*. A *firm* may recognise those *unfunded credit protection* providers set out in its *IRB permission* in addition to those indicated in the *CRM eligibility conditions*. Where a *firm's IRB permission* allows it to use its own *LGD* estimates for *dilution risk* of purchased corporate receivables, the *firm* may recognise *unfunded credit protection* by adjusting *PDs* subject to the provisions of *BIPRU 4.4.43R*.

[Note: BCD Annex VII Part 2 point 7]

- 4.8.24 R In the case of *retail exposures*, for *dilution risk* of purchased receivables *PD* must be set equal to *EL* estimates for *dilution risk*. If a *firm* can decompose its *EL* estimates for *dilution risk* of purchased receivables into *PDs* and *LGDs* in a reliable manner, the *PD* estimate may be used.

[Note: BCD Annex VII Part 2 point 19]

Calculation of risk weighted asset amounts: LGDs: Corporate exposures

- 4.8.25 R The following *LGD* values apply for purchased *corporate exposure* receivables:
- (1) for senior purchased *corporate exposure* receivables *exposures* where a *firm* cannot demonstrate that its *PD* estimates meet the *minimum IRB standards*, the value is 45%;

- (2) for subordinated purchased *corporate exposure* receivables *exposures* where a *firm* cannot demonstrate that its *PD* estimates meet the *minimum IRB standards*, the value is 100%; and
- (3) for *dilution risk* of purchased *corporate exposure* receivables, the value is 75%.

[Note: BCD Annex VII Part 2 point 8(e) to (g)]

- 4.8.26 R Notwithstanding BIPRU 4.4.34R and BIPRU 4.8.25R, for *dilution risk* and *default risk* if a *firm* is under its *IRB permission* using the *advanced IRB approach* for *LGD* estimates for *corporate exposures* and it can decompose its *EL* estimates for purchased *corporate exposure* receivables into *PDs* and *LGDs* in a reliable manner, the *LGD* estimate for purchased *corporate exposure* receivables may be used.

[Note: BCD Annex VII Part 2 point 9]

Calculation of risk weighted asset amounts: *LGDs*: Retail exposures

- 4.8.27 R For *dilution risk* of purchased *retail exposure* receivables an *LGD* value of 75% must be used. If a *firm* can decompose its *EL* estimates for *dilution risk* of purchased receivables into *PDs* and *LGDs* in a reliable manner, the *LGD* estimate may be used.

[Note: BCD Annex VII Part 2 point 21]

Calculation of risk weighted asset amounts: Exposure value

- 4.8.28 R The *exposure* value for the calculation of *risk weighted exposure amounts* of purchased receivables must be the outstanding amount minus the capital requirements for *dilution risk* prior to *credit risk mitigation*.

[Note: BCD Annex VII Part 3 point 6]

- 4.8.29 R (1) The *exposure* value for the items in (2) must be calculated as the committed but undrawn amount multiplied by a *conversion factor*.
- (2) For undrawn purchase commitments for revolving purchased receivables that are unconditionally cancellable or that effectively provide for automatic cancellation at any time by the *firm* without prior notice, a *conversion factor* of 0% applies. To apply a *conversion factor* of 0%, a *firm* must actively monitor the financial condition of the obligor, and its internal control systems must enable it immediately to detect a deterioration in the credit quality of the obligor.

[Note: BCD Annex VII Part 3 point 9 (c)]

Calculation of expected loss amounts

- 4.8.30 R The *expected loss* amounts for *dilution risk* of purchased receivables must be calculated according to the following formula:

expected loss (EL) = PD × LGD; and

expected loss amount = EL × exposure value.

[**Note:** *BCD* Article 88(5) and Annex VII Part 1 point 35]

4.9 The IRB approach: Securitisation, non-credit obligations assets and CIUs

Application

4.9.1 R *BIPRU 4.9* applies with respect to *securitisation exposures, non credit-obligation assets and exposures to CIUs*.

Securitisation exposures

4.9.2 R The following must be calculated in accordance with *BIPRU 9* (Securitisation):

(1) *risk-weighted exposure amounts* for *securitised exposures* and for *exposures* belonging to the *IRB exposure class* referred to in *BIPRU 4.3.2R(6)* (securitisation positions); and

(2) the *expected loss* amounts for *securitised exposures*.

[**Note:** *BCD* Article 87(10) and Article 88(3)]

Provision of credit protection

4.9.3 R Where a *firm* provides credit protection for a number of *exposures* under terms that the n^{th} default among the *exposures* shall trigger payment and that this credit event shall terminate the contract, if the product has an external credit assessment from an *eligible ECAI* the *risk weights* set out in *BIPRU 9* must be applied. If the product is not rated by an *eligible ECAI*, the *risk weights* of the *exposures* included in the basket must be aggregated, excluding $n-1$ *exposures* where the sum of the *expected loss* amount multiplied by 12.5 and the *risk weighted exposure amount* must not exceed the nominal amount of the protection provided by the credit derivative multiplied by 12.5. The $n-1$ *exposures* to be excluded from the aggregation must be determined on the basis that they must include those *exposures* each of which produces a lower *risk weighted exposure amount* than the *risk weighted exposure amount* of any of the *exposures* included in the aggregation.

[**Note:** *BCD* Annex VII Part 1 point 9]

Non credit obligation assets: Introduction

4.9.4 *BIPRU 4.9.5R-BIPRU 4.9.10R* apply to *non credit-obligation assets*.

Non credit obligation assets: Inclusion of residual value of leases

4.9.5 The *non credit obligation assets IRB exposure class* includes the residual value of leased properties, if not included in the lease *exposure* as defined in *BIPRU 4.4.75R*.

[**Note:** *BCD* Article 86(8)]

Non credit obligation assets: Risk weighted exposure amount

- 4.9.6 R The *risk weighted exposure amounts* must be calculated according to the formula:

Risk-weighted exposure amount = 100% * *exposure* value except for when the *exposure* is a residual value in which case it should be provisioned for each year and will be calculated as follows:

$1/t * 100\% * \textit{exposure value}$;

where t is the number of years of the lease contract term.

[**Note:** BCD Annex VII Part 1 point 27]

- 4.9.7 G t should be an integer number reflecting the nearest number of whole years of the lease remaining and should decrease as the lease matures so that the discounted value steps up gradually from a small value to 100% as the end of the lease approaches.

- 4.9.8 R Where a *firm* has full recourse in respect of purchased receivables for *default* risk and for *dilution risk*, to the seller of the purchased receivables, *BIPRU* 4.8.21R and *BIPRU* 4.8.30R need not be applied. The *exposure* may instead be treated as a collateralised *exposure*.

[**Note:** BCD Article 87(2) (part)]

Non credit obligation assets: Exposure value

- 4.9.9 R The *exposure* value of *non credit-obligation assets* must be the value presented in the financial statements.

[**Note:** BCD Annex VII Part 3 point 13]

Non credit obligation assets: Expected loss amounts

- 4.9.10 R For *non credit-obligation assets* the *expected loss* amount must be zero.

[**Note:** BCD Article 88(4)]

Collective investment undertakings

- 4.9.11 R (1) Where *exposures* in the form of a CIU meet the criteria set out in *BIPRU* 3.4.121R to *BIPRU* 3.4.122R (Conditions for look through treatment under the standardised approach) and the *firm* is aware of all of the underlying *exposures* of the CIU, the *firm* must look through to those underlying *exposures* in order to calculate *risk weighted exposure amounts* and *expected loss* amounts in accordance with the methods set out in *BIPRU* 4.

- (2) Where (1) applies but a *firm* does not meet the conditions for using the methods set out in *BIPRU 4*, *risk weighted exposure amounts* and *expected loss* amounts must be calculated in accordance with the following approaches.
- (3) For *equity exposures* the approach set out in *BIPRU 4.7.9R-BIPRU 4.7.12R* (Simple risk weights) must be used. If, for those purposes, the *firm* is unable to differentiate between private equity, exchange-traded and other *equity exposures*, it must treat the *exposures* concerned as other *equity exposures*.
- (4) For all other underlying *exposures*, the *standardised approach* must be used, subject to the following modifications:
 - (a) the *exposures* are assigned to the appropriate *exposure* class under the *standardised approach* and attributed the *risk weight* of the *credit quality step* immediately above the *credit quality step* that would normally be assigned to the *exposure*; and
 - (b) *exposures* assigned to the higher *credit quality steps*, to which a *risk weight* of 150% would normally be attributed, are assigned a *risk weight* of 200%.

[Note: *BCD* Article 87(11)]

- 4.9.12 R (1) Where *exposures* in the form of a *CIU* do not meet the criteria set out in *BIPRU 3.4.121R* to *BIPRU 3.4.122R* (Conditions for look through treatment under the standardised approach) or the *firm* is not aware of all of the underlying *exposures* of the *CIU*, a *firm* must look through to the underlying *exposures* and calculate *risk weighted exposure amounts* and *expected loss* amounts in accordance with the approach set out in *BIPRU 4.7.9R - BIPRU 4.7.12R* (Simple risk weights). If, for those purposes, the *firm* is unable to differentiate between private equity, exchange-traded and other *equity exposures*, it must treat the *exposures* concerned as other *equity exposures*. For these purposes, non-equity *exposures* must be assigned to one of the classes (private equity, exchange traded equity or other equity) set out in *BIPRU 4.7.9R* (Simple risk weight approach) and unknown *exposures* must be assigned to the other equity class.
- (2) Alternatively to the method described in (1), a *firm* may calculate itself or rely on a third party to calculate and report the average *risk weighted exposure amounts* based on the *CIU's* underlying *exposures* and calculated in accordance with the remaining provisions of this *rule*, provided that the correctness of the calculation and the report is adequately ensured.

- (3) For *exposures* belonging to the *equity exposure IRB exposure class*, the approach set out in *BIPRU 4.7.9R - BIPRU 4.7.12R* (Simple risk weight approach) must be used. If, for those purposes, a *firm* is unable to differentiate between private equity, exchange-traded and other *equity exposures*, it must treat the *exposures* concerned as other *equity exposures*.
- (4) For all other underlying *exposures*, the *standardised approach* must be used, subject to the following modifications:
 - (a) the *exposures* must be assigned to the appropriate *exposure class* under the *standardised approach* and attributed the *risk weight* of the *credit quality step* immediately above the *credit quality step* that would normally be assigned to the *exposure*; and
 - (b) *exposures* assigned to the higher *credit quality steps*, to which a *risk weight* of 150% would normally be attributed, must be assigned a *risk weight* of 200%.

[Note: BCD Article 87(12)]

- 4.9.13 G For the purposes of *BIPRU 4.9.12R(1)*, in the case of non-equity *exposures* a *firm* should look at the risk profile of the underlying *exposures* and map these to an equivalent equity *risk weight*. For example, if the underlying *exposures* are exchange-traded, the *risk weight* of exchange-traded *equity exposures* will apply. If the underlying *exposures* are unknown, the *risk weight* of the other equity class will apply. Only under exceptional circumstances would supervisors expect to see non-equity *exposures* mapped to the diversified private equity *risk weight*.
- 4.9.14 G For the purposes of *BIPRU 4.9.12R(2)*, a *firm* should ensure that any third party relied on for the calculations and report possesses the necessary competence and experience to ensure that the calculations and report are correct.
- 4.9.15 R The *expected loss* amounts for *exposures* referred to in *BIPRU 4.9.11R-BIPRU 4.9.12R* must be calculated in accordance with the methods set out in *BIPRU 4.4.61R* (Calculation of expected loss for sovereigns, institutions and corporates), *BIPRU 4.5.12R- BIPRU 4.5.14R* (Calculation of expected loss for specialised lending), *BIPRU 4.6.47R- BIPRU 4.6.48R* (Calculation of expected loss for retail exposures), *BIPRU 4.7.12R, BIPRU 4.7.17R* and *BIPRU 4.7.26R* (Calculation of expected loss for equity exposures) and *BIPRU 4.8.30R* (Dilution risk of purchased receivables).

[Note: BCD Article 88(6)]

4.10 The IRB approach: Credit risk mitigation

Application

4.10.1 G *BIPRU 4.10 applies to all exposures treated under the IRB approach.*

Purpose

4.10.2 G *BIPRU 4.10 sets out modifications to BIPRU 5 (Credit risk mitigation) for those exposures for which the IRB approach is being used.*

General

4.10.3 R *A firm using the IRB approach, but not using its own estimates of LGD and conversion factors, may recognise credit risk mitigation in accordance with BIPRU 5 as modified by BIPRU 4.10 in the calculation of risk weighted exposure amounts for the purposes of the calculation of the credit risk capital component or as relevant expected loss amounts for the purposes of the calculation in GENPRU 2.2.191R to GENPRU 2.2.193R or GENPRU 2.2.236R.*

[**Note:** *BCD Article 91 (as it applies to the IRB approach)*]

4.10.4 R (1) *Where the requirements of BIPRU 5.2.2R – BIPRU 5.2.8R are met the calculation of risk weighted exposure amounts, and, as relevant, expected loss amounts, may be modified in accordance with BIPRU 5 as modified by BIPRU 4.10.*

(2) *No exposure in respect of which credit risk mitigation is obtained must produce a higher risk weighted exposure amount or expected loss amount than an otherwise identical exposure in respect of which there is no credit risk mitigation.*

(3) *Where the risk weighted exposure amount already takes account of credit protection under the IRB approach the calculation of the credit protection must not be further recognised under BIPRU 5 or BIPRU 4.10.*

(4) *Subject to BIPRU 5.2.8R (Maturity mismatches), BIPRU 5.2.9R (Combinations of credit risk mitigation in the standardised approach) and BIPRU 5.7.27R to BIPRU 5.7.28R (Basket credit risk mitigation techniques), where the CRM eligibility conditions and the CRM minimum requirements are satisfied, the calculation of risk weighted exposure amounts and expected loss amounts under the IRB approach may be modified in accordance with the provisions of BIPRU 5 and BIPRU 4.10 that deal with calculating the effects of credit risk mitigation.*

[**Note:** *BCD Article 93 and Annex VIII Part 3 point 1(as they apply to the IRB approach)*]

Eligibility of funded credit protection: General

- 4.10.5 R In addition to the collateral set out in *BIPRU 5.3.1R* to *BIPRU 5.3.2R*, *BIPRU 5.4.1R* to *BIPRU 5.4.8R* and *BIPRU 5.6.1R* (Eligibility of funded credit protection) the provisions of *BIPRU 4.10.6R* - *BIPRU 4.10.12R* (Eligibility of real estate collateral), *BIPRU 4.10.14R* (Eligibility: receivables), *BIPRU 4.10.16R* (Eligibility: other physical collateral), and *BIPRU 4.10.19R* (Eligibility: leasing), apply where a firm calculates *risk weighted exposure amounts* and *expected loss* amounts under the *IRB approach*.

[Note: *BCD Annex VIII Part 1 point 12*]

Real estate collateral: Types of eligible collateral: General

- 4.10.6 R (1) Residential real estate property which is or will be occupied or let by the owner or the beneficial owner in the case of personal investment companies and commercial real estate property, that is offices and other commercial premises, may be recognised as eligible collateral where the conditions set out in the remaining provisions of this paragraph are met.
- (2) The value of the property must not materially depend upon the credit quality of the obligor. This requirement does not preclude situations where purely macro-economic factors affect both the value of the property and the performance of the borrower.
- (3) The risk of the borrower must not materially depend upon the performance of the underlying property or project, but rather on the underlying capacity of the borrower to repay the debt from other sources. As such, repayment of the facility must not materially depend on any cash flow generated by the underlying property serving as collateral.

[Note: *BCD Annex VIII Part 1 point 13*]

- 4.10.7 R The condition in *BIPRU 4.10.6R(3)* does not apply to *exposures* secured by residential real estate property situated within the *United Kingdom*.

[Note: *BCD Annex VIII Part 1 point 16 (part)*]

- 4.10.8 G (1) Under paragraph 16 of Part 1 of Annex VIII of the *Banking Consolidation Directive*, a *competent authority* may only disapply the condition in *BIPRU 4.10.6R(3)* if the *competent authority* has evidence that the relevant market is well-developed and long-established with loss-rates which are sufficiently low to justify such action.
- (2) If the evidence were to change so that the action was no longer justified the *FSA* would expect to revoke *BIPRU 4.10.7R*.

- 4.10.9 R (1) The condition in *BIPRU 4.10.6R(3)* does not apply for *exposures* secured by residential real estate property situated within the territory of another *EEA State*.

(2) However (1) only applies if and to the extent that the *CRD implementation measures* for that *EEA State* in relation to the *IRB approach* implement the option set out in paragraph 16 of Part 1 of Annex VIII of the *Banking Consolidation Directive* (waiver for residential real estate property) with respect to residential real estate property situated within that *EEA State*. Therefore (1) does not apply if the eligibility to use this treatment under those measures ceases as contemplated under paragraph 18 of Part 1 of Annex VIII of the *Banking Consolidation Directive* (suspension of alternative treatment).

[**Note:** *BCD* Annex VIII Part 1 point 16 (part)]

- 4.10.10 R (1) The condition in *BIPRU* 4.10.6R(3) does not apply for commercial real estate property situated within the territory of another *EEA State*.
- (2) However (1) only applies if and to the extent that the *CRD implementation measures* for that *EEA State* in relation to the *IRB approach* implement the option set out in paragraph 17 of Part 1 of Annex VIII of the *Banking Consolidation Directive* (waiver for commercial real estate property) with respect to commercial real estate property situated within that *EEA State*. Therefore (1) does not apply if the eligibility to use this treatment under those measures ceases as contemplated under paragraph 18 of Part 1 of Annex VIII of the *Banking Consolidation Directive* (suspension of alternative treatment).

[**Note:** *BCD* Annex VIII Part 1 point 19]

Real estate collateral: Types of eligible collateral: Finnish housing legislation

- 4.10.11 R A *firm* may also recognise as eligible collateral shares in Finnish residential housing companies operating in accordance with the Finnish Housing Company Act of 1991 or subsequent equivalent legislation in respect of residential property which is or will be occupied or let by the owner, as residential real estate collateral, provided that the conditions in *BIPRU* 4.10.6R are met.

[**Note:** *BCD* Annex VIII Part 1 point 14]

- 4.10.12 R A *firm* may also recognise as eligible collateral shares in Finnish housing companies operating in accordance with the Finnish Housing Company Act of 1991 or subsequent equivalent legislation as commercial real estate collateral, provided that the conditions in *BIPRU* 4.10.6R are met.

[**Note:** *BCD* Annex VIII Part 1 point 15]

Real estate collateral: Minimum requirements for recognition

- 4.10.13 R For the recognition of real estate collateral: the minimum requirements in *BIPRU* 3.4.64R - *BIPRU* 3.4.73R must be met with the following adjustments:
- (1) those provisions apply to all real estate collateral eligible under *BIPRU* 4.10; and

- (2) the minimum frequency of valuation as referred to in *BIPRU* 3.4.66R is once every year for commercial real estate.

[**Note:** *BCD* Annex VIII Part 2 point 8 (as it applies to the *IRB approach*)]

Receivables: Types of eligible collateral

- 4.10.14 R Amounts receivable linked to a commercial transaction or transactions with an original maturity of less than or equal to one year may be recognised as eligible collateral. Eligible receivables do not include those associated with *securitisations*, sub-participations or credit derivatives or amounts owed by affiliated parties.

[**Note:** *BCD* Annex VIII Part 1 point 20]

Receivables: Minimum requirements for recognition

- 4.10.15 R
- (1) For the recognition of receivables as collateral the requirements in this paragraph must be met.
 - (2) The legal mechanism by which the collateral is provided must be robust and effective and ensure that the lender has clear rights over the proceeds.
 - (3) A *firm* must take all steps necessary to fulfil local requirements in respect of the enforceability of security interests. There must be a framework which allows the lender to have a first priority claim over the collateral subject to any claims of preferential creditors provided for in applicable insolvency law.
 - (4) A *firm* must have conducted sufficient legal review confirming the enforceability of the collateral arrangements in all relevant jurisdictions.
 - (5) The collateral arrangements must be properly documented, with a clear and robust procedure for the timely collection of collateral. A *firm's* procedures must ensure that any legal conditions required for declaring the default of the borrower and timely collection of collateral are observed. In the event of the obligor's financial distress or default, a *firm* must have legal authority to sell or assign the receivables to other parties without consent of the receivables obligors.
 - (6) A *firm* must have a sound process for determining the credit risk associated with the receivables. Such a process must include, among other things, analyses of the obligor's business and industry and the types of customers with whom the obligor does business. Where a *firm* relies on the obligor to ascertain the credit risk of the customers, the *firm* must review the obligor's credit practices to ascertain their soundness and credibility.

- (7) The margin between the amount of the *exposure* and the value of the receivables must reflect all appropriate factors, including the cost of collection, concentration within the receivables pool pledged by an individual obligor, and potential concentration risk within the *firm's* total *exposures* beyond that controlled by the *firm's* general methodology. A *firm* must maintain a continuous monitoring process appropriate to the receivables. Additionally, compliance with loan covenants, environmental restrictions, and other legal requirements must be reviewed on a regular basis.
- (8) The receivables pledged by an obligor must be diversified and not be unduly correlated with the obligor. Where there is material positive correlation, the attendant risks must be taken into account in the setting of margins for the collateral pool as a whole.
- (9) Receivables from affiliates of the obligor (including *subsidiary undertakings* and employees) must not be recognised as risk mitigants.
- (10) A *firm* must have a documented process for collecting receivable payments in distressed situations. The requisite facilities for collection must be in place, even when the *firm* normally looks to the obligor for collections.

[Note: BCD Annex VIII Part 2 point 9]

Other physical collateral: Types of eligible collateral

- 4.10.16 R A *firm* may recognise as eligible collateral a physical item of a type other than those types indicated in BIPRU 4.10.6R - BIPRU 4.10.12R (Eligibility of real estate collateral) if its *IRB permission* provides that the *firm* may treat collateral of that type as eligible and if the *firm* is able to demonstrate the following:
- (1) the existence of liquid markets for disposal of the collateral in an expeditious and economically efficient manner;
 - (2) the existence of well-established, publicly available market prices for the collateral; and
 - (3) there is no evidence that the net prices it receives when collateral is realised deviates significantly from the market prices referred to in (b).

[Note: BCD Annex VIII Part 1 point 21]

- 4.10.17 G If a *firm* wishes to recognise other types of collateral in accordance with BIPRU 4.10.16R (whether as part of its application for an *IRB permission* or under a variation of its *IRB permission*) it should demonstrate to the *FSA* how the criteria in BIPRU 4.10.16R(1) – (3) have been met with respect to that type of collateral.

Other physical collateral: Minimum requirements for recognition

- 4.10.18 R
- (1) If a type of other physical collateral referred to in BIRU 4.10.16R is potentially eligible under a *firm's IRB permission* a *firm* must only recognise it as eligible if the minimum requirements in (2) to (10) are met.
 - (2) The collateral arrangement must be legally effective and enforceable in all relevant jurisdictions and must enable the *firm* to realise the value of the property within a reasonable timeframe.
 - (3) With the sole exception of permissible prior claims referred to in *BIPRU* 4.10.15R(3), only first liens on, or charges over, collateral must be permissible. As such, the *firm* must have priority over all other lenders to the realised proceeds of the collateral.
 - (4) The value of the property must be monitored on a frequent basis and at a minimum once every year. More frequent monitoring must be carried out where the market is subject to significant changes in conditions.
 - (5) The loan agreement (or other agreement documenting the *exposure*) must include detailed descriptions of the collateral plus detailed specifications of the manner and frequency of revaluation.
 - (6) The types of physical collateral accepted by the *firm* and policies and practices in respect of the appropriate amount of each type of collateral relative to the *exposure* amount must be clearly documented in internal credit policies and procedures available for examination.
 - (7) The *firm's* credit policies with regard to the transaction structure must address appropriate collateral requirements relative to the *exposure* amount, the ability to liquidate the collateral readily, the ability to establish objectively a price or market value, the frequency with which the value can readily be obtained (including a professional appraisal or valuation), and the volatility or a proxy of the volatility of the value of the collateral.
 - (8) Both initial valuation and revaluation must take fully into account any deterioration or obsolescence of the collateral. Particular attention must be paid in valuation and revaluation to the effects of the passage of time on fashion- or date-sensitive collateral.
 - (9) The *firm* must have the right to inspect the property physically. It must have policies and procedures addressing its exercise of the right to physical inspection.
 - (10) The *firm* must have procedures to monitor that the property taken as protection is adequately insured against damage.

[Note: *BCD* Annex VIII Part 2 point 10]

Leasing: Types of eligible transactions and conditions of eligibility

- 4.10.19 R (1) Where the requirements set out in this paragraph are met, *exposures* arising from transactions whereby a *firm* leases property to a third party must be treated the same as loans collateralised by the type of property leased.
- (2) For the *exposures* arising from leasing transactions to be treated as collateralised by the type of property leased, the following conditions must be met:
- (a) the conditions set out or referred to in *BIPRU* 4.10.13R or *BIPRU* 4.10.18R as appropriate for the recognition as collateral of the type of property leased are met;
 - (b) there is robust risk management on the part of the lessor with respect to the use to which the leased asset is put, its age, and planned duration of its use, including appropriate monitoring of the value of the security;
 - (c) there is in place a robust legal framework establishing the lessor's legal ownership of the asset and its ability to exercise its rights as owner in a timely fashion; and
 - (d) where this has not already been ascertained in calculating the *LGD* level, the difference between value of the unamortised amount and the market value of the security must not be so large as to overstate the *credit risk mitigation* attributed to the leased assets.

[**Note:** *BCD* Annex VIII Part 1 point 22 and Part 2 point 11]

Calculating risk-weighted exposure amounts and expected loss amounts for funded credit risk mitigation: Introduction

- 4.10.20 R *BIPRU* 4.10.21R - *BIPRU* 4.10.37R and *BIPRU* 4.10.49R set out how the calculation of *risk weighted exposure amounts* and *expected loss* amounts under *BIPRU* 4.1 - *BIPRU* 4.9 may be modified to take into account *credit risk mitigation* that meets the *CRM eligibility conditions* and the *CRM minimum requirements*.

Calculating risk weighted exposure amounts and expected loss amounts for funded credit risk mitigation: Valuation: Receivables

- 4.10.21 R The value of receivables for the purpose of calculating the effect of *credit risk mitigation* must be the amount receivable.

[**Note:** *BCD* Annex VIII Part 3 point 66]

Calculating risk weighted exposure amounts and expected loss amounts for funded credit risk mitigation: Valuation: Other physical collateral

- 4.10.22 R Physical collateral recognised as eligible as described in *BIPRU* 4.10.16R must be valued for the purpose of calculating the effect of *credit risk mitigation* at its market value. Market value is the estimated amount for which the property would exchange on the date of valuation between a willing buyer and a willing seller in an arm's-length transaction.

[Note: BCD Annex VIII Part 3 point 67]

Calculating risk weighted exposure amounts and expected loss amounts: General treatment

- 4.10.23 R *BIPRU* 4.10.24R-*BIPRU* 4.10.29R apply to collateral in the form of real estate collateral, receivables, other physical collateral and leasing permitted by *BIPRU* 4.10 and *exposures* secured by such collateral.
- 4.10.24 R LGD* (the effective *loss given default*) calculated as set out in *BIPRU* 4.10.25R-*BIPRU* 4.10.28R must be taken as the *LG*D.

[Note: BCD Annex VIII Part 3 point 68]

- 4.10.25 R Where the ratio of the value of the collateral (C) to the *exposure* value (E) is below a threshold level of C* (the required minimum collateralisation level for the *exposure*) as laid down in *BIPRU* 4.10.28R, LGD* must be the *LG*D laid down in the other sections of *BIPRU* 4 for uncollateralised *exposures* to the counterparty.

[Note: BCD Annex VIII Part 3 point 69]

- 4.10.26 R Where the ratio of the value of the collateral to the *exposure* value exceeds a second, higher threshold level of C** (i.e. the required level of collateralisation to receive full *LG*D recognition) as laid down in *BIPRU* 4.10.28R, LGD* must be that prescribed in that table.

[Note: BCD Annex VIII Part 3 point 70]

- 4.10.27 R Where the required level of collateralisation C** is not achieved in respect of the *exposure* as a whole, the *exposure* must be considered to be two *exposures* – that part in respect of which the required level of collateralisation C** is achieved and the remainder.

[Note: BCD Annex VIII Part 3 point 71]

4.10.28

Table: Minimum LGD for secured portion of exposures
This table belongs to BIPRU 4.10.24R - BIPRU 4.10.27R

	LGD* for senior claims or contingent claims	LGD* for subordinated claims or contingent claims	Required minimum collateralisation level of the exposure (C*)	Required minimum collateralisation level of the exposure (C**)
Receivables	35%	65%	0%	125%
Residential real estate/commercial real estate	35%	65%	30%	140%
Other collateral	40%	70%	30%	140%

[Note: BCD Annex VIII Part 3 point 72 (part)]

Calculating risk weighted exposure amounts and expected loss amounts for funded credit risk mitigation: Alternative treatment for real estate collateral

- 4.10.29 R (1) A firm may apply the treatment in paragraph 74 of Part 3 of Annex VIII of the *Banking Consolidation Directive* (50% risk weight for exposures secured by real estate) in respect of *exposures* collateralised by:
- (a) residential real estate property; or
 - (b) commercial real estate property;
- located in the territory of another *EEA State*.
- (2) However (1)(a) or (1)(b) only applies if the *CRD implementing measures* for that *EEA State* with respect to the *IRB approach* have implemented the option set out in the provision of the *Banking Consolidation Directive* referred to in (1) with respect to the relevant category of real estate property situated within that *EEA State*.
- (3) The use of the treatment in (1) with respect to property in another *EEA State* must be subject to the same conditions as apply under the relevant *CRD implementation measures* for that *EEA State*.

[Note: BCD Annex VIII Part 3 point 75]

Calculating risk weighted exposure amounts and expected loss amounts: Mixed pools of collateral

4.10.30 R (1) Where:

- (a) *risk weighted exposure amounts* and *expected loss* amounts are calculated under the *IRB approach*; and
- (b) an *exposure* is collateralised by both financial collateral and other eligible collateral;

LGD* to be taken as the *LGD* for the purposes of the *IRB approach* must be calculated in accordance with this *rule*.

- (2) A *firm* must subdivide the volatility-adjusted value of the *exposure* (i.e. the value after the application of the volatility adjustment as set out in *BIPRU 5.4.28R* (Volatility adjustments under the financial collateral comprehensive method) into parts each covered by only one type of collateral. That is, the *firm* must divide the *exposure* into the part covered by eligible financial collateral, the part covered by receivables, the parts covered by commercial real estate property collateral and/or residential real estate property collateral, the part covered by other eligible collateral, and the unsecured part, as relevant.
- (3) LGD* for each part of *exposure* must be calculated separately in accordance with the relevant provisions of *BIPRU 5* (Credit risk mitigation) and *BIPRU 4.10*.

[Note: BCD Annex VIII Part 3 points 76 to 78]

Calculating risk weighted exposure amounts and expected loss amounts for funded credit risk mitigation: Other modifications of the rules on credit risk mitigation: Financial collateral simple method

4.10.31 R The *financial collateral simple method* must not be used under the *IRB approach*.

[Note: BCD Annex VIII Part 3 point 24 (part)]

Calculating risk weighted exposure amounts and expected loss amounts for funded credit risk mitigation: Other modifications of the rules on credit risk mitigation: Master netting agreements

4.10.32 R (1) This *rule* sets out how the calculations under *BIPRU 5.6.11R* (Using the supervisory volatility adjustments or the own estimates volatility adjustments approaches to master netting agreements covering repurchase transactions and/or securities or commodities lending or borrowing transactions and/or other capital market driven transactions) must be modified under the *IRB approach*.

- (2) Where *risk weighted exposure amounts* and *expected loss* amounts are calculated under the *IRB approach*, E is the *exposure* value for each separate *exposure* under the agreement referred to in the provisions listed in (1) that would apply in the absence of the credit protection.

[**Note:** BCD Annex VIII Part 3 point 11 (as it applies to the *IRB approach*)]

- 4.10.33 R (1) This *rule* sets out how the calculations under *BIPRU 5.6.24R* (Using the internal models approach to master netting agreements covering repurchase transactions and/or securities or commodities lending or borrowing transactions and/or other capital market driven transactions) must be modified under the *IRB approach*.
- (2) Where *risk weighted exposure amounts* and *expected loss* amounts are calculated under the *IRB approach* E is the *exposure* value for each separate *exposure* under the agreement referred to in the provisions listed in (1) that would apply in the absence of the credit protection.

[**Note:** BCD Annex VIII Part 3 point 20 (as it applies to the *IRB approach*)]

- 4.10.34 R (1) This *rule* sets out how the calculations under *BIPRU 5.6.29R* (Calculating risk-weighted exposure amounts and expected loss amounts for master netting agreements covering repurchase transactions and/or securities or commodities lending or borrowing transactions and/or other capital market driven transactions) must be modified under the *IRB approach*.
- (2) E* must be taken as the *exposure* value of the *exposure* to the counterparty arising from the transactions subject to the master netting agreement referred to in the provisions listed in (1) for the purposes of *BIPRU 4*.

[**Note:** BCD Annex VIII Part 3 point 23 (as it applies to the *IRB approach*)]

Calculating risk weighted exposure amounts and expected loss amounts for funded credit risk mitigation: Other modifications of the rules on credit risk mitigation: Financial collateral comprehensive method

- 4.10.35 R (1) This *rule* sets out how the calculations under *BIPRU 5.4.28R* (Calculating adjusted values under the financial collateral comprehensive method) must be modified under the *IRB approach*.
- (2) E as referred to in the provisions listed in (1) is the *exposure* value as would be determined under the *IRB approach* if the *exposure* was not collateralised. For this purpose, where a *firm* calculates *risk weighted exposure amounts* under the *IRB approach*, the *exposure* value of the items listed in *BIPRU 4.4.37R* to *BIPRU 4.4.39R*, *BIPRU 4.4.45R*, *BIPRU 4.6.44R(3)* and *BIPRU 4.8.29R* must be calculated using a *conversion factor* of 100% rather than the *conversion factors* or percentages indicated in those provisions.
- 4.10.36 R (1) This *rule* sets out the calculation of risk weighted exposure amounts and expected loss amounts under the financial collateral comprehensive method for a *firm* using the *IRB approach*.

- (2) LGD* (the effective *loss given default*) calculated as set out in this paragraph must be taken as the *LGD* for the purposes of *BIPRU 4*.
- (3) $LGD^* = LGD \times (E^*/E)$ where:
- (a) *LGD* is the *loss given default* that would apply to the *exposure* under the *IRB approach* if the *exposure* was not collateralised;
 - (b) *E* is the *exposure* value as calculated under *BIPRU 5.X [provision implementing paragraph 34 of Part 3 of Annex VIII of the Banking Consolidation Directive]* ; and
 - (c) *E** is as calculated under *BIPRU 5.X [provision implementing paragraph 34 of Part 3 of Annex VIII of the Banking Consolidation Directive]* (Calculation of adjusted values under the financial collateral comprehensive method).

[Note: *BCD Annex VIII Part 3 point 61*]

- 4.10.37 R (1) In the case of a *firm* using the *IRB approach* to calculate *risk weighted exposure amounts* and *expected loss* amounts, the *persons* in (2) are added to the list in *BIPRU 5.4.64R* (Definition of core market participant).
- (2) The *persons* referred to in (1) are other financial companies (including insurance companies) *exposures* to which do not have a credit assessment by an *eligible ECAI* and are internally rated as having a *probability of default* equivalent to that associated with the credit assessments of *ECAs* that are associated with *credit quality step 2* or above under the *rules* for the *risk weighting* of *exposures* under the *standardised approach* to credit risk.

[Note: *BCD Annex VIII Part 3 point 58(h)* (as it applies to the *IRB approach*)]

Unfunded credit protection: Eligibility of providers

- 4.10.38 R (1) In the case of a *firm* using the *IRB approach* in calculating *risk weighted exposure amounts* and *expected loss* amounts, the *persons* in (2) are added to the list in *BIPRU 5.7.1R* (List of eligible providers of unfunded credit protection).
- (2) The *persons* referred to in (1) are other corporate entities, including *parent undertakings*, *subsidiary undertakings* and affiliate corporate entities of the *firm*, that do not have a credit assessment by an *eligible ECAI* and are internally rated as having a *probability of default* equivalent to that associated with the credit assessments of *ECAs* that are associated with *credit quality step 2* or above under the *rules* for the *risk weighting* of *exposures* under the *standardised approach* to credit risk.

[Note: *BCD Annex VIII Part 1 point 26(g)(ii)*]

4.10.39 R Where *risk weighted exposure amounts* and *expected loss* amounts are calculated under the *IRB approach*, to be eligible a guarantor must be internally rated by a *firm* in accordance with the provisions of the *minimum IRB standards*.

[Note: BCD Annex VIII Part 1 point 27]

Unfunded credit protection: Minimum requirements for assessing the effect of guarantees and credit derivatives: Introduction

4.10.40 R *BIPRU 4.10.41R* to *BIPRU 4.10.48R* set out the minimum requirements:

(1) assessing the effect of guarantees and credit derivatives for:

(a) *exposures* in the *sovereign, institutional and corporate IRB exposure class* where the *advanced IRB approach* is being used to calculate *LGDs*; and

(b) *retail exposures*; and

(2) additionally, in the case of *retail exposure* guarantees, to the assignment of *exposures* to grades or pools, and the estimation of *PD*.

[Note: BCD Annex VII Part 4 point 97]

4.10.41 R The requirements in *BIPRU 4.10.40R(2)* and *BIPRU 4.10.42R -BIPRU 4.10.48R* do not apply for guarantees provided by *institutions* and central governments and central banks if the *firm* has received approval under *BIPRU 4.2* to apply the *standardised approach* for *exposures* to such entities. In this case the requirements of *BIPRU 5* (credit risk mitigation) apply.

[Note: BCD Annex VII Part 4 point 96]

Unfunded credit protection: Minimum requirements for assessing the effect of guarantees and credit derivatives: Eligible guarantors and guarantees

4.10.42 R A *firm* must have clearly specified criteria for the types of guarantors it recognises for the calculation of *risk weighted exposure amounts*.

[Note: Annex VII Part 4 point 98]

4.10.43 R For recognised guarantors the same requirements as for obligors as set out in *BIPRU 4.3.43R - BIPRU 4.3.48R* (Assignment to grades and pools), *BIPRU 4.4.11R - BIPRU 4.4.18R* and *BIPRU 4.4.51R* (Assignment of exposures and rating systems), *BIPRU 4.5.6R* (Assignment of exposures) and *BIPRU 4.6.11R* and *BIPRU 4.6.14R* (Assignment of exposures and rating systems) apply.

[Note: BCD Annex VII Part 4 point 99]

- 4.10.44 R The guarantee must be evidenced in writing, non-cancellable on the part of the guarantor, in force until the obligation is satisfied in full (to the extent of the amount and tenor of the guarantee) and legally enforceable against the guarantor in a jurisdiction where the guarantor has assets to attach and enforce a judgement. Guarantees prescribing conditions under which the guarantor may not be obliged to perform (conditional guarantees) may be recognised if the *IRB permission* permits this. A *firm* must (in the case of a *firm* with an *IRB permission* that permits conditional guarantees) be able to demonstrate to the *FSA* that the assignment criteria adequately address any potential reduction in the risk mitigation effect.

[Note: *BCD Annex VII Part 4 point 100*]

Unfunded credit protection: Minimum requirements for assessing the effect of guarantees and credit derivatives: Adjustment criteria

- 4.10.45 R A *firm* must have clearly specified criteria for adjusting grades, pools or *LGD* estimates, and in the case of *retail exposures* and eligible purchased receivables, the process of allocating *exposures* to grades or pools, to reflect the impact of guarantees for the calculation of *risk weighted exposure amounts*. These criteria must comply with the minimum requirements referred to in *BIPRU 4.10.43*.

[Note: *BCD Annex VII Part 4 point 101*]

- 4.10.46 R The criteria in *BIPRU 4.10.45R* must be plausible and intuitive. They must address the guarantor's ability and willingness to perform under the guarantee, the likely timing of any payments from the guarantor, the degree to which the guarantor's ability to perform under the guarantee is correlated with the obligor's ability to repay, and the extent to which residual risk to the obligor remains.

[Note: *BCD Annex VII Part 4 point 102*]

Unfunded credit protection: Minimum requirements for assessing the effect of guarantees and credit derivatives: Credit derivatives

- 4.10.47 R The minimum requirements for guarantees set out in *BIPRU 4.10* also apply for single name credit derivatives. In relation to a mismatch between the underlying obligation and the reference obligation of the credit derivative or the obligation used for determining whether a credit event has occurred the requirements set out under *BIPRU 5.7.14R* (Mismatches and credit derivatives) apply. For *retail exposures* and eligible purchased receivables, this paragraph applies to the process of allocating *exposures* to grades or pools.

[Note: *BCD Annex VII Part 4 point 103*]

- 4.10.48 R The criteria applied by *BIPRU 4.10.47R* must address the payout structure of the credit derivative and conservatively assess the impact this has on the level and timing of recoveries. A *firm* must consider the extent to which other forms of residual risk remain.

[Note: *BCD Annex VII Part 4 point 104*]

Unfunded credit protection: Minimum requirements for assessing the effect of guarantees and credit derivatives: Calculating risk weighted exposure amounts and expected loss amounts

- 4.10.49 R (1) This *rule* relates to the calculation of *risk-weighted exposure amounts* and *expected loss* amounts in the case of *unfunded credit protection*.
- (2) *BIPRU 5.7.21R* (Tranching) applies for the purpose in (1).
- (3) The provisions in (4) replace those in *BIPRU 5.7.22R* to *BIPRU 5.7.25R* (Calculating risk weighted exposure amounts under the standardised approach in the case of unfunded credit protection).
- (4) For the covered portion of the *exposure* (based on the adjusted value of the credit protection G_A), the *PD* for the purposes of *BIPRU 4* may be the *PD* of the protection provider, or a *PD* between that of the borrower and that of the guarantor if a full substitution is deemed not to be warranted. In the case of subordinated *exposures* and non-subordinated unfunded protection, the *LGD* to be applied for the purposes of *BIPRU 4* may be that associated with senior claims.
- (5) For any uncovered portion of the *exposure* the *PD* must be that of the borrower and the *LGD* must be that of the underlying *exposure*.
- (6) G_A is the value of G^* as calculated under *BIPRU 5.7.17R* (Valuation of unfunded credit protection) further adjusted for any maturity mismatch as laid down in *BIPRU 4.10.51R* (Maturity mismatches).

[**Note:** *BCD Annex VIII Part 3* points 90 to 92]

Maturity mismatches

- 4.10.50 R In addition to *BIPRU 5.8.2R*, where there is a maturity mismatch the credit protection must not be recognised where the *exposure* is a short term *exposure* specified in the *firm's IRB permission* as being subject to a one-day floor rather than a one-year floor in respect of the maturity value (M) under *BIPRU 4.4.68R*.

[**Note:** *BCD Annex VIII Part 4* point 2(b)]

- 4.10.51 R G_A as calculated under *BIPRU 5.8.11R* is then taken as the value of the protection for the purposes of calculating the effects of *unfunded credit protection* under the *IRB approach*.

[**Note:** *BCD Annex VIII Part 4* point 8 (part)]

BIPRU 4 Annex 1R Supervisory Slotting Criteria for Specialised Lending

This Annex outlines the criteria that must be used to slot a *specialised lending exposure* into the categories in *BIPRU 4.5.6R*.

This table belongs to *BIPRU 4.5.6R* and must be used in accordance with that rule only for project finance exposures.

Table 1 – Supervisory Rating Grades for Project Finance Exposures

	Strong	Good	Satisfactory	Weak
Financial strength				
Market conditions	Few competing suppliers or substantial and durable advantage in location, cost, or technology. Demand is strong and growing	Few competing suppliers or better than average location, cost, or technology but this situation may not last. Demand is strong and stable	Project has no advantage in location, cost, or technology. Demand is adequate and stable	Project has worse than average location, cost, or technology. Demand is weak and declining
Financial ratios (e.g. debt service coverage ratio (DSCR), loan life coverage ratio (LLCR), project life coverage ratio (PLCR), and debt-to-equity ratio)	Strong financial ratios considering the level of project risk; very robust economic assumptions	Strong to acceptable financial ratios considering the level of project risk; robust project economic assumptions	Standard financial ratios considering the level of project risk	Aggressive financial ratios considering the level of project risk

	Strong	Good	Satisfactory	Weak
Stress analysis	The project can meet its financial obligations under sustained, severely stressed economic or sectoral conditions	The project can meet its financial obligations under normal stressed economic or sectoral conditions. The project is only likely to default under severe economic conditions	The project is vulnerable to stresses that are not uncommon through an economic cycle, and may default in a normal downturn	The project is likely to default unless conditions improve soon
<u>Financial structure</u>				
Duration of the credit compared to the duration of the project	Useful life of the project significantly exceeds tenor of the loan	Useful life of the project exceeds tenor of the loan	Useful life of the project exceeds tenor of the loan	Useful life of the project may not exceed tenor of the loan
Amortisation schedule	Amortising debt	Amortising debt	Amortising debt repayments with limited bullet payment	Bullet repayment or amortising debt repayments with high bullet repayment
Political and legal environment				
Political risk, including transfer risk, considering project type and mitigants	Very low exposure; strong mitigation instruments, if needed	Low exposure; satisfactory mitigation instruments, if needed	Moderate exposure; fair mitigation instruments	High exposure; no or weak mitigation instruments
Force majeure risk (war, civil unrest, etc),	Low exposure	Acceptable exposure	Standard protection	Significant risks, not fully mitigated

	Strong	Good	Satisfactory	Weak
Government support and project's importance for the country over the long term	Project of strategic importance for the country (preferably export-oriented). Strong support from Government	Project considered important for the country. Good level of support from Government	Project may not be strategic but brings unquestionable benefits for the country. Support from Government may not be explicit	Project not key to the country. No or weak support from Government
Stability of legal and regulatory environment (risk of change in law)	Favourable and stable regulatory environment over the long term	Favourable and stable regulatory environment over the medium term	Regulatory changes can be predicted with a fair level of certainty	Current or future regulatory issues may affect the project
Acquisition of all necessary supports and approvals for such relief from local content laws	Strong	Satisfactory	Fair	Weak
Enforceability of contracts, collateral and security	Contracts, collateral and security are enforceable	Contracts, collateral and security are enforceable	Contracts, collateral and security are considered enforceable even if certain non-key issues may exist	There are unresolved key issues in respect of actual enforcement of contracts, collateral and security
Transaction characteristics				
Design and technology risk	Fully proven technology and design	Fully proven technology and design	Proven technology and design – start-up issues are mitigated by a strong completion package	Unproven technology and design; technology issues exist and/or complex design

	Strong	Good	Satisfactory	Weak
<u>Construction risk</u>				
Permitting and siting	All permits have been obtained	Some permits are still outstanding but their receipt is considered very likely	Some permits are still outstanding but the permitting process is well defined and they are considered routine	Key permits still need to be obtained and are not considered routine. Significant conditions may be attached
Type of construction contract	Fixed-price date-certain turnkey construction EPC (engineering and procurement contract)	Fixed-price date-certain turnkey construction EPC	Fixed-price date-certain turnkey construction contract with one or several contractors	No or partial fixed-price turnkey contract and/or interfacing issues with multiple contractors
Completion guarantees	Substantial liquidated damages supported by financial substance and/or strong completion guarantee from sponsors with excellent financial standing	Significant liquidated damages supported by financial substance and/or completion guarantee from sponsors with good financial standing	Adequate liquidated damages supported by financial substance and/or completion guarantee from sponsors with good financial standing	Inadequate liquidated damages or not supported by financial substance or weak completion guarantees
Track record and financial strength of contractor in constructing similar projects.	Strong	Good	Satisfactory	Weak

	Strong	Good	Satisfactory	Weak
<u>Operating risk</u> Scope and nature of operations and maintenance (O & M) contracts Operator's expertise, track record, and financial strength	Strong long-term O&M contract, preferably with contractual performance incentives, and/or O&M reserve accounts Very strong, or committed technical assistance of the sponsors	Long-term O&M contract, and/or O&M reserve accounts Strong	Limited O&M contract or O&M reserve account Acceptable	No O&M contract: risk of high operational cost overruns beyond mitigants Limited/weak, or local operator dependent on local authorities
<u>Off-take risk</u> (a) If there is a take-or-pay or fixed-price off-take contract: (b) If there is no take-or-pay or fixed-price off-take contract:	Excellent creditworthiness of off-taker; strong termination clauses; tenor of contract comfortably exceeds the maturity of the debt Project produces essential services or a commodity sold widely on a world market; output can readily be absorbed at projected prices even at lower than historic market growth rates	Good creditworthiness of off-taker; strong termination clauses; tenor of contract exceeds the maturity of the debt Project produces essential services or a commodity sold widely on a regional market that will absorb it at projected prices at historical growth rates	Acceptable financial standing of off-taker; normal termination clauses; tenor of contract generally matches the maturity of the debt Commodity is sold on a limited market that may absorb it only at lower than projected prices	Weak off-taker; weak termination clauses; tenor of contract does not exceed the maturity of the debt Project output is demanded by only one or a few buyers or is not generally sold on an organised market

	Strong	Good	Satisfactory	Weak
<u>Supply risk</u>				
Price, volume and transportation risk of feed-stocks; supplier's track record and financial strength	Long-term supply contract with supplier of excellent financial standing	Long-term supply contract with supplier of good financial standing	Long-term supply contract with supplier of good financial standing – a degree of price risk may remain	Short-term supply contract or long-term supply contract with financially weak supplier – a degree of price risk definitely remains
Reserve risks (e.g. natural resource development)	Independently audited, proven and developed reserves well in excess of requirements over lifetime of the project	Independently audited, proven and developed reserves in excess of requirements over lifetime of the project	Proven reserves can supply the project adequately through the maturity of the debt	Project relies to some extent on potential and undeveloped reserves
Strength of Sponsor				
Sponsor's track record, financial strength, and country/sector experience	Strong sponsor with excellent track record and high financial standing	Good sponsor with satisfactory track record and good financial standing	Adequate sponsor with adequate track record and good financial standing	Weak sponsor with no or questionable track record and/or financial weaknesses
Sponsor support, as evidenced by equity, ownership clause and incentive to inject additional cash if necessary	Strong. Project is highly strategic for the sponsor (core business – long-term strategy)	Good. Project is strategic for the sponsor (core business – long-term strategy)	Acceptable. Project is considered important for the sponsor (core business)	Limited. Project is not key to sponsor's long-term strategy or core business

	Strong	Good	Satisfactory	Weak
Security Package				
Assignment of contracts and accounts	Fully comprehensive	Comprehensive	Acceptable	Weak
Pledge of assets, taking into account quality, value and liquidity of assets	First perfected security interest in all project assets, contracts, permits and accounts necessary to run the project	Perfected security interest in all project assets, contracts, permits and accounts necessary to run the project	Acceptable security interest in all project assets, contracts, permits and accounts necessary to run the project	Little security or collateral for lenders; weak negative pledge clause
Lender's control over cash flow (e.g. cash sweeps, independent escrow accounts)	Strong	Satisfactory	Fair	Weak
Strength of the covenant package (mandatory prepayments, payment deferrals, payment cascade, dividend restrictions...)	Covenant package is strong for this type of project	Covenant package is satisfactory for this type of project	Covenant package is fair for this type of project	Covenant package is insufficient for this type of project
Reserve funds (debt service, O&M, renewal and replacement, unforeseen events, etc)	Project may issue no additional debt	Project may issue extremely limited additional debt	Project may issue limited additional debt	Project may issue unlimited additional debt
	Longer than average coverage period, all reserve funds fully funded in cash or letters of credit from highly rated bank	Average coverage period, all reserve funds fully funded	Average coverage period, all reserve funds fully funded	Shorter than average coverage period, reserve funds funded from operating cash flows

This table belongs to *BIPRU* 4.5.6R and must be used in accordance with that rule only for income-producing real estate exposures

Table 2 – Supervisory Rating Grades for Income-Producing Real Estate Exposures

	Strong	Good	Satisfactory	Weak
Financial strength				
Market conditions	The supply and demand for the project's type and location are currently in equilibrium. The number of competitive properties coming to market is equal or lower than forecasted demand	The supply and demand for the project's type and location are currently in equilibrium. The number of competitive properties coming to market is roughly equal to forecasted demand	Market conditions are roughly in equilibrium. Competitive properties are coming on the market and others are in the planning stages. The project's design and capabilities may not be state of the art compared to new projects	Market conditions are weak. It is uncertain when conditions will improve and return to equilibrium. The project is losing tenants at lease expiration. New lease terms are less favourable compared to those expiring
Financial ratios and advance rate	The property's debt service coverage ratio (DSCR) is considered strong (DSCR is not relevant for the construction phase) and its loan to value ratio (LTV) is considered low given its property type. Where a secondary market exists, the transaction is underwritten to market standards	The DSCR (not relevant for development real estate) and LTV are satisfactory. Where a secondary market exists, the transaction is underwritten to market standards	The property's DSCR has deteriorated and its value has fallen, increasing its LTV	The property's DSCR has deteriorated significantly and its LTV is well above underwriting standards for new loans

	Strong	Good	Satisfactory	Weak
Stress analysis	The property's resources, contingencies and liability structure allow it to meet its financial obligations during a period of severe financial stress (e.g. interest rates, economic growth)	The property can meet its financial obligations under a sustained period of financial stress (e.g. interest rates, economic growth). The property is likely to default only under severe economic conditions	During an economic downturn, the property would suffer a decline in revenue that would limit its ability to fund capital expenditures and significantly increase the risk of default	The property's financial condition is strained and is likely to default unless conditions improve in the near term
Cash-flow predictability				
(a) For complete and stabilised property.	The property's leases are long-term with creditworthy tenants and their maturity dates are scattered. The property has a track record of tenant retention upon lease expiration. Its vacancy rate is low. Expenses (maintenance, insurance, security, and property taxes) are predictable	Most of the property's leases are long-term, with tenants that range in creditworthiness. The property experiences a normal level of tenant turnover upon lease expiration. Its vacancy rate is low. Expenses are predictable	Most of the property's leases are medium rather than long-term with tenants that range in creditworthiness. The property experiences a moderate level of tenant turnover upon lease expiration. Its vacancy rate is moderate. Expenses are relatively predictable but vary in relation to revenue	The property's leases are of various terms with tenants that range in creditworthiness. The property experiences a very high level of tenant turnover upon lease expiration. Its vacancy rate is high. Significant expenses are incurred preparing space for new tenants
(b) For complete but not stabilised property	Leasing activity meets or exceeds projections. The project should achieve stabilisation in the near future	Leasing activity meets or exceeds projections. The project should achieve stabilisation in the near future	Most leasing activity is within projections; however, stabilisation will not occur for some time	Market rents do not meet expectations. Despite achieving target occupancy rate, cash flow coverage is tight due to disappointing revenue

	Strong	Good	Satisfactory	Weak
(c) For construction phase	The property is entirely pre-leased through the tenor of the loan or pre-sold to an investment grade tenant or buyer, or the bank has a binding commitment for take-out financing from an investment grade lender	The property is entirely pre-leased or pre-sold to a creditworthy tenant or buyer, or the bank has a binding commitment for permanent financing from a creditworthy lender	Leasing activity is within projections but the building may not be pre-leased and there may not exist a take-out financing. The bank may be the permanent lender	The property is deteriorating due to cost overruns, market deterioration, tenant cancellations or other factors. There may be a dispute with the party providing the permanent financing
Asset characteristics				
Location	Property is located in highly desirable location that is convenient to services that tenants desire	Property is located in desirable location that is convenient to services that tenants desire	The property location lacks a competitive advantage	The property's location, configuration, design and maintenance have contributed to the property's difficulties
Design and condition	Property is favoured due to its design, configuration, and maintenance, and is highly competitive with new properties	Property is appropriate in terms of its design, configuration and maintenance. The property's design and capabilities are competitive with new properties	Property is adequate in terms of its configuration, design and maintenance	Weaknesses exist in the property's configuration, design or maintenance
Property is under construction	Construction budget is conservative and technical hazards are limited. Contractors are highly qualified	Construction budget is conservative and technical hazards are limited. Contractors are highly qualified	Construction budget is adequate and contractors are ordinarily qualified	Project is over budget or unrealistic given its technical hazards. Contractors may be under qualified

	Strong	Good	Satisfactory	Weak
Strength of Sponsor/Developer				
Financial capacity and willingness to support the property.	The sponsor/developer made a substantial cash contribution to the construction or purchase of the property. The sponsor/developer has substantial resources and limited direct and contingent liabilities. The sponsor/developer's properties are diversified geographically and by property type	The sponsor/developer made a material cash contribution to the construction or purchase of the property. The sponsor/developer's financial condition allows it to support the property in the event of a cash flow shortfall. The sponsor/developer's properties are located in several geographic regions	The sponsor/developer's contribution may be immaterial or non-cash. The sponsor/developer is average to below average in financial resources	The sponsor/developer lacks capacity or willingness to support the property
Reputation and track record with similar properties.	Experienced management and high sponsors' quality. Strong reputation and lengthy and successful record with similar properties	Appropriate management and sponsors' quality. The sponsor or management has a successful record with similar properties	Moderate management and sponsors' quality. Management or sponsor track record does not raise serious concerns	Ineffective management and substandard sponsors' quality. Management and sponsor difficulties have contributed to difficulties in managing properties in the past
Relationships with relevant real estate actors	Strong relationships with leading actors such as leasing agents	Proven relationships with leading actors such as leasing agents	Adequate relationships with leasing agents and other parties providing important real estate services	Poor relationships with leasing agents and/or other parties providing important real estate services

	Strong	Good	Satisfactory	Weak
Security Package				
Nature of lien	Perfected first lien ¹	Perfected first lien ¹	Perfected first lien ¹	Ability of lender to foreclose is constrained
Assignment of rents (for projects leased to long-term tenants)	The lender has obtained an assignment. They maintain current tenant information that would facilitate providing notice to remit rents directly to the lender, such as a current rent roll and copies of the project's leases	The lender has obtained an assignment. They maintain current tenant information that would facilitate providing notice to the tenants to remit rents directly to the lender, such as current rent roll and copies of the project's leases	The lender has obtained an assignment. They maintain current tenant information that would facilitate providing notice to the tenants to remit rents directly to the lender, such as current rent roll and copies of the project's leases	The lender has not obtained an assignment of the leases or has not maintained the information necessary to readily provide notice to the building's tenants
Quality of the insurance coverage	Appropriate	Appropriate	Appropriate	Substandard

¹ Lenders in some markets extensively use loan structures that include junior liens. Junior liens may be indicative of this level of risk if the total LTV inclusive of all senior positions does not exceed a typical first loan LTV.

This table belongs to *BIPRU* 4.5.6R and must be used in accordance with that rule only for object finance exposures

Table 3 – Supervisory Rating Grades for Object Finance Exposures

	Strong	Good	Satisfactory	Weak
Financial strength				
Market conditions	Demand is strong and growing, strong entry barriers, low sensitivity to changes in technology and economic outlook	Demand is strong and stable. Some entry barriers, some sensitivity to changes in technology and economic outlook	Demand is adequate and stable, limited entry barriers, significant sensitivity to changes in technology and economic outlook	Demand is weak and declining, vulnerable to changes in technology and economic outlook, highly uncertain environment
Financial ratios (debt service coverage ratio and loan-to-value ratio)	Strong financial ratios considering the type of asset. Very robust economic assumptions	Strong / acceptable financial ratios considering the type of asset. Robust project economic assumptions	Standard financial ratios for the asset type	Aggressive financial ratios considering the type of asset
Stress analysis	Stable long-term revenues, capable of withstanding severely stressed conditions through an economic cycle	Satisfactory short-term revenues. Loan can withstand some financial adversity. Default is only likely under severe economic conditions	Uncertain short-term revenues. Cash flows are vulnerable to stresses that are not uncommon through an economic cycle. The loan may default in a normal downturn	Revenues subject to strong uncertainties; even in normal economic conditions the asset may default, unless conditions improve
Market liquidity	Market is structured on a worldwide basis; assets are highly liquid	Market is worldwide or regional; assets are relatively liquid	Market is regional with limited prospects in the short term, implying lower liquidity	Local market and/or poor visibility. Low or no liquidity, particularly on niche markets

	Strong	Good	Satisfactory	Weak
Political and legal environment				
Political risk, including transfer risk	Very low; strong mitigation instruments, if needed	Low; satisfactory mitigation instruments, if needed	Moderate; fair mitigation instruments	High; no or weak mitigation instruments
Legal and regulatory risks	Jurisdiction is favourable to repossession and enforcement of contracts	Jurisdiction is favourable to repossession and enforcement of contracts	Jurisdiction is generally favourable to repossession and enforcement of contracts, even if repossession might be long and/or difficult	Poor or unstable legal and regulatory environment. Jurisdiction may make repossession and enforcement of contracts lengthy or impossible
Transaction characteristics				
Financing term compared to the economic life of the asset	Full payout profile/minimum balloon. No grace period	Balloon more significant, but still at satisfactory levels	Important balloon with potentially grace periods	Repayment in fine or high balloon
Operating risk				
Permits / licensing	All permits have been obtained; asset meets current and foreseeable safety regulations	All permits obtained or in the process of being obtained; asset meets current and foreseeable safety regulations	Most permits obtained or in process of being obtained, outstanding ones considered routine, asset meets current safety regulations	Problems in obtaining all required permits, part of the planned configuration and/or planned operations might need to be revised

	Strong	Good	Satisfactory	Weak
Scope and nature of O & M contracts	Strong long-term O&M contract, preferably with contractual performance incentives, and/or O&M reserve accounts (if needed)	Long-term O&M contract, and/or O&M reserve accounts (if needed)	Limited O&M contract or O&M reserve account (if needed)	No O&M contract: risk of high operational cost overruns beyond mitigants
Operator's financial strength, track record in managing the asset type and capability to re-market asset when it comes off-lease	Excellent track record and strong re-marketing capability	Satisfactory track record and re-marketing capability	Weak or short track record and uncertain re-marketing capability	No or unknown track record and inability to re-market the asset
Asset characteristics				
Configuration, size, design and maintenance (i.e. age, size for a plane) compared to other assets on the same market	Strong advantage in design and maintenance. Configuration is standard such that the object meets a liquid market	Above average design and maintenance. Standard configuration, maybe with very limited exceptions - such that the object meets a liquid market	Average design and maintenance. Configuration is somewhat specific, and thus might cause a narrower market for the object	Below average design and maintenance. Asset is near the end of its economic life. Configuration is very specific; the market for the object is very narrow
Resale value	Current resale value is well above debt value	Resale value is moderately above debt value	Resale value is slightly above debt value	Resale value is below debt value
Sensitivity of the asset value and liquidity to economic cycles	Asset value and liquidity are relatively insensitive to economic cycles	Asset value and liquidity are sensitive to economic cycles	Asset value and liquidity are quite sensitive to economic cycles	Asset value and liquidity are highly sensitive to economic cycles

	Strong	Good	Satisfactory	Weak
Strength of sponsor				
Operator's financial strength, track record in managing the asset type and capability to re-market asset when it comes off-lease	Excellent track record and strong re-marketing capability	Satisfactory track record and re-marketing capability	Weak or short track record and uncertain re-marketing capability	No or unknown track record and inability to re-market the asset
Sponsors' track record and financial strength	Sponsors with excellent track record and high financial standing	Sponsors with good track record and good financial standing	Sponsors with adequate track record and good financial standing	Sponsors with no or questionable track record and/or financial weaknesses
Security Package				
Asset control	Legal documentation provides the lender effective control (e.g. a first perfected security interest, or a leasing structure including such security) on the asset, or on the company owning it	Legal documentation provides the lender effective control (e.g. a perfected security interest, or a leasing structure including such security) on the asset, or on the company owning it	Legal documentation provides the lender effective control (e.g. a perfected security interest, or a leasing structure including such security) on the asset, or on the company owning it	The contract provides little security to the lender and leaves room to some risk of losing control on the asset
Rights and means at the lender's disposal to monitor the location and condition of the asset	The lender is able to monitor the location and condition of the asset, at any time and place (regular reports, possibility to lead inspections)	The lender is able to monitor the location and condition of the asset, almost at any time and place	The lender is able to monitor the location and condition of the asset, almost at any time and place	The lender is able to monitor the location and condition of the asset are limited

	Strong	Good	Satisfactory	Weak
Insurance against damages	Strong insurance coverage including collateral damages with top quality insurance companies	Satisfactory insurance coverage (not including collateral damages) with good quality insurance companies	Fair insurance coverage (not including collateral damages) with acceptable quality insurance companies	Weak insurance coverage (not including collateral damages) or with weak quality insurance companies

This table belongs to *BIPRU* 4.5.6R and must be used in accordance with that rule only for commodities finance exposures.

Table 4 – Supervisory Rating Grades for Commodities Finance Exposures

	Strong	Good	Satisfactory	Weak
Financial strength				
Degree of over-collateralisation of trade	Strong	Good	Satisfactory	Weak
Political and legal environment				
Country risk	No country risk	Limited exposure to country risk (in particular, offshore location of reserves in an emerging country)	Exposure to country risk (in particular, offshore location of reserves in an emerging country)	Strong exposure to country risk (in particular, inland reserves in an emerging country)
Mitigation of country risks	Very strong mitigation: Strong offshore mechanisms Strategic commodity 1 st class buyer	Strong mitigation: Offshore mechanisms Strategic commodity Strong buyer	Acceptable mitigation: Offshore mechanisms Less strategic commodity Acceptable buyer	Only partial mitigation: No offshore mechanisms Non-strategic commodity Weak buyer

	Strong	Good	Satisfactory	Weak
Asset characteristics				
Liquidity and susceptibility to damage	Commodity is quoted and can be hedged through futures or OTC instruments. Commodity is not susceptible to damage	Commodity is quoted and can be hedged through OTC instruments. Commodity is not susceptible to damage	Commodity is not quoted but is liquid. There is uncertainty about the possibility of hedging. Commodity is not susceptible to damage	Commodity is not quoted. Liquidity is limited given the size and depth of the market. No appropriate hedging instruments. Commodity is susceptible to damage
Strength of sponsor				
Financial strength of trader	Very strong, relative to trading philosophy and risks	Strong	Adequate	Weak
Track record, including ability to manage the logistic process	Extensive experience with the type of transaction in question. Strong record of operating success and cost efficiency	Sufficient experience with the type of transaction in question. Above average record of operating success and cost efficiency	Limited experience with the type of transaction in question. Average record of operating success and cost efficiency	Limited or uncertain track record in general. Volatile costs and profits
Trading controls and hedging policies	Strong standards for counterparty selection, hedging, and monitoring	Adequate standards for counterparty selection, hedging, and monitoring	Past deals have experienced no or minor problems	Trader has experienced significant losses on past deals
Quality of financial disclosure	Excellent	Good	Satisfactory	Financial disclosure contains some uncertainties or is insufficient

	Strong	Good	Satisfactory	Weak
Security package				
Asset control	First perfected security interest provides the lender legal control of the assets at any time if needed	First perfected security interest provides the lender legal control of the assets at any time if needed	At some point in the process, there is a rupture in the control of the assets by the lender. The rupture is mitigated by knowledge of the trade process or a third party undertaking as the case may be	Contract leaves room for some risk of losing control over the assets. Recovery could be jeopardised
Insurance against damages	Strong insurance coverage including collateral damages with top quality insurance companies	Satisfactory insurance coverage (not including collateral damages) with good quality insurance companies	Fair insurance coverage (not including collateral damages) with acceptable quality insurance companies	Weak insurance coverage (not including collateral damages) or with weak quality insurance companies

- 5 Credit risk mitigation
- 5.1 Application and purpose
 - Application
 - 5.1.1 R *BIPRU 5 applies to a BIPRU firm.*
 - Purpose
 - 5.1.2 G *BIPRU 5 implements, in part, Articles 78(1) and 91 to 93 and Annex VIII of the Banking Consolidation Directive.*
 - 5.1.3 G *BIPRU 5 sets out the principles for the recognition of credit risk mitigation in the calculation of risk weighted exposure amounts for the purposes of the calculation of the credit risk capital component.*
 - 5.1.4 G *BIPRU 4.10 implements those parts of Articles 91 to 93 and Annex VIII of the Banking Consolidation Directive which are specific to the recognition of credit risk mitigation by firms using the IRB approach, and modifies the application of the provisions in BIPRU 5 to those firms.*
 - 5.1.5 G *In certain cases provisions specific to the IRB approach have been kept in BIPRU 5 in order to reduce duplication. The main examples are certain references to expected loss and references in the IRB approach in the provisions in BIPRU 5.7 about basket CRM techniques.*

- 5.2 The central principles of credit risk mitigation
- 5.2.1 R A *firm* using the *standardised approach* may recognise *credit risk mitigation* in accordance with *BIPRU 5* in the calculation of *risk weighted exposure amounts* for the purposes of the calculation of the *credit risk capital component*.
- [Note: *BCD* Article 91]
- 5.2.2 R The technique used to provide the credit protection together with the actions and steps taken and procedures and policies implemented by a *lending firm* must be such as to result in credit protection arrangements which are legally effective and enforceable in all relevant jurisdictions.
- [Note: *BCD* Article 92(1)]
- 5.2.3 R (1) A *firm* must not recognise credit protection as eligible until it has conducted sufficient legal review confirming that the credit protection arrangements are legally effective and enforceable in all relevant jurisdictions in accordance with *BIPRU 5.2.2.R*.
- (2) A *firm* must re-conduct legal reviews as necessary to ensure continuing enforceability and effectiveness.
- 5.2.4 R A *lending firm* must take all appropriate steps to ensure the effectiveness of the credit protection arrangement and to address related risks.
- [Note: *BCD* Article 92(2)]
- Funded credit protection
- 5.2.5 R In the case of *funded credit protection*:
- (1) to be eligible for recognition the assets relied upon must be sufficiently liquid and their value over time sufficiently stable to provide appropriate certainty as to the credit protection achieved having regard to the approach used to calculate *risk weighted exposure amounts* and to the degree of recognition allowed; eligibility is limited to the assets set out in the *CRM eligibility conditions*; and
- (2) the *lending firm* must have the right to liquidate or retain, in a timely manner, the assets from which the protection derives in the event of the default, insolvency or bankruptcy of the obligor - or other credit event set out in the transaction documentation - and, where applicable, of the custodian holding the collateral; the degree of correlation between the value of the assets relied upon for protection and the credit quality of the obligor must not be undue.

[Note: BCD Article 92(3) and (4)]

Treatment of credit linked notes

- 5.2.6 G A credit linked note should be treated, to the extent of its cash funding, as *funded credit protection*. Therefore the conditions in *BIPRU 5* regulating the eligibility of protection providers for *unfunded credit protection* do not apply. However the other provisions about the requirements for the recognition of *unfunded credit protection* do apply.

Unfunded credit protection

- 5.2.7 R In the case of *unfunded credit protection*:
- (1) to be eligible for recognition the party giving the undertaking must be sufficiently reliable, and the protection agreement legally effective and enforceable in the relevant jurisdictions, to provide appropriate certainty as to the credit protection achieved having regard to the approach used to calculate *risk weighted exposure amounts* and to the degree of recognition allowed; and
 - (2) eligibility is limited to the protection providers and types of protection agreement set out in the *CRM eligibility conditions*.

[Note: BCD Article 92(5)]

Minimum requirements

- 5.2.8 R The minimum requirements set out in *BIPRU 5* must be complied with.

[Note: BCD Article 92(6)]

- 5.2.9 R A *firm* must be able to satisfy the *FSA* that it has adequate risk management processes to control those risks to which the *firm* may be exposed as a result of carrying out *credit risk mitigation*.

[Note: BCD Annex VIII Part 2 point 1]

- 5.2.10 R Notwithstanding the presence of *credit risk mitigation* taken into account for the purposes of calculating *risk-weighted exposure amounts* and as relevant *expected loss* amounts, a *firm* must continue to undertake full credit risk assessment of the underlying *exposure* and must be in a position to demonstrate to the *FSA* the fulfilment of this requirement. In the case of *repurchase transactions* and/or *securities or commodities lending or borrowing transactions* the underlying *exposure* must, for the purposes of this *rule* only, be deemed to be the net amount of the *exposure*.

[Note: BCD Annex VIII Part 2 point 2]

Calculating the effects of the credit risk mitigation

- 5.2.11 R Where the requirements of *BIPRU 5.2.2R* to *BIPRU 5.2.8R* are met the calculation of *risk-weighted exposure amounts*, may be modified in accordance with *BIPRU 5*.
- [Note: *BCD Article 93(1)*]
- 5.2.12 R No *exposure* in respect of which *credit risk mitigation* is obtained may produce a higher *risk-weighted exposure amount* than an otherwise identical *exposure* in respect of which there is no *credit risk mitigation*.
- [Note: *BCD Article 93(2)*]
- 5.2.13 R Where the *risk-weighted exposure amount* already takes account of credit protection under the *standardised approach* the calculation of the credit protection must not be further recognised under *BIPRU 5*.
- [Note: *BCD Article 93(3)*]
- 5.2.14 R Subject to *BIPRU 5.8R*, *BIPRU 5.9R* and *BIPRU 5.7.27R* to *BIPRU 5.7.28R*, where the *CRM eligibility conditions* and the *CRM minimum requirements* are satisfied, the calculation of *risk weighted exposure amounts* under the *standardised approach* may be modified in accordance with the provisions of *BIPRU 5*.
- [Note: *BCD Annex VIII Part 3 point 1*]
- 5.2.15 R Cash, *securities* or *commodities* purchased, borrowed or received under a *repurchase transaction* or *securities or commodities lending or borrowing transaction* must be treated as collateral.
- [Note: *BCD Annex VIII Part 3 point 2*]

5.3 On balance sheet netting

Eligibility

- 5.3.1 R A *firm* may recognise as eligible the on-balance sheet netting of mutual claims between the *firm* and its counterparty.

[Note: BCD Annex VIII Part 1 point 3]

- 5.3.2 R Without prejudice to BIPRU 5.6.1R, eligibility is limited to reciprocal cash balances between a *firm* and a counterparty. Only loans and deposits of the *lending firm* may be subject to a modification of *risk weighted exposure amounts* and, as relevant, *expected loss* amounts as a result of an on-balance sheet netting agreement.

[Note: BCD Annex VIII Part 1 point 4]

Minimum requirements

- 5.3.3 R For on-balance sheet netting agreements - other than master netting agreements covering *repurchase transactions, securities or commodities lending or borrowing transactions* and/or other *capital market-driven transactions* - to be recognised for the purposes of BIPRU 5 the following conditions must be satisfied:

- (1) they must be legally effective and enforceable in all relevant jurisdictions, including in the event of the insolvency or bankruptcy of a counterparty;
- (2) the *firm* must be able to determine at any time those assets and liabilities that are subject to the on-balance sheet netting agreement;
- (3) the *firm* must monitor and control the risks associated with the termination of the credit protection; and
- (4) the *firm* must monitor and control the relevant *exposures* on a net basis.

[Note: BCD Annex VIII Part 2 point 3]

Calculating the effects of credit risk mitigation

- 5.3.4 R Loans and deposits with a *lending firm* subject to on-balance sheet netting are to be treated as cash collateral.

[Note: BCD Annex VIII Part 3 point 4]

5.4 Financial collateral

Eligibility

- 5.4.1 R (1) Where the *credit risk mitigation* used relies on the right of a *firm* to liquidate or retain assets, eligibility depends upon whether *risk-weighted exposure amounts*, and, as relevant, *expected loss* amounts, are calculated under the *standardised approach* or the *IRB approach*.
- (2) Eligibility further depends upon whether the *financial collateral simple method* is used or the *financial collateral comprehensive method*.
- (3) In relation to *repurchase transactions* and *securities or commodities lending or borrowing transactions*, eligibility also depends upon whether the transaction is booked in the *non-trading book* or the *trading book*.

[Note: BCD Annex VIII Part 1 point 6]

- 5.4.2 R The following financial items may be recognised as eligible collateral under all approaches and methods:
- (1) cash on deposit with, or *cash assimilated instruments* held by, the *lending firm*;
- (2) *debt securities* issued by central governments or *central banks* which *securities* have a credit assessment by an *eligible ECAI* or export credit agency recognised as eligible for the purposes of the *standardised approach*, which is associated with *credit quality step 4* or above under the *rules* for the *risk weighting* of *exposures* to central governments and *central banks* under the *standardised approach*;
- (3) *debt securities* issued by *institutions* which *securities* have a credit assessment by an *eligible ECAI* associated with *credit quality step 3* or above under the *rules* for the *risk weighting* of *exposures* to a *credit institution* under the *standardised approach*;
- (4) *debt securities* issued by other entities which *securities* have a credit assessment by an *eligible ECAI* associated with *credit quality step 3* or above under the *rules* for the *risk weighting* of *exposures* to *corporates* under the *standardised approach*;
- (5) *debt securities* with a short-term credit assessment by an *eligible ECAI* associated with *credit quality step 3* or above under the *rules* for the *risk weighting* of *short term exposures* under the *standardised approach*;

- (6) equities or *convertible* bonds that are included in a main index; and
- (7) gold.

[Note: BCD Annex VIII Part 1 point 7 (part)]

5.4.3 R For the purposes of BIPRU 5.4.2R(2), ‘*debt securities* issued by central governments or *central banks*’ include –

- (1) *debt securities* issued by regional governments or local authorities *exposures* to which are treated as *exposures* to the central government in whose jurisdiction they are established under the *standardised approach*;
- (2) *debt securities* issued by *public sector entities* which are treated as *exposures* to central governments in accordance with BIPRU 3.4.24R;
- (3) *debt securities* issued by *multilateral development banks* to which a 0% *risk weight* is assigned under the *standardised approach*; and
- (4) *debt securities* issued by *international organisations* which are assigned a 0% *risk weight* under the *standardised approach*.

[Note: BCD Annex VIII Part 1 point 7 (part)]

5.4.4 R For the purposes of BIPRU 5.4.2R(3), ‘*debt securities* issued by *institutions*’ include:

- (1) *debt securities* issued by regional governments or local authorities other than those *exposures* to which are treated as *exposures* to the central government in whose jurisdiction they are established under the *standardised approach*;
- (2) *debt securities* issued by *public sector entities*, *exposures* to which are treated as *exposures* to a *credit institution* under the *standardised approach*;
- (3) *debt securities* issued by *multilateral development banks* other than those to which a 0% *risk weight* is assigned under the *standardised approach*.

[Note: BCD Annex VIII Part 1 point 7 (part)]

5.4.5 R *Debt securities* issued by *institutions* which *securities* do not have a credit assessment by an *eligible ECAI* may be recognised as eligible collateral if they fulfil the following criteria:

- (1) they are listed on a *recognised investment exchange* or a *designated investment exchange*;

- (2) they qualify as senior debt;
- (3) all other rated issues by the issuing *institution* of the same seniority have a credit assessment by an *eligible ECAI* associated with *credit quality step 3* or above under the *rules* for the *risk weighting* of *exposures to institutions* or short term *exposures* under the *standardised approach*;
- (4) the *lending firm* has no information to suggest that the issue would justify a credit assessment below that indicated in (3); and
- (5) the *firm* can demonstrate to the *FSA* that the market liquidity of the instrument is sufficient for these purposes.

[**Note:** *BCD Annex VIII Part 1 point 8*]

- 5.4.6 R (1) Units in *CIUs* may be recognised as eligible collateral if the following conditions are satisfied:
- (a) they have a daily public price quote; and
 - (b) the *CIU* is limited to investing in instruments that are eligible for recognition under *BIPRU 5.4.2R* to *BIPRU 5.4.5R*.
- (2) The use (or potential use) by a *CIU* of derivative instruments to hedge permitted investments shall not prevent units in that *CIU* from being eligible.

[**Note:** *BCD Annex VIII Part 1 point 9*]

- 5.4.7 R In relation to *BIPRU 5.4.2R(2)* to (5):
- (1) where a *security* has two credit assessments by *eligible ECAs*, the less favourable assessment must be deemed to apply;
 - (2) in cases where a *security* has more than two credit assessments by *eligible ECAs*:
 - (a) the two most favourable assessments must be deemed to apply; or
 - (b) if the two most favourable credit assessments are different, the less favourable of the two must be deemed to apply.

[**Note:** *BCD Annex VIII Part 1 point 10*]

- 5.4.8 R (1) In addition to the collateral set out in *BIPRU 5.4.2R* to *BIPRU 5.4.7R*, where a *firm* uses the *financial collateral comprehensive method*, the following financial items may be recognised as eligible collateral:
- (a) equities or *convertible* bonds not included in a main index but traded on a *recognised investment exchange* or a *designated investment exchange*;
 - (b) units in *CIUs* if the following conditions are met:
 - (i) they have a daily public price quote; and
 - (ii) the *CIU* is limited to investing in instruments that are eligible for recognition under *BIPRU 5.4.2R* to *BIPRU 5.4.5R* and the items mentioned in (a).
- (2) The use (or potential use) by a *CIU* of derivative instruments to hedge permitted investments shall not prevent units in that *CIU* from being eligible.

[**Note:** *BCD Annex VIII Part 1 point 11*]

Minimum requirements

- 5.4.9 R For the recognition of financial collateral and gold, the following conditions must be met:
- (1) the low correlation conditions in *BIPRU 5.4.10R*
 - (2) the legal certainty conditions in *BIPRU 5.4.11R*; and
 - (3) the operational requirements in *BIPRU 5.4.12R*.

[**Note:** *BCD Annex VIII Part 2 point 6*]

- 5.4.10 R The low correlation conditions referred to in *BIPRU 5.4.9R(1)* are as follows:
- (1) (a) the credit quality of the obligor and the value of the collateral must not have a material positive correlation; and
 - (b) *securities* issued by the obligor, or any related *group* entity are not eligible.

- (2) notwithstanding (1)(b), the obligor's own issues of *covered bonds* falling within the terms of *BIPRU 3.4.107R* to *BIPRU 3.4.109R* may be recognised as collateral for *repurchase transactions*, provided that (1)(a) is complied with.

[**Note:** *BCD Annex VIII Part 2 point 6(a)*]

5.4.11 R The legal certainty conditions referred to in *BIPRU 5.4.9R(2)* are as follows:

- (1) a *firm* must fulfil any contractual and statutory requirements in respect of, and take all steps necessary to ensure, the enforceability of the collateral arrangements under the law applicable to its interest in the collateral;
- (2) in accordance with the general principle in *BIPRU 5.2.2R*, a *firm* must have conducted sufficient legal review confirming the enforceability of the collateral arrangements in all relevant jurisdictions; and
- (3) a *firm* must re-conduct such review as necessary to ensure continuing enforceability.

[**Note:** *BCD Annex VIII Part 2 point 6(b)*]

5.4.12 R The operational requirements referred to in *BIPRU 5.4.9R(3)* are as follows:

- (1) the collateral arrangements must be properly documented, with a clear and robust procedure for the timely liquidation of collateral;
- (2) a *firm* must employ robust procedures and processes to control risks arising from the use of collateral – including risks of failed or reduced credit protection, valuation risks, risks associated with the termination of the credit protection, concentration risk arising from the use of collateral and the interaction with the *firm*'s overall risk profile;
- (3) a *firm* must have documented policies and practices concerning the types and amounts of collateral accepted;
- (4) a *firm* must calculate the market value of the collateral, and revalue it accordingly, with a minimum frequency of once every six months and whenever the *firm* has reason to believe that there has occurred a significant decrease in its market value; and
- (5) where the collateral is held by a third party, a *firm* must take reasonable steps to ensure that the third party segregates the collateral from its own assets.

[**Note:** *BCD Annex VIII Part 2 point 6(c)*]

- 5.4.13 R In addition to the requirements set out in *BIPRU 5.4.9R*, for the recognition of financial collateral under the *financial collateral simple method* the residual maturity of the protection must be at least as long as the residual maturity of the *exposure*.

[**Note:** *BCD Annex VIII Part 2 point 7*]

The financial collateral simple method: General

- 5.4.14 R *BIPRU 5.4.17R - BIPRU 5.4.22R* set out the calculation of the effects of *credit risk mitigation* under the *financial collateral simple method*.

- 5.4.15 R The *financial collateral simple method* is available only where *risk weighted exposure amounts* are calculated under the *standardised approach* to credit risk.

[**Note:** *BCD Annex VIII Part 3 point 24 (part)*]

- 5.4.16 R A *firm* must not use both the *financial collateral simple method* and the *financial collateral comprehensive method*.

[**Note:** *BCD Annex VIII Part 3 point 24 (part)*]

The financial collateral simple method: Valuation

- 5.4.17 R Under the *financial collateral simple method*, recognised financial collateral is assigned a value equal to its market value as determined in accordance with *BIPRU 5.4.12R*.

[**Note:** *BCD Annex VIII Part 3 point 25*]

The financial collateral simple method: Calculating risk-weighted exposure amounts

- 5.4.18 R The *risk weight* that would be assigned under the *standardised approach* to credit risk if the *lending firm* had a direct *exposure* to the collateral instrument must be assigned to those portions of claims collateralised by the market value of recognised collateral. The *risk weight* of the collateralised portion must be a minimum of 20% except as specified in *BIPRU 5.4.19R* to *BIPRU 5.4.21R*. The remainder of the *exposure* receives the *risk weight* that would be applied to an unsecured *exposure* to the counterparty under the *standardised approach*.

[**Note:** *BCD Annex VIII Part 3 point 26*]

The financial collateral simple method: Repurchase transactions and securities lending or borrowing transactions

- 5.4.19 R A *risk weight* of 0% must be assigned to the collateralised portion of the *exposure* arising from transactions which fulfil the criteria enumerated in *BIPRU 5.4.62R* or *BIPRU 5.4.65R*. If the counterparty to the transaction is not a *core market participant* a *risk weight* of 10% must be assigned.

[**Note:** *BCD Annex VIII Part 3 point 27*]

The financial collateral simple method: financial derivative instruments subject to daily mark-to-market

- 5.4.20 R A *risk weight* of 0% must, to the extent of the collateralisation, be assigned to the *exposure* values determined under *BIPRU 13* for *financial derivative instruments* and subject to daily marking-to-market, collateralised by cash or *cash-assimilated instruments* where there is no currency mismatch. A *risk weight* of 10% must be assigned to the extent of the collateralisation to the *exposure* values of such transactions collateralised by *debt securities* issued by central governments or *central banks* which are assigned a 0% *risk weight* under the *standardised approach*.

[**Note:** *BCD Annex VIII Part 3 point 28 (part)*]

- 5.4.21 R A 0% *risk weight* may be assigned where the *exposure* and the collateral are denominated in the same currency, and either:

- (1) the collateral is cash on deposit or a *cash assimilated instrument*; or
- (2) the collateral is in the form of *debt securities* issued by central governments or *central banks* eligible for a 0% *risk weight* under the *standardised approach*, and its market value has been discounted by 20%.

[**Note:** *BCD Annex VIII Part 3 point 29*]

- 5.4.22 R For the purposes of *BIPRU 5.4.20R* and *BIPRU 5.4.21R* '*debt securities* issued by central governments or *central banks*' must include:

- (1) *debt securities* issued by regional governments or local authorities *exposures* to which are treated as *exposures* to the central government in whose jurisdiction they are established under the *standardised approach*;
- (2) *debt securities* issued by *multilateral development banks* to which a 0% *risk weight* is assigned under or by virtue of the *standardised approach*; and
- (3) *debt securities* issued by *international organisations* which are assigned a 0% *risk weight* under the *standardised approach*.

[Note: BCD Annex VIII Part 3 point 28 (part)]

The financial collateral comprehensive method: General

5.4.23 R *BIPRU 5.4.24R - BIPRU 5.4.66R* set out the calculation of the effects of *credit risk mitigation* under the *financial collateral comprehensive method*.

5.4.24 R In valuing financial collateral for the purposes of the *financial collateral comprehensive method*, volatility adjustments must be applied to the market value of collateral, as set out in *BIPRU 5.4.30R* to *BIPRU 5.4.65R*, in order to take account of price volatility.

[Note: BCD Annex VIII Part 3 point 30]

5.4.25 R Subject to the treatment for currency mismatches in the case of *financial derivative instruments* set out in *BIPRU 5.4.26*, where collateral is denominated in a currency that differs from that in which the underlying *exposure* is denominated, an adjustment reflecting currency volatility must be added to the volatility adjustment appropriate to the collateral as set out in *BIPRU 5.4.30R* to *BIPRU 5.4.65R*.

[Note: BCD Annex VIII Part 3 point 31]

5.4.26 R In the case of *financial derivative instruments* covered by netting agreements recognised under *BIPRU 13*, a volatility adjustment reflecting currency volatility must be applied when there is a mismatch between the collateral currency and the settlement currency. Even in the case where multiple currencies are involved in the transactions covered by the netting agreement, only a single volatility adjustment may be applied.

[Note: BCD Annex VIII Part 3 point 32]

5.4.27 R In the case of a *firm* using the *financial collateral comprehensive method*, where an *exposure* takes the form of securities or *commodities* sold, posted or lent under a *repurchase transaction* or under a *securities or commodities lending or borrowing transaction*, and *margin lending transactions* the *exposure* value must be increased by the volatility adjustment appropriate to such securities or *commodities* as prescribed in *BIPRU 5.4.30R* to *BIPRU 5.4.65R*.

[Note: BCD Article 78(1), third sentence]

The financial collateral comprehensive method: Calculating adjusted values

- 5.4.28 R (1) The volatility-adjusted value of the collateral to be taken into account is calculated as follows in the case of all transactions except those transactions subject to recognised master netting agreements to which the provisions set out in *BIPRU 5.6.5R* to *BIPRU 5.6.29R* are to be applied:

$$C_{VA} = C \times (1 - H_C - H_{FX})$$

- (2) The volatility-adjusted value of the *exposure* to be taken into account is calculated as follows:

$$E_{VA} = E \times (1 + H_E), \text{ and in the case of } \textit{financial derivative instruments} \\ E_{VA} = E.$$

- (3) The fully adjusted value of the *exposure*, taking into account both volatility and the risk-mitigating effects of collateral is calculated as follows:

$$E^* = \max \{0, [E_{VA} - C_{VAM}]\}$$

Where:

- (a) E is the *exposure* value as would be determined under the *standardised approach* if the *exposure* was not collateralised.
 - (b) E_{VA} is the volatility-adjusted *exposure* amount.
 - (c) C_{VA} is the volatility-adjusted value of the collateral.
 - (d) C_{VAM} is C_{VA} further adjusted for any maturity mismatch in accordance with the provisions of *BIPRU 5.8*.
 - (e) H_E is the volatility adjustment appropriate to the *exposure* (E), as calculated under *BIPRU 5.4.30R* to *BIPRU 5.4.65R*.
 - (f) H_C is the volatility adjustment appropriate for the collateral, as calculated under *BIPRU 5.4.30R* to *BIPRU 5.4.65R*.
 - (g) H_{FX} is the volatility adjustment appropriate for currency mismatch, as calculated under *BIPRU 5.4.30R* to *BIPRU 5.4.65R*.
 - (h) E^* is the fully adjusted *exposure* value taking into account volatility and the risk-mitigating effects of the collateral.
- (4) For the purpose of (3)(a), for a *firm* calculating *risk weighted exposure amounts* under the *standardised approach* the *exposure* value of off-balance sheet items listed in *BIPRU 3.7* must be 100% of its value rather than the percentages indicated in *BIPRU 3.2.1R* and *BIPRU 3.7.2R*.

[Note: BCD Annex VIII Part 3 point 33]

The financial collateral comprehensive method: Calculation of volatility adjustments to be applied: General

- 5.4.29 R *BIPRU 5.4.30R - BIPRU 5.4.65R set out the calculation of volatility adjustments under the financial collateral comprehensive method.*
- 5.4.30 R Volatility adjustments may be calculated in two ways: the *supervisory volatility adjustments approach* and the *own estimates of volatility adjustments approach*.

[Note: BCD Annex VIII Part 3 point 34]

- 5.4.31 R A *firm* may choose to use the *supervisory volatility adjustments approach* or the *own estimates of volatility adjustments approach* independently of the choice it has made between the *standardised approach* and the *IRB approach* for the calculation of *risk-weighted exposure amounts*. However, if a *firm* seeks to use the *own estimates of volatility adjustments approach*, it must do so for the full range of instrument types, excluding immaterial portfolios where it may use the *supervisory volatility adjustments approach*.

[Note: BCD Annex VIII Part 3 point 35 (part)]

- 5.4.32 R Where the collateral consists of a number of recognised items, the volatility adjustment must be

$$(H = \sum_i \alpha_i H_i)$$

where:

- (1) α_i is the proportion of an item to the collateral as a whole; and
- (2) H_i is the volatility adjustment applicable to that item.

[Note: BCD Annex VIII Part 3 point 35 (part)]

The financial collateral comprehensive method: Supervisory volatility adjustments approach

- 5.4.33 R *BIPRU 5.4.34R - BIPRU 5.4.43R set out the calculation of volatility adjustments under the supervisory volatility adjustments approach.*
- 5.4.34 R The volatility adjustments to be applied under the *supervisory volatility adjustments approach* (assuming daily revaluation) are those set out in the tables in *BIPRU 5.4.35R - BIPRU 5.4.38R*.

[Note: BCD Annex VIII Part 3 point 36]

Table: Volatility adjustments for debt securities described in BIPRU 5.4.2R(2) and (3) – (4)

5.4.35 R This table belongs to *BIPRU* 5.4.34R .

<i>Credit quality step</i> with which the credit assessment of the <i>debt security</i> is associated	Residual Maturity	Volatility adjustments for <i>debt securities</i> issued by entities described in <i>BIPRU</i> 5.4.2R(2)			Volatility adjustments for <i>debt securities</i> issued by entities described in <i>BIPRU</i> 5.4.2R(3) and (4)		
		20 day liquidation period (%)	10 day liquidation period (%)	5 day liquidation period (%)	20 day liquidation period (%)	10 day liquidation period (%)	5 day liquidation period (%)
1	≤ 1 year	0.707	0.5	0.354	1.414	1	0.707
	<1 ≤ 5 years	2.828	2	1.414	5.657	4	2.828
	> 5 years	5.657	4	2.828	11.314	8	5.657
2-3	≤ 1 year	1.414	1	0.707	2.828	2	1.414
	> 1 ≤ 5 years	4.243	3	2.121	8.485	6	4.243
	> 5 years	8.485	6	4.243	16.971	12	8.485
4	≤ 1 year	21.213	15	10.607	N/A	N/A	N/A
	> 1 ≤ 5 years	21.213	15	10.607	N/A	N/A	N/A
	> 5 years	21.213	15	10.607	N/A	N/A	N/A

Table: Volatility adjustments for debt securities described in BIPRU 5.4.2R(5)

5.4.36 R This table belongs to *BIPRU* 5.4.34R.

<i>Credit quality step</i> with which the credit assessment of a short term debt security is associated	Volatility adjustments for <i>debt securities</i> issued by entities described in <i>BIPRU</i> 5.4.2R(2) with short-term credit assessments			Volatility adjustments for <i>debt securities</i> issued by entities described in <i>BIPRU</i> 5.4.2R(3) and (4) with short-term credit assessments		
	20 day liquidation period (%)	10 day liquidation period (%)	5 day liquidation period (%)	20 day liquidation period (%)	10 day liquidation period (%)	5 day liquidation period (%)
1	0.707	0.5	0.354	1.414	1	0.707
2-3	1.414	1	0.707	2.828	2	1.414

Table: Volatility adjustments for other collateral or exposure types

This table belongs to *BIPRU* 5.4.34R.

5.4.37

Other collateral or <i>exposure</i> types			
	20 day liquidation period (%)	10 day liquidation period (%)	5 day liquidation period (%)
Main index equities, main index <i>convertible</i> bonds	21.213	15	10.607
Other equities or <i>convertible</i> bonds listed on a <i>recognised investment exchange</i> or <i>designated investment exchange</i>	35.355	25	17.678
Cash	0	0	0
Gold	21.213	15	10.607

Table: Volatility adjustments for currency mismatch

5.4.38 R This table belongs to *BIPRU 5.4.34R*.

Volatility adjustment for currency mismatch		
20 day liquidation period (%)	10 day liquidation period (%)	5 day liquidation period (%)
11.314	8	5.657

- 5.4.39 R (1) For *secured lending transactions* the liquidation period is 20 business days.
- (2) For *repurchase transactions* (except insofar as such transactions involve the transfer of *commodities* or guaranteed rights relating to title to *commodities*) and *securities lending or borrowing transactions* the liquidation period is 5 business days.
- (3) For other *capital market driven transactions*, the liquidation period is 10 business days.

[**Note:** *BCD Annex VIII Part 3 point 37*]

5.4.40 R In the tables in *BIPRU 5.4.35R - BIPRU 5.4.38R* and in *BIPRU 5.4.41R to BIPRU 5.4.43R*, the *credit quality step* with which a credit assessment of the *debt security* is associated is the *credit quality step* with which the external credit assessment is associated under the *standardised approach*. For the purposes of this *rule*, *BIPRU 5.4.7R* also applies.

[**Note:** *BCD Annex VIII Part 3 point 38*]

5.4.41 R For non-eligible *securities* or for *commodities* lent or sold under *repurchase transactions* or *securities or commodities lending or borrowing transactions*, the volatility adjustment is the same as for non-main index equities listed on a *recognised investment exchange* or a *designated investment exchange*.

[**Note:** *BCD Annex VIII Part 3 point 39*]

5.4.42 R For eligible units in *CIUs* the volatility adjustment is the weighted average volatility adjustments that would apply, having regard to the liquidation period of the transaction as specified in *BIPRU 5.4.39R*, to the assets in which the fund has invested. If the assets in which the fund has invested are not known to the *firm*, the volatility adjustment is the highest volatility adjustment that would apply to any of the assets in which the fund has the

right to invest.

[Note: BCD Annex VIII Part 3 point 40]

- 5.4.43 R For unrated *debt securities* issued by *institutions* and satisfying the eligibility criteria in BIPRU 5.4.5R the volatility adjustments are the same as for *securities* issued by *institutions* or *corporates* with an external credit assessment associated with *credit quality steps* 2 or 3.

[Note: BCD Annex VIII Part 3 point 41]

The financial collateral comprehensive method: Own estimates of volatility adjustments approach: General

- 5.4.44 R BIPRU 5.4.45R - BIPRU 5.4.60R deal with the calculation of volatility adjustments under the *own estimates of volatility adjustments approach*.

- 5.4.45 R A *firm* complying with the requirements set out in BIPRU 5.4.50R to BIPRU 5.4.60R may use the *own estimates of volatility adjustments approach* for calculating the volatility adjustments to be applied to collateral and *exposures*.

[Note: BCD Annex VIII Part 3 point 42]

- 5.4.46 R When *debt securities* have a credit assessment from an *eligible ECAI* equivalent to investment grade or better, a *firm* may calculate a volatility estimate for each category of *security*.

[Note: BCD Annex VIII Part 3 point 43]

- 5.4.47 R In determining relevant categories, a *firm* must take into account the type of issuer of the *security* the external credit assessment of the *securities*, their residual maturity, and their modified duration. Volatility estimates must be representative of the *securities* included in the category by the *firm*.

[Note: BCD Annex VIII Part 3 point 44]

- 5.4.48 R For *debt securities* having a credit assessment from an *eligible ECAI* equivalent to below investment grade and for other eligible collateral the volatility adjustments must be calculated for each individual item.

[Note: BCD Annex VIII Part 3 point 45]

- 5.4.49 R A *firm* using the *own estimates of volatility adjustments approach* must estimate volatility of the collateral or foreign exchange mismatch without taking into account any correlations between the unsecured *exposure*, collateral and/or exchange rates.

[Note: BCD Annex VIII Part 3 point 46]

The financial collateral comprehensive method: Own estimates of volatility adjustments approach: Quantitative Criteria

5.4.50 R In calculating the volatility adjustments, a 99th percentile one-tailed confidence interval must be used.

[Note: BCD Annex VIII Part 3 point 47]

5.4.51 R The liquidation period is 20 *business days* for *secured lending transactions*; 5 *business days* for *repurchase transactions* except insofar as such transactions involve the transfer of *commodities* or guaranteed rights relating to title to *commodities* and *securities lending or borrowing transactions*; and 10 *business days* for other *capital market driven transactions*.

[Note: BCD Annex VIII Part 3 point 48]

5.4.52 R A *firm* may use volatility adjustment numbers calculated according to shorter or longer liquidation periods, scaled up or down to the liquidation period set out in *BIPRU* 5.4.51R for the type of transaction in question, using the square root of time formula:

$$(H_M = H_N) \sqrt{T_M/T_N}$$

where:

- (1) T_M is the relevant liquidation period;
- (2) H_M is the volatility adjustment under T_M ; and
- (3) H_N is the volatility adjustment based on the liquidation period T_N .

[Note: BCD Annex VIII Part 3 point 49]

5.4.53 R A *firm* must take into account the illiquidity of lower-quality assets. The liquidation period must be adjusted upwards in cases where there is doubt concerning the liquidity of the collateral. A *firm* must also identify where historical data may understate potential volatility, e.g. a pegged currency. Such cases must be dealt with by means of a stress scenario.

[Note: BCD Annex VIII Part 3 point 50]

5.4.54 R The historical observation period (sample period) for calculating volatility adjustments must be a minimum length of one year. For a *firm* that uses a weighting scheme or other methods for the historical observation period, the effective observation period must be at least one year (that is, the weighted average time lag of the individual observations must not be less than 6 months).

[Note: BCD Annex VIII Part 3 point 51]

5.4.55 G The *FSA* may also require a *firm* to calculate its volatility adjustments using a shorter observation period if, in the *FSA's* judgement, this is justified by a

significant upsurge in price volatility.

- 5.4.56 R A *firm* must update its data sets at least once every three months and must also reassess them whenever market prices are subject to material changes. This implies that volatility adjustments must be computed at least every three months.

[**Note:** *BCD* Annex VIII Part 3 point 52]

The financial collateral comprehensive method: Own estimates of volatility adjustments approach: Qualitative Criteria

- 5.4.57 R The volatility estimates must be used in the day-to-day risk management process of a *firm* including in relation to its internal *exposure* limits.

[**Note:** *BCD* Annex VIII Part 3 point 53]

- 5.4.58 R If the liquidation period used by a *firm* in its day-to-day risk management process is longer than that set out in *BIPRU* 5.4 for the type of transaction in question, the *firm's* volatility adjustments must be scaled up in accordance with the square root of time formula set out in *BIPRU* 5.4.52R.

[**Note:** *BCD* Annex VIII Part 3 point 54]

- 5.4.59 R A *firm* must have established procedures for monitoring and ensuring compliance with a documented set of policies and controls for the operation of its system for the estimation of volatility adjustments and for the integration of such estimations into its risk management process.

[**Note:** *BCD* Annex VIII Part 3 point 55]

- 5.4.60 R An independent review of a *firm's* system for the estimation of volatility adjustments must be carried out regularly in the *firm's* own internal auditing process. A review of the overall system for the estimation of volatility adjustments and for integration of those adjustments into the *firm's* risk management process must take place at least once a year and must specifically address, at a minimum:

- (1) the integration of estimated volatility adjustments into daily risk management;
- (2) the validation of any significant change in the process for the estimation of volatility adjustments;
- (3) the verification of the consistency, timeliness and reliability of data sources used to run the system for the estimation of volatility adjustments, including the independence of such data sources; and
- (4) the accuracy and appropriateness of the volatility assumptions.

[Note: BCD Annex VIII Part 3 point 56]

The financial collateral comprehensive method: Scaling up of volatility adjustments

- 5.4.61 R The volatility adjustments set out in *BIPRU 5.4.34R* to *BIPRU 5.4.43R* are the volatility adjustments to be applied where there is daily revaluation. Similarly, where a *firm* uses its own estimates of the volatility adjustments in accordance with *BIPRU 5.4.45R* to *BIPRU 5.4.60R*, these must be calculated in the first instance on the basis of daily revaluation. If the frequency of revaluation is less than daily, larger volatility adjustments must be applied. These must be calculated by scaling up the daily revaluation volatility adjustments, using the following ‘square root of time’ formula:

$$(H = H_M \sqrt{(N_R + (T_M - 1)) / (T_M)})$$

where:

- (1) H is the volatility adjustment to be applied;
- (2) H_M is the volatility adjustment where there is daily revaluation;
- (3) N_R is the actual number of business days between revaluations; and
- (4) T_M is the liquidation period for the type of transaction in question.

[Note: BCD Annex VIII Part 3 point 57]

The financial collateral comprehensive method: Conditions for applying a 0% volatility adjustment

- 5.4.62 R In relation to *repurchase transactions* and *securities lending or borrowing transactions*, where a *firm* uses the *supervisory volatility adjustments approach* or the *own estimates of volatility adjustments approach* and where the conditions set out in (1) - (8) are satisfied, a *firm* may, instead of applying the volatility adjustments calculated under *BIPRU 5.4.30R* to *BIPRU 5.4.61R*, apply a 0% volatility adjustment:

- (1) both the *exposure* and the collateral are cash or *debt securities* issued by central governments or *central banks* within the meaning of *BIPRU 5.4.2R(2)* and eligible for a 0% *risk weight* under the *standardised approach*;
- (2) both the *exposure* and the collateral are denominated in the same currency;
- (3) either the maturity of the transaction is no more than one day or both the *exposure* and the collateral are subject to daily marking-to-market or daily remargining;

- (4) it is considered that the time between the last marking-to-market before a failure to remargin by the counterparty and the liquidation of the collateral is no more than four business days;
- (5) the transaction is settled across a settlement system proven for that type of transaction;
- (6) the documentation covering the agreement is standard market documentation for *repurchase transactions* or *securities lending or borrowing transactions* in the *securities* concerned;
- (7) the transaction is governed by documentation specifying that if the counterparty fails to satisfy an obligation to deliver cash or *securities* or to deliver margin or otherwise defaults, then the transaction is immediately terminable; and
- (8) the counterparty is a *core market participant*.

[**Note:** BCD Annex VIII Part 3 point 58 (part)]

5.4.63 R The option in *BIPRU* 5.4.62R is not available in respect of a *firm* using the *master netting agreement internal models approach*.

[**Note:** BCD Annex VIII Part 3 point 58 (part)]

5.4.64 R *Core market participant* means the following entities:

- (1) the entities mentioned in *BIPRU* 5.4.2R(2) *exposures* to which are assigned a 0% *risk weight* under the *standardised approach* to credit risk;
- (2) *institutions*;
- (3) other financial companies (including insurance companies) *exposures* which are assigned a 20% *risk weight* under the *standardised approach*;
- (4) regulated *CIUs* that are subject to capital or leverage requirements;
- (5) regulated pension funds; and
- (6) a *recognised clearing house* or *designated clearing house*.

[**Note:** BCD Annex VIII Part 3 point 58 (part)]

5.4.65 R If under the *CRD implementation measure* for a particular *EEA State* with respect to point 58 of Part 3 of Annex VIII of the *Banking Consolidation Directive* (Conditions for applying the 0% volatility adjustment) the treatment set out in that point is permitted to be applied in the case of *repurchase transactions* or *securities lending or borrowing transactions* in *securities* issued by the domestic government of that *EEA State*, then a *firm*

may adopt the same approach to the same transactions.

[**Note:** *BCD* Annex VIII Part 3 point 59]

Financial collateral comprehensive method: Calculating risk-weighted exposure amounts

5.4.66 Under the *standardised approach* E^* as calculated under *BIPRU* 5.4.28R must be taken as the *exposure* value for the purposes of *BIPRU* 3.2.20R to *BIPRU* 3.2.26R. In the case of off-balance sheet items listed in *BIPRU* 3.7, E^* must be taken as the value to which the percentages indicated in *BIPRU* 3.2.1R and *BIPRU* 3.7.2R must be applied to arrive at the *exposure* value.

[**Note:** *BCD* Annex VIII Part 3 point 60]

5.5 Other funded credit risk mitigation

Deposits with third parties: Eligibility

- 5.5.1 R Cash on deposit with, or *cash assimilated instruments* held by, a third party *institution* in a non-custodial arrangement and pledged to a *lending firm* may be recognised as eligible credit protection.

[Note: BCD Annex VIII Part 1 point 23]

Deposits with third parties: Minimum requirements

- 5.5.2 R To be eligible for the treatment set out at *BIPRU 5.5.3R*, the protection referred to in *BIPRU 5.5.1R* must satisfy the following conditions:

- (1) the borrower's claim against the third party *institution* is openly pledged or assigned to the *lending firm* and such pledge or assignment is legally effective and enforceable in all relevant jurisdictions;
- (2) the third party *institution* is notified of the pledge or assignment;
- (3) as a result of the notification, the third party *institution* is able to make payments solely to the *lending firm* or to other parties with the *lending firm's* consent; and
- (4) the pledge or assignment is unconditional and irrevocable.

[Note: BCD Annex VIII Part 2 point 12]

Deposits with third parties: Calculating the effects of the credit risk mitigation

- 5.5.3 R Where the conditions set out in *BIPRU 5.5.2R* are satisfied, credit protection falling within the terms of *BIPRU 5.5.1R* may be treated as a guarantee by the third party *institution*.

[Note: BCD Annex VIII Part 3 point 79]

Life insurance policies: Eligibility

- 5.5.4 R Life insurance policies pledged to a *lending firm* may be recognised as eligible credit protection.

[Note: BCD Annex VIII Part 1 point 24]

Life insurance policies: Minimum requirements

- 5.5.5 R For life insurance policies pledged to a *lending firm* to be recognised the following conditions must be met:
- (1) the party providing the life insurance may be recognised as an eligible unfunded credit protection provider under *BIPRU 5.7.1R*;
 - (2) the life insurance policy is openly pledged or assigned to the *lending firm*;
 - (3) the party providing the life insurance is notified of the pledge or assignment and as a result may not pay amounts payable under the contract without the consent of the *lending firm*;
 - (4) the declared surrender value of the policy is non-reducible;
 - (5) the *lending firm* must have the right to cancel the policy and receive the surrender value in a timely way in the event of the default of the borrower;
 - (6) the *lending firm* is informed of any non-payments under the policy by the policyholder;
 - (7) the credit protection must be provided for the maturity of the loan; and
 - (8) the pledge or assignment must be legally effective and enforceable in all jurisdictions which are relevant at the time of the conclusion of the credit agreement.

[**Note:** *BCD Annex VIII Part 2 point 13 (part)*]

- 5.5.6 R Where it is not possible for a *firm* to meet the condition set out in *BIPRU 5.5.5R(7)*, because the insurance relationship ends before the loan relationship expires, the *firm* must ensure that the amount deriving from the insurance contract serves the *firm* as security until the end of the duration of the credit agreement.

[**Note:** *BCD Annex VIII Part 2 point 13 (part)*]

Life insurance policies: Calculating the effects of the credit risk mitigation

- 5.5.7 R Where the conditions set out in *BIPRU 5.5.5R* are satisfied, credit protection falling within the terms of *BIPRU 5.5.4R* may be treated as a guarantee by the party providing the life insurance. The value of the credit

protection recognised must be the surrender value of the life insurance policy.

[Note: BCD Annex VIII Part 3 point 80]

Instruments purchased on request: Eligibility

- 5.5.8 R Instruments issued by third party *institutions* which will be repurchased by that *institution* on request may be recognised as eligible credit protection.

[Note: BCD Annex VIII Part 1 point 25]

Instruments purchased on request: Calculating the effects of the credit risk mitigation

- 5.5.9 R Instruments eligible under *BIPRU* 5.5.8R may be treated as a guarantee by the issuing *institution*.

[Note: BCD Annex VIII Part 3 point 81]

- 5.5.10 R For the purposes of *BIPRU* 5.5.9R, the value of the credit protection recognised is the following:

- (1) where the instrument will be repurchased at its face value, the value of the protection is that amount; or
- (2) where the instrument will be repurchased at market price, the value of the protection is the value of the instrument valued in the same way as the *debt securities* specified in *BIPRU* 5.4.5R.

[Note: BCD Annex VIII Part 3 point 82]

Credit linked notes

- 5.5.11 R Investments in credit linked notes issued by a *lending firm* may be treated as cash collateral.

[Note: BCD Annex VIII Part 3 point 3]

5.6 Master netting agreements

Eligibility

- 5.6.1 R (1) For a *firm* adopting the *financial collateral comprehensive method*, the effects of bilateral netting contracts covering *repurchase transactions, securities or commodities lending or borrowing transactions*, and/or other *capital market-driven transactions* with a counterparty may be recognised.
- (2) Without prejudice to *BIPRU 14* to be recognised the collateral taken and *securities or commodities* borrowed within such agreements must comply with the eligibility requirements for collateral set out at *BIPRU 5.4.2R* to *BIPRU 5.4.8R*.

[**Note:** *BCD Annex VIII Part 1 point 5*]

Minimum requirements

- 5.6.2 R For master netting agreements covering *repurchase transactions* and/or *securities or commodities lending or borrowing transactions* and/or other *capital market driven transactions* to be recognised for the purposes of *BIPRU 5*, they must:
- (1) be legally effective and enforceable in all relevant jurisdictions, including in the event of the bankruptcy or insolvency of the counterparty;
- (2) give the non-defaulting party the right to terminate and close-out in a timely manner all transactions under the agreement upon the event of default, including in the event of the bankruptcy or insolvency of the counterparty; and
- (3) provide for the netting of gains and losses on transactions closed out under a master agreement so that a single net amount is owed by one party to the other.

[**Note:** *BCD Annex VIII Part 2 point 4*]

- 5.6.3 R In addition the minimum requirements for the recognition of financial collateral under the *financial collateral comprehensive method* set out in *BIPRU 5.4.9R* must be fulfilled.

[**Note:** *BCD Annex VIII Part 2 point 5*]

Calculation of the fully adjusted exposure value: the supervisory volatility

adjustments approach and the own estimates of volatility adjustments approach

5.6.4 R *BIPRU 5.6.5R to BIPRU 5.6.11R set out the calculation of the fully adjusted exposure value under the supervisory volatility adjustments approach and the own estimates of volatility adjustments approach.*

5.6.5 R In calculating the ‘fully adjusted exposure value’ (E^*) for the exposures subject to an eligible master netting agreement covering *repurchase transactions* and/or *securities or commodities lending or borrowing transactions* and/or other *capital market-driven transactions*, a firm must calculate the volatility adjustments to be applied in the manner set out in *BIPRU 5.6.6R to BIPRU 5.6.11R* either using the *supervisory volatility adjustments approach* or the *own estimates of volatility adjustments approach* as set out in *BIPRU 5.4.30R to BIPRU 5.4.65R* for the *financial collateral comprehensive method*. For the use of the *own estimates of volatility adjustments approach* the same conditions and requirements apply as under the *financial collateral comprehensive method*.

[Note: BCD Annex VIII Part 3 point 5]

5.6.6 R A firm must calculate the net position in each type of *security* or *commodity* by subtracting from the total value of the *securities* or *commodities* of that type lent, sold or provided under the master netting agreement, the total value of *securities* or *commodities* of that type borrowed, purchased or received under the agreement.

[Note: BCD Annex VIII Part 3 point 6]

5.6.7 R For the purposes of *BIPRU 5.6.6R*, type of *security* means *securities* which are issued by the same entity, have the same issue date, the same maturity and are subject to the same terms and conditions and are subject to the same liquidation periods as indicated in *BIPRU 5.4.30R to BIPRU 5.4.65R*.

[Note: BCD Annex VIII Part 3 point 7]

5.6.8 R A firm must calculate the net position in each currency other than the settlement currency of the master netting agreement by subtracting from the total value of *securities* denominated in that currency lent, sold or provided under the master netting agreement added to the amount of cash in that currency lent or transferred under the agreement, the total value of *securities* denominated in that currency borrowed, purchased or received under the agreement added to the amount of cash in that currency borrowed or received under the agreement.

[Note: BCD Annex VIII Part 3 point 8]

5.6.9 R A firm must apply the volatility adjustment appropriate to a given type of *security* or cash position to the absolute value of the positive or negative net position in the *securities* of that type.

[Note: BCD Annex VIII Part 3 point 9]

- 5.6.10 R A *firm* must apply the foreign exchange risk (fx) volatility adjustment to the net positive or negative position in each currency other than the settlement currency of the master netting agreement.

[Note: BCD Annex VIII Part 3 point 10]

- 5.6.11 R E^* must be calculated according to the following formula:

$$E^* = \max \{0, [(\sum(E) - \sum(C)) + \sum(|\text{net position in each security}| \times H_{\text{sec}}) + (\sum|E_{\text{fx}}| \times H_{\text{fx}})]\}$$

where:

- (1) (where *risk weighted exposure amounts* are calculated under the *standardised approach*) E is the *exposure* value for each separate *exposure* under the agreement that would apply in the absence of the credit protection;
- (2) C is the value of the *securities* or *commodities* borrowed, purchased or received or the cash borrowed or received in respect of each such *exposure*;
- (3) $\sum(E)$ is the sum of all Es under the agreement;
- (4) $\sum(C)$ is the sum of all Cs under the agreement;
- (5) E_{fx} is the net position (positive or negative) in a given currency other than the settlement currency of the agreement as calculated under *BIPRUI 5.6.8R*;
- (6) H_{sec} is the volatility adjustment appropriate to a particular type of *security*;
- (7) H_{fx} is the foreign exchange volatility adjustment; and
- (8) E^* is the fully adjusted *exposure* value.

[Note: BCD Annex VIII Part 3 point 11]

Calculation of the fully adjusted exposure value: the master netting agreement internal models approach

- 5.6.12 R *BIPRU 5.6.16R* to *BIPRU 5.6.28G* apply to a *firm* that has a *master netting agreement internal models approach permission* and set out the calculation of the effects of *credit risk mitigation* under the *master netting agreement internal models approach*.

- 5.6.13 G A *firm* that wishes to use the *master netting agreement internal models approach* will need to apply to the *FSA* for a *master netting agreement internal models approach permission*. *BIPRU* 1.3 sets out the requirements and procedures relating to those applications.
- 5.6.14 G A *master netting agreement internal models approach permission* will amend, to the extent set out in the *master netting agreement internal models approach permission*, *BIPRU* 5.6.1R so as to provide that, with the exceptions provided in *BIPRU* 5.6, a *firm* must use the *master netting agreement internal models approach* for the purposes of the calculations specified in *BIPRU* 5.6.
- 5.6.15 G A *firm* which has been granted a *VaR model waiver* will still need to make an application to the *FSA* for a *master netting agreement internal models approach permission*. However, the application should generally be straightforward as a *firm* which is able to satisfy the requirements for a *VaR model waiver* should usually also be able to satisfy the requirements for a *master netting agreement internal models approach permission*.

[Note: *BCD* Annex VIII Part 3 point 14]

- 5.6.16 R The *master netting agreement internal models approach* is an alternative to using the *supervisory volatility adjustments approach* or the *own estimates volatility adjustments approach* in calculating volatility adjustments for the purpose of calculating the ‘fully adjusted exposure value’ (E*) resulting from the application of an eligible master netting agreement covering *repurchase transactions, securities or commodities lending or borrowing transactions* and/or other *capital market-driven transactions* other than derivative transactions. The *master netting agreement internal models approach* takes into account correlation effects between security positions subject to a master netting agreement as well as the liquidity of the instruments concerned. The internal model used for the *master netting agreement internal model approach* must provide estimates of the potential change in value of the unsecured *exposure* amount ($\sum E - \sum C$).

[Note: *BCD* Annex VIII Part 3 point 12 (part)]

- 5.6.17 R A *firm* may also use the internal model used for the *master netting agreement internal model approach* for *margin lending transactions* if the transactions are covered under the *firm’s master netting agreement internal models approach permission* and the transactions are covered by a bilateral master netting agreement that meets the requirements set out in *BIPRU* 13.7.

[Note: *BCD* Annex VIII Part 3 point 12 (part)]

- 5.6.18 R A *firm* may use the *master netting agreement internal models approach* independently of the choice it has made between the *standardised approach* and the *IRB approach* for the calculation of *risk weighted exposure amounts*. However, if a *firm* uses the *master netting agreement internal models approach*, it must do so for all counterparties and *securities*, excluding immaterial portfolios where it may use the *supervisory volatility adjustments*

approach or the *own estimates volatility adjustments approach* as set out in BIPRU 5.4.30R to BIPRU 5.4.65R.

[Note: BCD Annex VIII Part 3 point 13]

- 5.6.19 R
- (1) A *firm* must be able to satisfy the *FSA* that the *firm's* risk management system for managing the risks arising on the transactions covered by the master netting agreement is conceptually sound and implemented with integrity and that, in particular, the minimum qualitative standards in (2) – (11) are met.
 - (2) The internal risk-measurement model used for calculation of potential price volatility for the transactions is closely integrated into the daily risk-management process of the *firm* and serves as the basis for reporting risk *exposures* to senior management of the *firm*.
 - (3) The *firm* has a risk control unit that is independent from business trading units and reports directly to senior management. The unit must be responsible for designing and implementing the *firm's* risk-management system. It must produce and analyse daily reports on the output of the risk-measurement model and on the appropriate measures to be taken in terms of position limits.
 - (4) The daily reports produced by the risk-control unit are reviewed by a level of management with sufficient authority to enforce reductions of positions taken and of overall risk *exposure*.
 - (5) The *firm* has sufficient staff skilled in the use of sophisticated models in the risk control unit.
 - (6) The *firm* has established procedures for monitoring and ensuring compliance with a documented set of internal policies and controls concerning the overall operation of the risk-measurement system.
 - (7) The *firm's* models have a proven track record of reasonable accuracy in measuring risks demonstrated through the back-testing of its output using at least one year of data.
 - (8) The *firm* frequently conducts a rigorous programme of stress testing and the results of these tests are reviewed by senior management and reflected in the policies and limits it sets.
 - (9) The *firm* must conduct, as part of its regular internal auditing process, an independent review of its risk-measurement system. This review must include both the activities of the business trading units and of the independent risk-control unit.

- (10) At least once a year, the *firm* must conduct a review of its risk management system.
- (11) The internal model used for the *master netting agreement internal model approach* must meet the requirements set out in *BIPRU* 13.6.65R to *BIPRU* 13.6.67R.

[**Note:** *BCD* Annex VIII Part 3 point 16]

- 5.6.20 R The calculation of the potential change in value must be subject to the following minimum standards:
- (1) at least daily calculation of the potential change in value;
 - (2) a 99th percentile, one-tailed confidence interval;
 - (3) a 5-day equivalent liquidation period, except in the case of transactions other than *securities repurchase transactions* or *securities lending or borrowing transactions* where a 10-day equivalent liquidation period should be used;
 - (4) an effective historical observation period of at least one year except where a shorter observation period is justified by a significant upsurge in price volatility; and
 - (5) three-monthly data set updates.

[**Note:** *BCD* Annex VIII Part 3 point 17]

- 5.6.21 R The internal risk-measurement model must capture a sufficient number of risk factors in order to capture all material price risks.

[**Note:** *BCD* Annex VIII Part 3 point 18]

- 5.6.22 R A *firm* may use empirical correlations within risk categories and across risk categories provided that it is able to satisfy the *FSA* that the *firm's* system for measuring correlations is sound and implemented with integrity.

[**Note:** *BCD* Annex VIII Part 3 point 19]

- 5.6.23 G The *FSA* will not grant a *master netting agreement internal models approach permission* if it is not satisfied that the standards in *BIPRU* 5.6.19R to *BIPRU* 5.6.22R are met.

- 5.6.24 R The fully adjusted *exposure* value (E^*) for a *firm* using the *master netting agreement internal models approach* must be calculated according to the following formula:

$$E^* = \max \{0, [(\sum E - \sum C) + (VaR \text{ output of the internal models})]\}$$

where

- (1) (where *risk weighted exposure amounts* are calculated under the *standardised approach*) E is the *exposure* value for each separate *exposure* under the agreement that would apply in the absence of the credit protection;
- (2) C is the value of the *securities* borrowed, purchased or received or the cash borrowed or received in respect of each such *exposure*;
- (3) $\sum (E)$ is the sum of all Es under the agreement; and
- (4) $\sum (C)$ is the sum of all Cs under the agreement.

[Note: BCD Annex VIII Part 3 point 20]

- 5.6.25 R In calculating *risk weighted exposure amounts* using the *master netting agreement internal models approach*, a *firm* must use the previous *business day's* model output.

[Note: BCD Annex VIII Part 3 point 21]

- 5.6.26 G No changes should be made to the internal model used for the *master netting agreement internal model approach* unless the change is not material. Material changes to such a model will require a variation of the *master netting agreement internal models approach permission*. Materiality is measured against the model as it was at the time that the *master netting agreement internal models approach permission* was originally granted or, any later date set out in the *master netting agreement internal models approach permission* for this purpose. If a *firm* is considering making material changes to such a model then it should notify the *FSA* at once.

- 5.6.27 G If a *firm* ceases to meet the requirements of *BIPRU 5* in relation to the *master netting agreement internal models approach*, the *firm* should notify the *FSA* at once.

- 5.6.28 G The *FSA* is likely to revoke a *master netting agreement internal models approach permission* if a *firm* ceases to meet the requirements of *BIPRU 5* in relation to the *master netting agreement internal models approach*.

Calculation of risk weighted exposure amounts under the standardised approach

- 5.6.29 R (1) A *firm* must under the *standardised approach* calculate *risk-weighted exposure amounts* for *repurchase transactions* and/or *securities or commodities lending or borrowing transactions* and/or other *capital market-driven transactions* covered by master netting agreements under this *rule*.

- (2) E^* as calculated under *BIPRU* 5.6.5R to *BIPRU* 5.6.25R must be taken as the *exposure* value of the *exposure* to the counterparty arising from the transactions subject to the master netting agreement for the purposes of *BIPRU* 3.2.20R to *BIPRU* 3.2.26R.

[**Note:** *BCD* Annex VIII Part 3 point 22]

5.7 Unfunded credit protection

Eligibility

5.7.1 R The following parties may be recognised as eligible providers of *unfunded credit protection*:

- (1) central governments and *central banks*;
- (2) regional governments or local authorities;
- (3) *multilateral development banks*;
- (4) *international organisations exposures* which are assigned a 0% *risk weight* under the *standardised approach*;
- (5) *public sector entities, claims* on which are treated as claims on *institutions* or central governments under the *standardised approach*;
- (6) *institutions*;
- (7) other corporate entities, including *parent undertakings, subsidiary undertakings* and affiliate corporate entities of the *firm*, that have a credit assessment by an *eligible ECAI* associated with *credit quality step 2* or above under the *rules* for the *risk weighting* of *exposures to corporates* under the *standardised approach*.

[Note: BCD Annex VIII Part 1 point 26]

Types of credit derivatives

5.7.2 R The following types of credit derivatives, and instruments that may be composed of such credit derivatives or that are economically effectively similar, may be recognised as eligible;

- (1) credit default swaps;
- (2) total return swaps; and
- (3) credit linked notes to the extent of their cash funding.

[Note: BCD Annex VIII Part 1 point 30]

5.7.3 R Where a *firm* buys credit protection through a total return swap and records the net payments received on the swap as net income, but does not record offsetting deterioration in the value of the asset that is protected (either

through reductions in fair value or by an addition to reserves), the credit protection must not be recognised as eligible.

[Note: BCD Annex VIII Part 1 point 31]

Internal hedges

- 5.7.4 R When a *firm* conducts an internal hedge using a credit derivative - i.e. hedges the credit risk of an *exposure* in the *non-trading book* with a credit derivative booked in the *trading book* - in order for the protection to be recognised as eligible for the purposes of *BIPRU 4.10* or *BIPRU 5* the credit risk transferred to the *trading book* must be transferred out to a third party or parties. In such circumstances, subject to the compliance of such transfer with the requirements for the recognition of *credit risk mitigation* set out in *BIPRU 4.10* or *BIPRU 5*, the *rules* for the calculation of *risk weighted exposure amounts* and *expected loss amounts* where *unfunded credit protection* is acquired set out in *BIPRU 4.10* or *BIPRU 5* must be applied.

[Note: BCD Annex VIII Part 1 point 32]

Minimum requirements: General

- 5.7.5 R *BIPRU 5.7.6R* to *BIPRU 5.7.10R* deal with requirements common to guarantees and credit derivatives.
- 5.7.6 R Subject to *BIPRU 5.7.9R*, for the credit protection deriving from a guarantee or credit derivative to be recognised the following conditions must be met:
- (1) the credit protection must be direct;
 - (2) the extent of the credit protection must be clearly defined and incontrovertible;
 - (3) the credit protection contract must not contain any clause, the fulfilment of which is outside the direct control of the lender, that:
 - (a) would allow the protection provider unilaterally to cancel the protection;
 - (b) would increase the effective cost of protection as a result of deteriorating credit quality of the protected *exposure*;
 - (c) could prevent the protection provider from being obliged to pay out in a timely manner in the event that the original obligor fails to make any payments due; or
 - (d) could allow the maturity of the credit protection to be reduced by the protection provider; and

- (4) it must be legally effective and enforceable in all jurisdictions which are relevant at the time of the conclusion of the credit agreement.

[Note: BCD Annex VIII Part 2 point 14]

- 5.7.7 G For the purposes of *BIPRU 5.7.6R(3)(a)*, payment of premiums and other monies due under the contract is within the control of the *lending firm*. So a clause that allows the protection provider unilaterally to cancel the contract after a reasonable period due to non payment of such monies will not mean that the condition in that *rule* is not met.

Minimum requirements: Operational requirements

- 5.7.8 R A *firm* must be able to satisfy the *FSA* that it has systems in place to manage potential concentration of risk arising from the *firm's* use of guarantees and credit derivatives. The *firm* must be able to demonstrate how its strategy in respect of its use of credit derivatives and guarantees interacts with its management of its overall risk profile.

[Note: BCD Annex VIII Part 2 point 15]

Minimum requirements: Sovereign and other public sector counter-guarantees

- 5.7.9 R Where an *exposure* is protected by a guarantee which is counter-guaranteed by a central government or *central bank*, a regional government or local authority or a *public sector entity* claims on which are treated as claims on the central government in whose jurisdiction they are established under the *standardised approach*, a *multilateral development bank* to which a 0% *risk weight* is assigned under or by virtue of the *standardised approach*, or a *public sector entity* claims on which are treated as claims on *credit institutions* under the *standardised approach*, the *exposure* may be treated as protected by a guarantee provided by the entity in question provided the following conditions are satisfied:

- (1) the counter-guarantee covers all credit risk elements of the claim;
- (2) both the original guarantee and the counter-guarantee meet the requirements for guarantees set out in *BIPRU 5.7.6R*, *BIPRU 5.7.8R* and *BIPRU 5.7.11R*, except that the counter-guarantee need not be direct; and
- (3) the *firm* is able to satisfy the *FSA* that the cover is robust and that nothing in the historical evidence suggests that the coverage of the counter-guarantee is less than effectively equivalent to that of a direct guarantee by the entity in question.

[Note: BCD Annex VIII Part 2 point 16]

5.7.10 R The treatment of *BIPRU 5.7.9R* applies, also, to an *exposure* which is not counter-guaranteed by an entity listed in that *rule* if the *exposure's* counter-guarantee is in its turn directly guaranteed by one of the listed entities and the conditions listed in *BIPRU 5.7.9R* are satisfied.

[**Note:** *BCD Annex VIII Part 2 point 17*]

Additional requirements for guarantees

5.7.11 R For a guarantee to be recognised the following conditions must also be met:

- (1) on the qualifying default of and/or non-payment by the counterparty, the *lending firm* must have the right to pursue, in a timely manner, the guarantor for any monies due under the claim in respect of which the protection is provided;
- (2) payment by the guarantor must not be subject to the *lending firm* first having to pursue the obligor;
- (3) in the case of *unfunded credit protection* covering residential mortgage loans, the requirements in *BIPRU 5.7.6R(3)(c)* and in this *rule* have only to be satisfied within 24 months;
- (4) the guarantee must be an explicitly documented obligation assumed by the guarantor;
- (5) subject to (6), the guarantee must cover all types of payments the obligor is expected to make in respect of the claim; and
- (6) where certain types of payment are excluded from the guarantee, the recognised value of the guarantee must be adjusted to reflect the limited coverage.

[**Note:** *BCD Annex VIII Part 2 point 18*]

5.7.12 R In the case of guarantees provided in the context of mutual guarantee schemes recognised for these purposes by another EEA *competent authority* under a *CRD implementation measure* with respect to point 19 of Part 2 of Annex VIII of the *Banking Consolidation Directive* or provided by or counter-guaranteed by entities referred to in *BIPRU 5.7.9R*, the requirements in *BIPRU 5.7.11R(1) – (3)* will be satisfied where either of the following conditions are met:

- (1) the *lending firm* has the right to obtain in a timely manner a provisional payment by the guarantor calculated to represent a robust estimate of the amount of the economic *loss*, including losses resulting from the non-payment of interest and other types of payment which the borrower is obliged to make, likely to be incurred by the *lending firm* proportional to the coverage of the guarantee; or

- (2) the *lending firm* is able to demonstrate to the *FSA* that the loss-protecting effects of the guarantee, including losses resulting from the non-payment of interest and other types of payments which the borrower is obliged to make, justify such treatment.

[Note: *BCD* Annex VIII Part 2 point 19]

Additional requirements for credit derivatives

- 5.7.13 R For a credit derivative to be met the following conditions must also be met.
- (1) Subject to (2), the credit events specified under the credit derivative must at a minimum include:
 - (a) the failure to pay the amounts due under the terms of the underlying obligation that are in effect at the time of such failure (with a grace period that is closely in line with or shorter than the grace period in the underlying obligation);
 - (b) the bankruptcy, insolvency or inability of the obligor to pay its debts, or its failure or admission in writing of its inability generally to pay its debts as they become due, and analogous events; and
 - (c) the restructuring of the underlying obligation involving forgiveness or postponement of principal, interest or fees that results in a credit loss event (i.e. value adjustment or other similar debit to the profit and loss account).
 - (2) Where the credit events specified under the credit derivative do not include restructuring of the underlying obligation as described in (1)(c), the credit protection may nonetheless be recognised subject to a reduction in the recognised value as specified in *BIPRU* 5.7.16R.
 - (3) In the case of credit derivatives allowing for cash settlement a robust valuation process must be in place in order to estimate loss reliably. There must be a clearly specified period for obtaining post-credit-event valuations of the underlying obligation.
 - (4) If the protection purchaser's right and ability to transfer the underlying obligation to the protection provider is required for settlement, the terms of the underlying obligation must provide that any required consent to such transfer may not be unreasonably withheld.
 - (5) The identity of the parties responsible for determining whether a credit event has occurred must be clearly defined. This determination must not be the sole responsibility of the protection provider. The

protection buyer must have the right/ability to inform the protection provider of the occurrence of a credit event.

[Note: BCD Annex VIII Part 2 point 20]

- 5.7.14 R A mismatch between the underlying obligation and the reference obligation under the credit derivative (i.e. the obligation used for the purposes of determining cash settlement value or the deliverable obligation) or between the underlying obligation and the obligation used for purposes of determining whether a credit event has occurred is permissible only if the following conditions are met:
- (1) the reference obligation or the obligation used for purposes of determining whether a credit event has occurred, as the case may be, ranks pari passu with or is junior to the underlying obligation; and
 - (2) the underlying obligation and the reference obligation or the obligation used for purposes of determining whether a credit event has occurred, as the case may be, share the same obligor (i.e., the same legal entity) and there are in place legally enforceable cross-default or cross-acceleration clauses.

[Note: BCD Annex VIII Part 2 point 21]

Unfunded credit protection: Valuation

- 5.7.15 R *BIPRU 5.7.16R to BIPRU 5.7.19R* set out the provisions applying to the valuation of *unfunded credit protection*.
- 5.7.16 R
- (1) The value of *unfunded credit protection* (G) is the amount that the protection provider has undertaken to pay in the event of the default or non-payment of the borrower or on the occurrence of other specified credit events.
 - (2) In the case of credit derivatives which do not include as a credit event restructuring of the underlying obligation involving forgiveness or postponement of principal, interest or fees that result in a credit loss event (e.g. value adjustment, the making of a value adjustment or other similar debit to the profit and loss account):
 - (a) where the amount that the protection provider has undertaken to pay is not higher than the *exposure* value, the value of the credit protection calculated under (1) must be reduced by 40%; or
 - (b) where the amount that the protection provider has undertaken to pay is higher than the *exposure* value, the value of the

credit protection must be no higher than 60% of the *exposure* value.

[**Note:** BCD Annex VIII Part 3 point 83]

- 5.7.17 R Where *unfunded credit protection* is denominated in a currency different from that in which the *exposure* is denominated (a currency mismatch) the value of the credit protection must be reduced by the application of a volatility adjustment H_{FX} as follows:

$$G^* = G \times (1 - H_{FX})$$

where:

- (1) G is the nominal amount of the credit protection;
- (2) G^* is G adjusted for any *foreign currency* risk; and
- (3) H_{fx} is the volatility adjustment for any currency mismatch between the credit protection and the underlying obligation.

[**Note:** BCD Annex VIII Part 3 point 84 (part)]

- 5.7.18 R Where there is no currency mismatch:

$$G^* = G$$

[**Note:** BCD Annex VIII Part 3 point 84 (part)]

- 5.7.19 R The volatility adjustments to be applied for any currency mismatch may be calculated based on the *supervisory volatility adjustments approach* or the *own estimates of volatility adjustments approach* as set out in BIPRU 5.4.30R to BIPRU 5.4.65R.

[**Note:** BCD Annex VIII Part 3 point 85]

Calculating risk weighted exposure amounts and expected loss amounts

- 5.7.20 R BIPRU 5.7.21R to BIPRU 5.7.28R set out the provisions applying to the calculation of *risk weighted exposure amounts*.

Calculating risk weighted exposure amounts: Partial protection – tranching

- 5.7.21 R Where a *firm* transfers a part of the risk of a loan in one or more *tranches*, BIPRU 9 applies. Materiality thresholds on payments below which no payment shall be made in the event of loss are considered to be equivalent to

retained first loss positions and to give rise to a *tranch*ed transfer of risk.

[Note: BCD Annex VIII Part 3 point 86]

Calculating risk-weighted exposure amounts : The standardised approach

- 5.7.22 R *BIPRU 5.7.23R to BIPRU 5.7.25R set out the provisions applying to the calculation of risk weighted exposure amounts under the standardised approach in the case of unfunded credit protection.*

Calculating risk weighted exposure amounts: standardised approach: Full protection

- 5.7.23 R For the purposes of *BIPRU 3.2.20R to BIPRU 3.2.26R*, *g* shall be the *risk weight* to be assigned to an *exposure* which is fully protected by *unfunded credit protection* (G_A), where:

- (1) *g* is the *risk weight* of *exposures* to the protection provider as specified under the *standardised approach*; and
- (2) G_A is the value of G^* as calculated under *BIPRU 5.7.17R* further adjusted for any maturity mismatch as laid down in *BIPRU 5.8R*.

[Note: BCD Annex VIII Part 3 point 87]

Calculating risk weighted exposure amounts: Standardised approach: Partial protection – equal seniority

- 5.7.24 R Where the protected amount is less than the *exposure* value and the protected and unprotected portions are of equal seniority – ie the *firm* and the protection provider share losses on a pro-rata basis, proportional regulatory capital relief is afforded. For the purposes of *BIPRU 3.2.20R to BIPRU 3.2.26R* *risk weighted exposure amounts* must be calculated in accordance with the following formula:

$$(E-G_A) \times r + G_A \times g$$

where:

- (1) *E* is the *exposure* value;
- (2) G_A is the value of G^* as calculated under *BIPRU 5.7.17R* further adjusted for any maturity mismatch as laid down in *BIPRU 5.8R*;
- (3) *r* is the *risk weight* of *exposures* to the obligor as specified under the *standardised approach*; and

- (4) g is the *risk weight* of *exposures* to the protection provider as specified under the *standardised approach*.

[Note: BCD Annex VIII Part 3 point 88]

Calculating risk weighted exposure amounts: standardised approach:
Sovereign guarantees

- 5.7.25 R A *firm* may apply the treatment provided for in *BIPRU 3.4.5R* to *BIPRU 3.4.7R* to *exposures* or parts of *exposures* guaranteed by the central government or *central bank*, where the guarantee is denominated in the domestic currency of the borrower and the *exposure* is funded in that currency.

[Note: BCD Annex VIII Part 3 point 89]

Calculating risk-weighted exposure amounts and expected loss amounts:
Basket CRM techniques

- 5.7.26 R *BIPRU 5.7.27R* to *BIPRU 5.7.28R* set out the provisions applying to the calculation of *risk weighted exposure amounts* and *expected loss* amounts where basket *credit risk mitigation* techniques are used.

First-to-default credit derivatives

- 5.7.27 R Where a *firm* obtains credit protection for a number of *exposures* under terms that the first default among the *exposures* will trigger payment and that this credit event will terminate the contract, the *firm* may modify the calculation of the *risk weighted exposure amount* and, as relevant, the *expected loss* amount of the *exposure* which would in the absence of the credit protection produce the lowest *risk weighted exposure amount* under the *standardised approach* or the *IRB approach* as appropriate in accordance with *BIPRU 4.10* or *BIPRU 5*, but only if the *exposure* value is less than or equal to the value of the credit protection.

[Note: BCD Annex VIII Part 6 point 1]

Nth-to-default credit derivatives

- 5.7.28 R Where the *n*th default among the *exposures* triggers payment under the credit protection provided by a credit derivative, a *firm* purchasing the protection may only recognise the protection for the calculation of *risk weighted exposure amounts* and, as relevant, *expected loss* amounts if protection has also been obtained for defaults 1 to *n-1* or when *n-1* defaults have already occurred. In such cases the methodology must follow that set out in *BIPRU 5.7.27R* for first-to-default derivatives appropriately modified for *n*th-to-default products.

[**Note:** *BCD* Annex VIII Part 6 point 2]

5.8 Maturity mismatches

- 5.8.1 R For the purposes of calculating *risk weighted exposure amounts*, a maturity mismatch occurs when the residual maturity of the credit protection is less than that of the protected *exposure*. Protection of less than three months residual maturity, the maturity of which is less than the maturity of the underlying *exposure*, must not be recognised.

[Note: BCD Annex VIII Part 4 point 1]

- 5.8.2 R Where there is a maturity mismatch the credit protection must not be recognised where the original maturity of the protection is less than 1 year.

[Note: BCD Annex VIII Part 4 point 2 (part)]

Definition of maturity

- 5.8.3 R Subject to a maximum of 5 years, the effective maturity of the underlying is the longest possible remaining time before the obligor is scheduled to fulfil its obligations. Subject to *BIPRU 5.8.4R*, the maturity of the credit protection is the time to the earliest date at which the protection may terminate or be terminated.

[Note: BCD Annex VIII Part 4 point 3]

- 5.8.4 R Where there is an option to terminate the protection which is at the discretion of the protection seller, the maturity of the protection must be taken to be the time to the earliest date at which that option may be exercised. Where there is an option to terminate the protection which is at the discretion of the protection buyer and the terms of the arrangement at origination of the protection contain a positive incentive for the *firm* to call the transaction before contractual maturity, the maturity of the protection must be taken to be the time to the earliest date at which that option may be exercised; otherwise such an option may be considered not to affect the maturity of the protection.

[Note: BCD Annex VIII Part 4 point 4]

- 5.8.5 R Where a credit derivative is not prevented from terminating prior to expiration of any grace period required for a default on the underlying obligation to occur as a result of a failure to pay the maturity of the protection must be reduced by the amount of the grace period.

[Note: BCD Annex VIII Part 4 point 5]

Valuation of protection: Transactions subject to funded credit protection - financial collateral simple method

- 5.8.6 R *BIPRU 5.8.7R* sets out the calculation for the valuation of transactions

subject to *funded credit protection* under the *financial collateral simple method*.

- 5.8.7 R Where there is a mismatch between the maturity of the *exposure* and the maturity of the protection, the collateral must not be recognised.

[Note: BCD Annex VIII Part 4 point 6]

Valuation of protection: Transactions subject to funded credit protection - financial collateral comprehensive method

- 5.8.8 R *BIPRU 5.8.9R* sets out the calculation for the valuation of transactions subject to *funded credit protection* under the *financial collateral comprehensive method*.

- 5.8.9 R (1) The maturity of the credit protection and that of the *exposure* must be reflected in the adjusted value of the collateral according to the following formula:

$$C_{VAM} = C_{VA} \times (t-t^*) / (T-t^*)$$

where:

- (a) C_{VA} is the volatility adjusted value of the collateral as specified in *BIPRU 5.4.28R* or the amount of the *exposure*, whichever is the lowest;
 - (b) t is the number of years remaining to the maturity date of the credit protection calculated in accordance with *BIPRU 5.8.3R* to *BIPRU 5.8.5*, or the value of T , whichever is the lower;
 - (c) T is the number of years remaining to the maturity date of the *exposure* calculated in accordance with *BIPRU 5.8.3R* to *BIPRU 5.8.5*, or 5 years, whichever is the lower; and
 - (d) t^* is 0.25.
- (2) C_{VAM} must be taken as C_{VA} further adjusted for maturity mismatch to be included in the formula for the calculation of the fully adjusted value of the *exposure* (E^*) set out at *BIPRU 5.4.28R*.

[Note: BCD Annex VIII Part 4 point 7]

Valuation of protection: Transactions subject to unfunded credit protection

- 5.8.10 R *BIPRU 5.8.11R* sets out the calculation for the valuation of transactions subject to *unfunded credit protection*.

- 5.8.11 R (1) The maturity of the credit protection and that of the *exposure* must be reflected in the adjusted value of the credit protection according to the following formula:

$$G_A = G^* \times (t-t^*) / (T-t^*)$$

where:

- (a) G^* is the amount of the protection adjusted for any currency mismatch;
 - (b) G_A is G^* adjusted for any maturity mismatch;
 - (c) t is the number of years remaining to the maturity date of the credit protection calculated in accordance with *BIPRU 5.8.3R* to *BIPRU 5.8.5R*, or the value of T , whichever is the lower;
 - (d) T is the number of years remaining to the maturity date of the *exposure* calculated in accordance with *BIPRU 5.8.3R* to *BIPRU 5.8.5R*, or 5 years, whichever is the lower; and
 - (e) t^* is 0.25.
- (2) G_A is then taken as the value of the protection for the purposes of *BIPRU 5.7.16R* to *BIPRU 5.7.25R*.

[**Note:** *BCD Annex VIII Part 4 point 8*]

- 5.9 Combinations of credit risk mitigation in the standardised approach
- 5.9.1 R In the case where a *firm* calculating *risk weighted exposure amounts* under the *standardised approach* has more than one form of *credit risk mitigation* covering a single *exposure* (e.g. a *firm* has both collateral and a guarantee partially covering an *exposure*), *the firm* must subdivide the *exposure* into parts covered by each type of *credit risk mitigation* tool (e.g. a part covered by collateral and a portion covered by guarantee) and the *risk-weighted exposure amount* for each portion must be calculated separately in accordance with the provisions of the *standardised approach* and *BIPRU 5*.
- [**Note:** *BCD Annex VIII Part 5 point 1*]
- 5.9.2 R When credit protection provided by a single protection provider has differing maturities, a similar approach to that described in *BIPRU 5.9.1R* must be applied.
- [**Note:** *BCD Annex VIII Part 5 point 2*]

- 6 Operational risk
- 6.1. Operational risk: Application and purpose
- Application
- 6.1.1 R *BIPRU 6* applies to a *BIPRU firm* except for:
- (1) a *BIPRU limited licence firm*; and
 - (2) a *BIPRU limited activity firm*.
- 6.1.2 G A *BIPRU limited licence firm* or *BIPRU limited activity firm* that wishes to calculate an *operational risk capital requirement* in accordance with this chapter for the purposes of its *capital resources requirement* should apply for a *waiver* to modify *GENPRU 1.1* or seek a variation to its *permission* so that it is treated as a *full scope BIPRU investment firm*.
- Purpose
- 6.1.3 G The purpose of *BIPRU 6* is:
- (1) to detail the requirement to hold capital to cover *operational risk* losses and have appropriate systems and controls in place to manage *operational risk*; and
 - (2) to explain how to calculate the *operational risk capital requirement*, or *ORCR*.
- 6.1.4 G *BIPRU 6* implements:
- (1) Articles 102 to 104;
 - (2) Article 105, in part; and
 - (3) Annex X;
- of the *Banking Consolidation Directive*.
-

6.2 Operational risk: Methodologies and systems

The definition of ORCR

6.2.1 R The *operational risk capital requirement (ORCR)* for a *firm* is an amount calculated in accordance with:

(1) the *basic indicator approach* (see *BIPRU* 6.3); or

(2) the *standardised approach* (see *BIPRU* 6.4).

[Note: *BCD* Article 102(1)]

6.2.2 G The simplest method of calculating the *ORCR* is the *basic indicator approach* and a *firm* should use this approach if it does not, or is not permitted to, use another approach.

6.2.3 G A *firm* does not need a *waiver* to use the *standardised approach*. However there are eligibility conditions that a *firm* should satisfy if it is to use this approach. If it does not satisfy them, it should not use this approach.

6.2.4 G A *firm* may apply to the *FSA* for a *waiver* from *BIPRU* 6.2.1R in order to use its own *advanced measurement approach* for the calculation of its *ORCR* (see *BIPRU* 6.5). If the *waiver* is granted, the *ORCR* will be an amount determined in accordance with such *waiver*.

[Note: *BCD* Article 105(1)]

Restrictions on changing the approach used for calculating ORCR

6.2.5 R A *firm* that calculates its *ORCR* using the *standardised approach* must not change to calculating its *ORCR* using the *basic indicator approach*.

[Note: *BCD* Article 102(2) (part)]

6.2.6 G A *firm* may apply to the *FSA* for a *waiver* from *BIPRU* 6.2.5R where it can demonstrate good cause for changing to the *basic indicator approach*.

[Note: *BCD* Article 102(2) (part)]

6.2.7 R A *firm* that calculates its *ORCR* using an *advanced measurement approach* must not change to calculating its *ORCR* using the *standardised approach* or the *basic indicator approach*.

[Note: *BCD* Article 102(3) (part)]

6.2.8 G A *firm* may apply to the *FSA* for a *waiver* from *BIPRU* 6.2.7R where it can demonstrate good cause for changing to *standardised approach* or the *basic indicator approach* as the case may be.

[Note: BCD Article 102(3) (part)]

Combination of different methodologies

- 6.2.9 R Without prejudice to any other conditions that may be imposed by a *firm's AMA permission*, where a *firm's AMA permission* allows it to use an *advanced measurement approach* in combination with either the *basic indicator approach* or the *standardised approach*, the *firm* must comply with the following conditions:
- (1) all *operational risks* of the *firm* are captured;
 - (2) the *firm* must be able to satisfy the *FSA* with respect to the methodology used to cover different activities, geographical locations or other relevant divisions determined on an internal basis; and
 - (3) *BIPRU 6.4.1R* and *BIPRU 6.5.6R* must be complied with for the part of activities covered by the *standardised approach* and *advanced measurement approaches* respectively.

[Note: BCD Article 102(4) and Annex X, Part 4 point 1]

- 6.2.10 G Where a *firm's AMA permission* allows it to use an *advanced measurement approach* in combination with either the *basic indicator approach* or the *standardised approach*, the *FSA* may impose additional conditions on a case by case basis as follows:
- (1) on the date of implementation of an *advanced measurement approach*, a significant part of the *firm's operational risks* are captured by the *advanced measurement approach*; and
 - (2) the *firm* is obliged to roll out the *advanced measurement approach* to a material part of its operations within a time schedule set out in its *AMA permission*.

[Note: BCD Annex X, Part 4 point 2]

- 6.2.11 R A *firm* applying for an *AMA permission* to use a combination of different approaches must be able to show that:
- (1) at the date of implementation of the *advanced measurement approach*, approximately 50% (or more) of the *firm's operational risk* is captured under the *AMA*; and
 - (2) the *firm* has committed to roll out the *advanced measurement approach* for around 85% (or more) of its *operational risk*, subject to the remaining percentage not being concentrated in a single operation, within a timescale set out in the *AMA permission*.

- 6.2.12 R For the determination of its *ORCR*, a *firm* must not use any of the following combinations of methodologies:
-

- (1) the *basic indicator approach* with the *standardised approach*;
- (2) the *basic indicator approach* with the *alternative standardised approach*; or
- (3) the *standardised approach* with the *alternative standardised approach* for the same business line.

6.2.13 G A *firm* may apply to the *FSA* for a *waiver* from *BIPRU* 6.2.12R(1) and (2) in exceptional circumstances, such as the recent acquisition of new business, which require a transition period for the roll out of the *standardised approach* (or the *alternative standardised approach*). In this event, a *firm* will need to make a commitment to roll out the *standardised approach* (or the *alternative standardised approach*) within a time schedule agreed with the *FSA*.

[**Note:** *BCD* Annex X, Part 4 points 3 and 4]

6.3 Operational risk: Basic indicator approach

ORCR

- 6.3.1 R The *ORCR* under the *basic indicator approach* is equal to 15% of the relevant indicator defined in this section.

[**Note:** *BCD* Article 103 and Annex X, Part 1 point 1]

Relevant indicator: General

- 6.3.2 R (1) The relevant indicator is the three-year average of the sum of:
- (a) a *firm's* net interest income; and
 - (b) a *firm's* net non-interest income.
- (2) The three-year average must be calculated on the basis of the last three yearly observations at the end of the financial year. When audited figures are not available, business estimates may be used.
- (3) If for any given observation, the sum of a *firm's* net interest income and net non-interest income, is negative or equal to zero, this figure must be excluded from both the numerator and denominator when calculating the three year average. The relevant indicator must be calculated as the sum of the positive figures divided by the number of positive figures.

[**Note:** *BCD* Annex X, Part 1 points 2 to 4]

Relevant indicator: An example calculation

- 6.3.3 G If a *firm* has: . . .
- (1) two positive yearly relevant indicators of £20 each; and
 - (2) the final yearly observation shows a negative figure of £5; then
- the relevant indicator is calculated as £20, being £40 (sum of positive figures) divided by 2 (number of positive figures).

Relevant indicator: Insufficient income data

- 6.3.4 G A *firm* that does not have sufficient income data to meet the three-year requirement (e.g. a start-up) may use its forecasted gross income projections for all or part of the three year time period when calculating its relevant indicator.

Relevant indicator: Application of accounting categories

- 6.3.5 R (1) This *rule* applies to a *firm* that is subject to the *Bank Accounts Directive*.
-

- (2) Based on accounting categories for the profit and loss account of *credit institutions* under Article 27 of the *Bank Accounts Directive*, the relevant indicator in *BIPRU* 6.3.2R must be expressed as the sum of the elements listed in the table in *BIPRU* 6.3.6R.
- (3) Each element in the table in *BIPRU* 6.3.6R must be included in the sum with its positive or negative sign.

[Note: *BCD* Annex X, Part 1 point 5]

- 6.3.6 R Table: Relevant indicators
This table belongs to *BIPRU* 6.3.5R

1	Interest receivable and similar income
2	Interest payable and similar charges
3	Income from shares and other variable/fixed-yield securities.
4	Commissions/fees receivable
5	Commission/fees payable
6	Net profit or net loss on financial operations
7	Other operating income

- 6.3.7 G Income from a *participation* held in an *undertaking* by the *firm* or a *subsidiary undertaking* of the *firm* should not be included in the relevant indicator calculations, to ensure that intra-group dividends and other intra-group income flows are not double counted.
- 6.3.8 G Income received under an operating lease should be included as gross income less depreciation, not as gross rental income.
- 6.3.9 G (1) If a *firm* considers that, due to exceptional circumstances, using a three year average to calculate the relevant indicator would lead to a major overestimation of its *ORCR*, the *firm* may apply for a *waiver* from *BIPRU* 6.3.2R.
- (2) Exceptional circumstances might include stopping or selling a major business line.

Qualifications

- 6.3.10 R (1) The relevant indicator for the *basic indicator approach* must be calculated before the deduction of any provisions and operating expenses.

- (2) Operating expenses must include fees paid for outsourcing services rendered by third parties which are not a *parent undertaking* or *subsidiary undertaking* of the *firm* or a *subsidiary undertaking* of a *parent undertaking* which is also the *parent undertaking* of the *firm*. Expenditure on the outsourcing of services rendered by third parties may reduce the relevant indicator if the expenditure is incurred by an undertaking subject to supervision under, or equivalent to, the *Banking Consolidation Directive*.

[Note: *BCD Annex X, Part 1 point 7*]

- 6.3.11 G The definition of 'outsourcing' for the purposes of *BIPRU 6.3.10R(2)* is set out in detail in a Joint Forum paper of the Basel Committee on Banking Supervision entitled "Outsourcing in Financial Services" dated February 2005 and can be summarised as meaning a *firm's* use of a third party to perform activities on a continuing basis that would normally be undertaken by the *firm*, now or in the future and can be the initial transfer of an activity (or part of that activity) from the *firm* to a third party or a further transfer of an activity (or part thereof) from one third party service provider to another.
- 6.3.12 R The following elements must not be used in the calculation of the relevant indicator:
- (1) realised profits/losses from the sale of *non-trading book* items;
 - (2) income from extraordinary or irregular items; and
 - (3) income derived from insurance.

[Note: *BCD Annex X, Part 1 point 8 (part)*]

- 6.3.13 R When revaluation of trading items is part of the profit and loss statement, revaluation may be included in the calculation of the relevant indicator.

[Note: *BCD Annex X, Part 1 point 8 (part)*]

- 6.3.14 R When Article 36(2) of the *Bank Accounts Directive* is applied, revaluation booked in the profit and loss account must be included in the calculation of the relevant indicator.

[Note: *BCD Annex X, Part 1 point 8 (part)*]

- 6.3.15 R When a *firm* is subject to an accounting framework different from the one established by the *Bank Accounts Directive*, it must calculate the relevant income indicator on the basis of internal data that best reflect the definition in this section.

[Note: *BCD Annex X, Part 1 points 6 and 9*]

General risk management standards

- 6.3.16 G In common with all *BIPRU firms*, a *firm* calculating its *ORCR* using the *basic indicator approach* is required to meet the general risk management standards set out in *SYSC 4.1.1R* to *SYSC 4.1.2R* and *SYSC 7.1.15R*.
-

6.4 Operational risk: Standardised approach

Eligibility

- 6.4.1 R (1) To be eligible for the *standardised approach*, a *firm* must meet the qualifying criteria set out in this *rule*, in addition to the general risk management standards set out in SYSC 4.1.1R to SYSC 4.1.2R and SYSC 7.1.15R.
- (2) A *firm* must have a well-documented assessment and management system for *operational risk* with clear responsibilities for the system assigned within the *firm*. The system must identify the *firm's* exposures to *operational risk* and track relevant *operational risk* data, including material loss data.
- (3) A *firm's operational risk* assessment and management system must be subject to regular independent review.
- (4) A *firm's operational risk* assessment system must be closely integrated into the *firm's* risk management processes. Its output must be an integral part of the process of monitoring and controlling the *firm's operational risk* profile.
- (5) A *firm* must implement a system of management reporting that provides *operational risk* reports to relevant functions within the *firm*. A *firm* must have procedures in place for taking appropriate action in response to the information contained in such reports.

[Note: BCD Article 104(6) and Annex X, Part 2 point 12 (part)]

- 6.4.2 R A *firm* must comply with the criteria in BIPRU 6.4.1R having regard to the size and scale of its activities and to the principle of proportionality.

[Note: BCD Annex X, Part 2 point 12 (part)]

Business lines

- 6.4.3 R Under the *standardised approach*, a *firm* must divide its activities into a number of business lines as set out in this section.

[Note: BCD Article 104(1)]

- 6.4.4 G The list of activities in BIPRU 6.4.15R is not a complete definition of the activities within a business line and it may be possible for an activity to be allocated to a business line other than the one to which it is attributed in BIPRU 6.4.15R.

- 6.4.5 R For each business line, a *firm* must calculate a capital requirement for *operational risk* as a certain percentage of a relevant indicator, in accordance with the *rules* in this section.

[Note: BCD Article 104(2)]

ORCR calculated using the standardised approach

- 6.4.6 R The *ORCR* under the *standardised approach* is the average over three years of the risk weighted relevant indicators calculated each year across the business lines in 6.4.15 R.

[Note: BCD Annex X, Part 2 point 1 (part)]

- 6.4.7 R In each year, a negative capital requirement in one business line, resulting from a negative relevant indicator, may be imputed to the whole. However, where the aggregate capital charge across all business lines within a given year is negative, then the input to the average for that year must be zero.

[Note: BCD Annex X, Part 2 point 1 (part)]

- 6.4.8 G (1) If a *firm* considers that, due to exceptional circumstances, using a three year average to calculate the relevant indicator would lead to a major overestimation of its *ORCR*, the *firm* may apply for a *waiver* from *BIPRU* 6.4.5R.
- (2) Exceptional circumstances might include stopping or selling a major business line.

Relevant indicator

- 6.4.9 R The three year average in *BIPRU* 6.4.6R must be calculated on the basis of the last three twelve monthly observations at the end of the financial year. When audited figures are not available, business estimates may be used.

[Note: BCD Annex X, Part 2 point 2]

Principles for business line mapping

- 6.4.10 R A *firm* must develop and document specific policies and criteria for mapping the relevant indicator for current business lines and activities into the framework for the *standardised approach*. The criteria must be reviewed and adjusted for new or changing business activities and risks as appropriate.

[Note: BCD Annex X, Part 2 point 4 (part)]

- 6.4.11 R (1) The principles for business line mapping that a *firm* must meet are set out in this *rule*.
- (2) All activities must be mapped into the business lines in a mutually exclusive and jointly exhaustive manner.
-

- (3) Any activity which cannot be readily mapped into the business line framework, but which represents an ancillary function to an activity included in the framework, must be allocated to the business line it supports. If more than one business line is supported through the ancillary activity, an objective mapping criterion must be used (e.g., proportional allocation of the indicators).
- (4) If an activity cannot be mapped into a particular business line then the business line yielding the highest charge for the *firm* must be used. The same business line equally applies to any associated ancillary activity.
- (5) A *firm* may use internal pricing methods to allocate the relevant indicator between business lines.
- (6) The mapping of activities into business lines for *operational risk* capital purposes must be consistent with the definitions of business lines used by the *firm* for credit and market risks.
- (7) Senior management must be responsible for the mapping policy.
- (8) The mapping process to business lines must be subject to independent review.

[Note: BCD Annex X, Part 2 point 4 (part)]

- 6.4.12 G A *firm* that is mapping activities to a business line should take into account:
- (1) the activities listed in respect of each business line in the table in *BIPRU* 6.4.15R; and
 - (2) the organisation of the *firm's* business in respect of that business line.
- 6.4.13 G A *firm* should take into account its business and organisation when mapping activities to the business lines in the table in *BIPRU* 6.4.15R.
- 6.4.14 R For the purposes of *BIPRU* 6.4.11R(5), costs generated in one business line which are imputable to a different business line may be reallocated to the business line to which they pertain, for instance by using a treatment based on internal transfer costs between two business lines.
- [Note: BCD Annex X, Part 2 point 4 (part)]
- 6.4.15 R Table: Percentages applying to the income indicator of individual business lines
This table belongs to *BIPRU* 6.4.3R

Business line	List of activities	Percentage
Corporate finance	<ul style="list-style-type: none"> • Underwriting of financial instruments and/or placing of financial instruments 	18%

Business line	List of activities	Percentage
	<p>on a firm commitment basis</p> <ul style="list-style-type: none"> • Services related to underwriting • Investment advice • Advice to <i>undertakings</i> on capital structure, industrial strategy and related matters and advice and services relating to the mergers and the purchase of <i>undertakings</i> • Investment research and financial analysis and other forms of general recommendation relating to transactions in financial instruments 	
Trading and sales	<ul style="list-style-type: none"> • Dealing on own account • Money broking • Reception and transmission of orders in relation to one or more financial instruments • Execution of orders on behalf of clients • Placing of financial instruments on a best efforts basis • Operation of <i>multilateral trading facilities</i> 	18%
Retail brokerage (Activities with individual physical persons or with a <i>retail SME</i> as defined under the <i>standardised approach</i> to credit risk)	<ul style="list-style-type: none"> • Reception and transmission of orders in relation to one or more financial instruments • Execution of orders of behalf of clients • Placing of financial instruments without a firm commitment basis 	12%
Commercial banking	<ul style="list-style-type: none"> • Acceptance of deposits and other repayable funds • Lending • Financial leasing 	15%

Business line	List of activities	Percentage
	<ul style="list-style-type: none"> • Guarantees and commitments 	
Retail banking (Activities with an individual physical persons or with a <i>retail SME</i> as defined under the <i>standardised approach</i> to credit risk)	<ul style="list-style-type: none"> • Acceptance of deposits and other repayable funds • Lending • Financial leasing • Guarantees and commitments 	12%
Payment and settlement	<ul style="list-style-type: none"> • Money transmission services • Issuing and administering means of payment 	18%
Agency services	<ul style="list-style-type: none"> • Safekeeping and administration of financial instruments for the account of clients including custodianship and related services such as cash/collateral management 	15%
Asset management	<ul style="list-style-type: none"> • Portfolio management • UCITS management and other forms of asset management 	12%

The alternative standardised approach

- 6.4.16 G Under the *alternative standardised approach*, a *firm* using the *standardised approach* may use alternative indicators for retail banking and commercial banking business lines if it complies with *BIPRU* 6.4.17R to 6.4.21R.

[Note: *BCD* Annex X, Part 2 point 3]

Eligibility for the alternative standardised approach

- 6.4.17 R To be eligible to use the *alternative standardised approach*, a *firm* must meet the following conditions, in addition to the general risk management standards set out in *SYSC* 4.1.1R to *SYSC* 4.1.2R and *SYSC* 7.1.15R:

- (1) the *firm* must meet the eligibility criteria for the *standardised approach* in *BIPRU* 6.4.1R;
- (2) the *firm* must be overwhelmingly active in retail and/or commercial banking activities, which must account for at least 90% of its income; and

- (3) the *firm* must be able to demonstrate that a significant proportion of its retail and/or commercial banking activities comprise loans associated with a high *probability of default*, and that the *alternative standardised approach* provides an improved basis for assessing the *operational risk*.

[Note: BCD Article 104(3) and Annex X, Part 2 points 5 and 8 to 11]

- 6.4.18 G In relation to BIPRU 6.4.18R(3), the FSA's view is that a high *probability of default* is equal to or greater than 3.5%.

ORCR calculated using the alternative standardised approach

- 6.4.19 R (1) The relevant indicators under the *alternative standardised approach* are the same as for the *standardised approach* except for the two following business lines:
- (a) retail banking; and
 - (b) commercial banking.
- (2) For retail banking and commercial banking, the *ORCR* must be calculated as a normalised income indicator equal to the three-year average of the total nominal amount of loans and advances multiplied:
- (a) by 0.035, and then
 - (b) by the appropriate business line percentage set out in BIPRU 6.4.15R.

[Note: BCD Annex X, Part 2 point 6]

- 6.4.20 R For the retail and/or commercial banking business lines, the loans and advances must consist of the total drawn amounts in the corresponding credit portfolios.

[Note: BCD Annex X, Part 2 point 7 (part)]

- 6.4.21 R For the commercial banking business line, the securities held in the *non-trading book* must also be included.

[Note: BCD Annex X, Part 2 point 7 (part)]

6.5 Operational risk: Advanced measurement approaches

Application

6.5.1 R *BIPRU 6.5 applies to a BIPRU firm with an AMA permission.*

AMA permissions: general

6.5.2 G The *rules* in *GENPRU* and *BIPRU* do not allow a *firm* to use the *advanced measurement approach*. A *firm* that wishes to use an *advanced measurement approach*, based on the *firm's* own *operational risk* measurement systems, for the calculation of its *ORCR* should therefore apply for *AMA permission* to use the *advanced measurement approach* as explained in *BIPRU 1.3*.

6.5.3 G The *FSA* will not grant a *firm* an *AMA permission* to use the *advanced measurement approach* if the *firm* does not meet the standards in *BIPRU 6.5.5R*.

6.5.4 G An *AMA permission* will generally modify *BIPRU 6.2.1R* (Calculation of *ORCR*) by amending, to the extent set out in the *AMA permission*, the calculation of the *ORCR* of the *firm* to be calculated in accordance with *BIPRU 6.5*.

Minimum standards

6.5.5 R A *firm* must be able to satisfy the *FSA* that it meets:

- (1) the general risk management standards in *SYSC 4.1.1R* to *SYSC 4.1.2R* and *SYSC 7.1.15R*;
- (2) the qualitative standards set out in this section; and
- (3) the quantitative standards set out in this section.

[**Note:** *BCD* Article 105(2) and Annex X Part 3 point 1]

Qualitative standards

- 6.5.6 R
- (1) This *rule* sets out the qualitative standards that a *firm's operational risk* measurement system must meet.
 - (2) A *firm's* internal *operational risk* measurement system must be closely integrated into its day-to-day risk management processes.
 - (3) A *firm* must have an independent risk management function for *operational risk*.
 - (4) There must be regular reporting of *operational risk* exposures and loss experience. The *firm* must have procedures for taking appropriate corrective action.
 - (5) A *firm's* risk management system must be well documented. The *firm* must have a routine in place for ensuring compliance and policies for the treatment of non-compliance.
-

- (6) A *firm's operational risk* management processes and measurement systems must be subject to regular reviews performed by internal and/or external auditors.
- (7) A *firm* must ensure that in respect of its *operational risk* measurement system:
 - (a) its internal validation processes are operating in a satisfactory manner; and
 - (b) the data flows and processes associated with the risk measurement system are transparent and accessible.

[Note: BCD Annex X Part 3 points 2 to 7]

- 6.5.7 G For the purposes of *BIPRU* 6.5.6R(2), a *firm* should be able to show that:
- (1) its *operational risk* measurement systems and processes provide benefits to the *firm* and are not limited to determining regulatory capital;
 - (2) the *operational risk* measurement system and framework forms part of the systems and controls it has in place; and
 - (3) the *operational risk* measurement system and framework are capable of adapting to the changes in the business of the *firm* and evolving as the *firm* gains experience of risk management techniques.
- 6.5.8 G For the purposes of *BIPRU* 6.5.6R(3), a *firm* should be able to show that the independent risk management function is sufficiently separate from the business units of the *firm* to allow its professional judgement and recommendations to be effective and impartial.
- 6.5.9 G For the purposes of *BIPRU* 6.5.6R(4), a *firm* should ensure that:
- (1) its *governing body* or *designated committee* (where one is used) possesses a general understanding of the *firm's AMA*; and
 - (2) its senior management possesses a good understanding of the *firm's AMA* and its operation.
- 6.5.10 G
- (1) A *firm's governing body* or *designated committee* may choose to approve only material aspects of the *firm's AMA* and material changes to the *firm's AMA*.
 - (2) Where a *firm's governing body* or *designated committee* chooses to approve only material aspects of the *firm's AMA* and material changes to the *firm's AMA*:
-

- (a) the *firm's governing body* or *designated committee* should define the *firm's* overall approach to the *AMA* and approve a policy statement defining that approach; and
- (b) the *firm* should define and document the process for approval of non-material aspects of the *firm's AMA*.

6.5.11 G For the purposes of *BIPRU* 6.5.6R(7), a *firm* should develop and adopt an internal validation methodology of its *operational risk* measurement system and management processes that:

- (1) is proportionate and appropriate to the business of the *firm*;
- (2) takes into account changing market and operating conditions of the *firm*;
- (3) encompasses both quantitative and qualitative methods of the *firm's operational risk* measurement system;
- (4) is periodically assessed by the *firm*;
- (5) is subject to regular independent review to ensure effective implementation; and
- (6) is clearly documented;

Quantitative standards: process

- 6.5.12 R
- (1) This *rule* sets out the quantitative standards that a *firm's operational risk* measurement system must meet with respect to process.
 - (2) A *firm* must calculate its capital requirement as comprising both expected loss and unexpected loss, unless the *firm* can demonstrate that expected loss is adequately captured in its internal business practices.
 - (3) The *operational risk* measure of a *firm* must capture potentially severe tail events, achieving a soundness standard comparable to a 99.9% confidence interval over a one year period.
 - (4) The *operational risk* measurement system of a *firm* must have certain key elements to meet the soundness standard set out in (2) and (3). These elements must include the use of internal data, external data, scenario analysis and factors reflecting the business environment and internal control systems as set out in *BIPRU* 6.5.21R to *BIPRU* 6.5.25R.
 - (5) A *firm* must have a well documented approach for weighting the use of the four elements in (4) in its overall risk measurement system.
 - (6) A *firm's* risk measurement system must capture the major drivers of risk affecting the shape of the tail of the loss estimates.
-

- (7) A *firm* must only recognise correlations in *operational risk* losses across individual *operational risk* estimates to the extent they are set out in its *AMA permission*. The *firm* must validate its correlation assumptions using appropriate quantitative and qualitative techniques.
- (8) A *firm's* risk measurement system must be internally consistent and must avoid the multiple counting of qualitative assessments or risk mitigants recognised in other areas of the capital adequacy framework.

[**Note:** *BCD* Annex X Part 3 points 8 to 10, 11 (part) and 12]

- 6.5.13 R For the purposes of *BIPRU* 6.5.12R(7), the *firm* must be able to show that its system for measuring correlations is sound, implemented with integrity, and takes into account the uncertainty surrounding any such correlation estimates, particularly in periods of stress.

[**Note:** *BCD* Annex X Part 3 point 11 (part)]

- 6.5.14 G A *firm* should be able to satisfy the *FSA* that it has considered the following with respect to its *operational risk* measurement systems:
- (1) whether the choice of distributions used provides both a good fit with the data and an ability adequately to account for rare events;
 - (2) whether the estimated parameters and capital numbers used for the simulated inclusion or exclusion of unusually large losses are sufficiently robust;
 - (3) the co-dependency, or independency, of assumptions governing the relationships between risk types and between business lines;
 - (4) the number of simulations or iterations required during model execution to provide reasonably stable capital results;
 - (5) the emergence of different data types, such as the combination of internal and external loss data, based on different degrees of credibility; and
 - (6) the methodologies used for the purposes of achieving a soundness standard comparable to a 99.9% confidence interval.

- 6.5.15 G For the purposes of *BIPRU* 6.5.12R(2), a *firm* should be able to show that its *operational risk* measurement systems that capture expected loss are:
- (1) clearly documented;
 - (2) sound, implemented with integrity and consistently applied, and take into account uncertainty surrounding expected loss;
 - (3) subject to regular reviews by the *firm* of the reasonableness of the expected loss estimates and comparisons with subsequent outcomes; and
-

- (4) based on justifiable assumptions for capturing and reviewing the reasonableness of the expected loss estimates.
- 6.5.16 G For the purposes of *BIPRU* 6.5.15G, the *firm* should use the business management definition it uses for the purposes of identifying an expected loss.
- 6.5.17 G Where a *firm* is using a combination of budgeting and pricing for the purposes of the *operational risk* measurement system for capturing expected loss, a *firm* should be able to show that:
- (1) the process is transparent, can be repeated and provides support to the *firm's* management of its business;
 - (2) to a reasonable degree of certainty, budgeted resources for the relevant year cover budgeted expected losses;
 - (3) its forecasting takes into account both historic performance and drivers which may affect future trends; and
 - (4) the forecasting in (3) is monitored on a periodic basis and adjusted as appropriate.
- 6.5.18 G For the purposes of *BIPRU* 6.5.12R(3), a *firm* should be able to show that in respect of its *operational risk* measurement system:
- (1) the methodology for obtaining a soundness standard comparable to a 99.9% confidence level is practical and appropriate;
 - (2) it has assessed its overall model outputs as sufficiently robust; and
 - (3) it reviews its methodology on an ongoing basis.
- 6.5.19 G For the purpose of developing and reviewing its methodology for obtaining a soundness standard comparable to a 99.9% confidence level, a *firm* should consider whether any of the following are appropriate:
- (1) stress testing;
 - (2) sensitivity analysis;
 - (3) scenario analysis;
 - (4) back testing; and
 - (5) boot-strapping techniques.
- 6.5.20 G Where a *firm* is using scaling for the purposes of the *operational risk* measurement system, it should be able to show that the methodology used is robust and based on assumptions that are meaningful and credible.

Quantitative standards: internal data

- 6.5.21 R (1) This *rule* sets out the quantitative standards that a *firm's operational risk* measurement system must meet with respect to internal data.
- (2) A *firm's* internally generated *operational risk* measures must be based on a minimum historical observation period of five years. When a *firm* first moves to the *advanced measurement approach*, a three year historical observation period may be used.
- (3) A *firm* must be able to map its historical internal loss data into the business lines defined in *BIPRU 6.4.15R* and into the event type categories defined in *BIPRU 6.5.25R*, and must be able to provide this data to the FSA upon request. The *firm* must have documented, objective criteria for allocating losses to the specified business lines and event types. A *firm's operational risk* losses that are related to credit risk and have historically been included in the internal credit risk databases must be recorded in the *operational risk* databases and be separately identified. Such losses will not be subject to the *ORCR*, as long as they continue to be treated as credit risk for the purposes of calculating the *capital resources requirement*. *Operational risk* losses that are related to market risks must be included in the scope of the capital requirement for *operational risk*.
- (4) A *firm's* internal loss data must be comprehensive in that it captures all material activities and exposures from all appropriate sub-systems and geographic locations. A *firm* must be able to demonstrate that any excluded activities or exposures, both individually and in combination, would not have a material impact on the overall risk estimates. A *firm* must define appropriate minimum loss thresholds for internal loss data collection.
- (5) Aside from information on gross loss amounts, a *firm* must collect information about the date of the event, any recoveries of gross loss amounts, as well as some descriptive information about the drivers or causes of the loss event.
- (6) A *firm* must have specific criteria for assigning loss data arising from an event in a centralised function or an activity that spans more than one business line, as well as from related events over time.
- (7) A *firm* must have documented procedures for assessing the ongoing relevance of historical loss data, including those situations in which judgement overrides, scaling or other adjustments may be used, to what extent they may be used and who is authorised to make such decisions.

[**Note:** *BCD Annex X Part 3 points 13 to 18*]

Quantitative standards: external data

- 6.5.22 R (1) This *rule* sets out the quantitative standards that a *firm's operational risk* measurement system must meet with respect to external data.
-

- (2) A *firm's operational risk* measurement system must use relevant external data, especially when there is reason to believe that the *firm* is exposed to infrequent, yet potentially severe, losses. A *firm* must have a systematic process for determining the situations for which external data should be used and the methodologies used to incorporate the data in its measurement system. The conditions and practices for external data use should be regularly reviewed, documented and subject to periodic independent review.

[**Note:** BCD Annex X Part 3 point 19]

Quantitative standards: scenario analysis

- 6.5.23 R
- (1) This *rule* sets out the quantitative standards that a *firm's operational risk* measurement system must meet with respect to scenario analysis.
 - (2) A *firm* must use scenario analysis of expert opinion in conjunction with external data to evaluate its exposure to high severity events. Over time, such assessments must be validated and re-assessed through comparison to actual loss experience to ensure their reasonableness.

[**Note:** BCD Annex X Part 3 point 20]

Quantitative standards: business environment and internal control factors

- 6.5.24 R
- (1) This *rule* sets out the quantitative standards that a *firm's operational risk* measurement system must meet with respect to business environment and internal control factors.
 - (2) A *firm's firm-wide* risk assessment methodology must capture key business environment and internal control factors that can change its *operational risk* profile.
 - (3) A *firm* must be able to justify the choice of each factor as a meaningful driver of risk, based on experience and involving the expert judgment of the affected business areas.
 - (4) The sensitivity of risk estimates to changes in the factors and the relative weighting of the various factors must be well reasoned. In addition to capturing changes in risk due to improvements in risk controls, the framework must also capture potential increases in risk due to greater complexity of activities or increased business volume.
 - (5) A *firm* must document this framework and make it subject to independent review within the *firm* and make it available for review by supervisors.
 - (6) Over time, a *firm* must validate and re-assess the process and the outcomes through comparison to actual internal loss experience and relevant external data.

[**Note:** BCD Annex X Part 3 points 21 to 24]

Loss event type classification

Table: Loss event type classification

6.5.25 R This table belongs to BIPRU 6.5.21R(3).

Event-Type Category	Definition
Internal fraud	Losses due to acts of a type intended to defraud, misappropriate property or circumvent regulations, the law or company policy, excluding diversity/discrimination events, which involves at least one internal party
External fraud	Losses due to acts of a type intended to defraud, misappropriate property or circumvent the law, by a third party
Employee Practices and Workplace Safety	Losses arising from acts inconsistent with employment, health or safety laws or agreements, from payment of personal injury claims, or from diversity/discrimination events
Clients, Products & Business Practices	Losses arising from an unintentional or negligent failure to meet a professional obligation to specific clients (including fiduciary and suitability requirements), or from the nature or design of a product
Damage to Physical Assets	Losses arising from loss or damage to physical assets from natural disaster or other events
Business disruption and system failures	Losses arising from disruption of business or system failures
Execution, Delivery & Process Management	Losses from failed transaction processing or process management, from relations with trade counterparties and vendors

[**Note:** BCD Annex X Part 5 Table 3]

Impact of insurance and risk transfer mechanisms

6.5.26 R (1) *A firm may recognise the impact of insurance for the purposes of its operational risk measurement system subject to the conditions set out in this rule and BIPRU 6.5.27R.*

- (2) The provider must be authorised to provide insurance or re-insurance.
- (3) The provider must have a minimum claims paying ability rating by an *eligible ECAI* associated with *credit quality step 3* or above under the rules for the risk weighting of exposures to *firms* under the *standardised approach* to credit risk .

[Note: BCD Annex X Part 3 points 25 to 26]

- 6.5.27 R
- (1) A *firm* must ensure that its insurance and its insurance framework meet the conditions in this *rule*.
 - (2) The insurance policy must have a initial term of no less than one year. For policies with a residual term of less than one year the *firm* must make appropriate haircuts to reflect the declining residual term of the policy, up to a full 100% haircut for policies with a residual term of 90 days or less.
 - (3) The insurance policy must have a minimum notice period for cancellation of the contract of 90 days.
 - (4) The insurance policy must contain no exclusions or limitations based upon supervisory actions or, in the case of a failed *firm*, that preclude the *firm*, its receiver or liquidator from recovering for damages suffered or expenses incurred by the *firm*, except in respect of events occurring after the initiation of receivership or liquidation proceedings in respect of the *firm*. The insurance policy may exclude coverage for any fine, penalty or punitive damages resulting from actions by a *competent authority* or *third country competent authority*.
 - (5) The risk mitigation calculations must reflect the insurance coverage in a manner that is transparent in its relationship to, and consistent with, the actual likelihood and impact of loss used in the overall determination of the *ORCR*.
 - (6) The insurance must be provided by a third party entity. In the case of insurance through captives and affiliates, the exposure must be laid off to an independent third party entity, for example through reinsurance that meets the eligibility criteria.
 - (7) The framework for recognising insurance must be well reasoned and documented.
 - (8) The methodology for recognising insurance must capture the following elements through discounts or haircuts in the amount of insurance recognition:
 - (a) the residual term of a policy, where less than one year, as noted in (2);
 - (b) a policy's cancellation terms, where less than one year;
 - (c) mismatches in coverage of insurance policies; and
-

(d) the uncertainty of payment.

- (9) The capital alleviation arising from the recognition of insurance must not exceed 20% of the capital requirement before the recognition of risk mitigation techniques.

[Note: BCD Annex X Part 3 points 27 to 29]

- 6.5.28 G For the purposes of *BIPRU* 6.5.27R(7), a *firm* should be able to demonstrate that the mitigating effect of the insurance is appropriate and relevant to the *firm's* business.
- 6.5.29 G For the purposes of *BIPRU* 6.5.27R(9), a *firm* should be able to set out clearly how it made its assessment of the appropriate level of capital alleviation, including any assumptions made by the *firm* and how the insurance has been factored into the *firm's* risk measurement system.
- 6.5.30 R A *firm* may recognise a risk transfer mechanism other than insurance to the extent that a noticeable risk mitigating effect is achieved and the risk transfer mechanism is included in the *firm's AMA permission*.

Use of an advanced measurement approach on a groupwide basis

- 6.5.31 R Where an *EEA parent institution* and its *subsidiary undertakings* or an *EEA parent financial holding company* and its *subsidiary undertakings* use an *advanced measurement approach* on a unified basis for the *parent undertaking* and its *subsidiary undertakings*, the qualifying criteria set out in *BIPRU* 6.5 may be met by the *parent undertaking* and its *subsidiary undertakings* considered together where permitted by the *AMA permission*.

[Note: BCD Article 105(4)]

- 6.5.32 G Where the *AMA* is used on a unified basis for the *parent undertaking* and its *subsidiary undertakings*, and approval and reporting of the *AMA* are carried out at the group level, the qualifying criteria in *BIPRU* 6.5 may be met if:
- (1) the *subsidiary undertakings* have delegated to the *governing body* or *designated committee* of the *EEA parent institution* or *EEA parent financial holding company* responsibility for approval of the *AMA*;
 - (2) the *governing body* or *designated committee* of the *EEA parent institution* or *EEA parent financial holding company* approves either:
 - (a) all aspects of the *AMA*, and material changes; or
 - (b) all aspects of the *AMA* that are material in the context of the group, and material changes to those, and a policy statement defining the overall approach to the *AMA*.

- 7 Market risk
- 7.1 Application, purpose, general provisions and non-standard transactions
- Application
- 7.1.1 R This chapter applies to a *BIPRU firm*.
- Purpose
- 7.1.2 G The purpose of this chapter is to implement Annexes I, III, IV and V of the *Capital Adequacy Directive*.
- General provisions: Obligation to calculate PRR
- 7.1.3 R A *firm* must calculate a *PRR* in respect of:
- (1) all its *trading book positions*;
 - (2) all *positions* falling within *BIPRU 7.5.3* (Scope of the foreign exchange PRR calculation), whether or not in the *trading book*; and
 - (3) all *positions* in *commodities* (including *physical commodities*) whether or not in the *trading book*;
- even if no treatment is provided for that *position* in the other sections of this chapter.
- 7.1.4 R A *firm* must calculate a *PRR* for any *position* falling into *BIPRU 7.1.3R* using:
- (1) the *PRR* calculations contained in *BIPRU 7*; or
 - (2) another method provided the *firm* is able to demonstrate that in all circumstances the calculation being employed results in a higher *PRR* for the *position* than would be required under (1).
- General provisions: Non-trading book items
- 7.1.5 G *Positions* in instruments which are *non-trading book* items should be treated under *BIPRU 3* (Standardised credit risk), *BIPRU 4* (The IRB approach) or *BIPRU 13* (Financial derivatives, SFTs and long settlement transactions) unless deducted as an *illiquid asset*. If they fall into *BIPRU 7.1.3R(2)* or (3) they also give rise to a *PRR charge*.
- General provisions: Frequency of calculation

- 7.1.6 R A *firm* must be able to monitor its total *PRR* on an intra-day basis, and, before executing any trade, must be able to re-calculate *PRR* to the level of detail necessary to establish whether or not the *firm's capital resources* exceed its *capital resources requirement*.
- 7.1.7 G A *firm* may rely on intra-day limits for the purposes of *BIPRU 7.1.6R*.
Purpose of rules for non-standard transactions and instruments for which no *PRR* treatment has been specified
- 7.1.8 G The methodologies which have been developed for calculating *PRR charges* have been based on existing instruments and assume instruments with standard characteristics. However, as a result of innovation and because there are instruments which, although based on a standard contract, contain structural features which would make the *rules* in the rest of this chapter inappropriate, flexible *rules* are required. The *rules* in this section about transactions for which no *PRR* treatment has been specified and non-standard transactions are designed to address this.
Instruments for which no *PRR* treatment has been specified
- 7.1.9 R Where a *firm* has a *position* for which no *PRR* treatment has been specified, it must calculate the *PRR* for that *position* in accordance with *BIPRU 7.1.12R - BIPRU 7.1.13R*.
- 7.1.10 R If *BIPRU 7.1.9R* applies, a *firm* must document its policies and procedures for calculating the *PRR* for that *position* of that type in its *trading book policy statement*.
- 7.1.11 G Under *BIPRU 1.2.30R(2)* a *firm* should notify the *FSA* as soon as is reasonably practicable if its *trading book policy statement* is subject to significant changes. Therefore if a *firm* makes a change in accordance with *BIPRU 7.1.10R* it should consider whether it is necessary to report it to the *FSA*.
- 7.1.12 R A *firm* may calculate the *PRR* for a *position* falling into *BIPRU 7.1.9R* by applying by analogy the *rules* relating to the calculation of the *interest rate PRR*, the *equity PRR*, the *commodity PRR*, the *foreign exchange PRR*, the *option PRR* or the *collective investment undertaking PRR* if doing so is appropriate and if the *position* and *PRR item* are sufficiently similar to those that are covered by those *rules*.
- 7.1.13 R Where a *firm* has a *position* for which no *PRR* treatment has been specified and it is not applying *BIPRU 7.1.12R*, it must calculate a *PRR* of an appropriate percentage of the current value of the *position* calculated under *GENPRU 1.3 (Valuation)*.
Instruments in non-standard form
- 7.1.14 R (1) If a *firm* has a *position*:

- (a) in a *PRR item* in non-standard form; or
- (b) that is part of a non-standard arrangement; or
- (c) that, taken together with other *positions* (whether or not they are subject to *PRR charges* under *BIPRU 7*), gives rise to a non-standard *market risk*;

the *firm* must notify the *FSA* of that fact and of details about the *position*, *PRR item*, arrangements and type of risk concerned.

- (2) Except as (1) provides to the contrary, (1) applies to a *position* that is subject to a *PRR* under *BIPRU 7.1.3R*.
- (3) The question of what is non-standard for the purposes of (1) must be judged by reference to the standards:
 - (a) prevailing at the time the *rule* is being applied; and
 - (b) of *firms* generally who carry on business which gives rise to *PRRs* under *BIPRU 7* rather than merely by reference to the *firm's* own business.

7.1.15 R If a firm has a *position* or combination of *positions* falling into *BIPRU 7.1.14R* and the *PRR* relating to that *position* or *positions* materially underestimates the *market risk* incurred by the *firm* to which they give rise, the *firm* must calculate the *PRR* for that *position* or *positions* under *BIPRU 7.1.13R*.

Meaning of appropriate percentage for non-standard transactions

- 7.1.16 E
- (1) In *BIPRU 7.1.13R* and, to the extent that that *rule* applies *BIPRU 7.1.13R*, *BIPRU 7.1.15R*, an "appropriate percentage" is:
 - (a) 100%; or
 - (b) a percentage which takes account of the characteristics of the *position* concerned and of discussions with the *FSA* or a predecessor regulator under the Banking Act 1987 or the Financial Services Act 1986.
 - (2) Compliance with (1) may be relied on as tending to establish compliance with *BIPRU 7.1.13R* or, insofar as it incorporates the requirements relating to an appropriate percentage, *BIPRU 7.1.15R*.
 - (3) Contravention of (1) may be relied on as tending to establish contravention with *BIPRU 7.1.13R* or, insofar as it incorporates the requirements relating to an appropriate percentage, *BIPRU 7.1.15R*.

7.2 Interest rate PRR

General rule

- 7.2.1 R (1) A *firm* must calculate its *interest rate PRR* under *BIPRU 7.2* by:
- (a) identifying which *positions* must be included within the *interest rate PRR* calculation;
 - (b) deriving the net *position* in each debt *security* in accordance with *BIPRU 7.2.36R - BIPRU 7.2.41R*;
 - (c) including these net *positions* in the *interest rate PRR* calculation for *general market risk* and the *interest rate PRR* calculation for *specific risk*; and
 - (d) summing all *PRRs* calculated for *general market risk* and *specific risk*.
- (2) A *firm* must calculate its *interest rate PRR* by adding the amount calculated under (1) to the amount calculated under the basic *interest rate PRR* calculation under *BIPRU 7.3.45R*.
- (3) All net *positions*, irrespective of their signs, must be converted on a daily basis into the *firm's base currency* at the prevailing spot exchange rate before their aggregation.
- (4) Net *positions* must be classified according to the currency in which they are denominated. A *firm* must calculate the capital requirement for *general market risk* and *specific risk* in each individual currency separately.
- 7.2.2 G The *interest rate PRR* calculation divides the interest rate risk into the risk of loss from a general move in market interest rates, and the risk of loss from an individual debt *security's* price changing for reasons other than a general move in market interest rates. These are called *general market risk* and *specific risk* respectively.

Scope of the interest rate PRR calculation

- 7.2.3 R A *firm's interest rate PRR* calculation must:
- (1) include all *trading book positions* in debt *securities*, preference *shares* and *convertibles*, except:
 - (a) *positions* in *convertibles* which have been included in the *firm's equity PRR* calculation;

- (b) *positions* fully deducted as a *material holding* under the calculations under the *capital resources table*, in which case the *firm* may exclude them; or
 - (c) *positions* hedging an *option* which is being treated under BIPRU 7.6.26R (Table: Appropriate treatment for equities, debt securities or currencies hedging options);
- (2) include notional *positions* arising from *trading book positions* in the instruments listed in the table in BIPRU 7.2.4R; and
- (3) (if the *firm* is the transferor of *debt securities* or guaranteed rights relating to title to *debt securities* in a *repurchase agreement* or the lender of *debt securities* in a *debt securities* lending agreement) include such *debt securities* if those *debt securities* meet the criteria for inclusion in the *trading book*.

7.2.4 R Table: Instruments which result in notional positions
This table belongs to BIPRU 7.2.3R(2)

Instrument	See
<i>Futures, forwards</i> or <i>synthetic futures</i> on <i>debt securities</i>	BIPRU 7.2.13R
<i>Futures, forwards</i> or <i>synthetic futures</i> on <i>debt indices</i> or <i>baskets</i>	BIPRU 7.2.14R
<i>Interest rate futures</i> or <i>forward rate agreements (FRAs)</i>	BIPRU 7.2.18R
<i>Interest rate swaps</i> or <i>foreign currency swaps</i>	BIPRU 7.2.21R
<i>Deferred start interest rate swaps</i> or <i>foreign currency swaps</i>	BIPRU 7.2.24R
The interest rate leg of an <i>equity swap</i> (unless the <i>firm</i> calculates the <i>interest rate PRR</i> on the instrument using the basic <i>interest rate PRR</i> calculation in BIPRU 7.3 (Equity PRR and basic interest rate PRR for equity derivatives))	BIPRU 7.2.27R
The cash leg of a <i>repurchase agreement</i> or a <i>reverse repurchase agreement</i>	BIPRU 7.2.30R
Cash borrowings or deposits	BIPRU 7.2.31R

<i>Options on a debt security, a basket of debt securities, a debt security index, an interest rate or an interest rate future or swap (including an option on a future on a debt security) (unless the firm calculates a PRR on the option under BIPRU 7.6 (Option PRR))</i>	<i>BIPRU 7.2.32R</i>
Dual currency bonds	<i>BIPRU 7.2.33R</i>
<i>Foreign currency futures or forwards</i>	<i>BIPRU 7.2.34R</i>
Gold futures or forwards	<i>BIPRU 7.2.34R</i>
<i>Forwards, futures or options (except cliquets) on an equity, basket of equities or equity index (unless the firm calculates the interest rate PRR on the instrument using the basic interest rate PRR calculation in BIPRU 7.3)</i>	<i>BIPRU 7.2.34R</i>
Credit derivatives	<i>BIPRU 7.11</i>
A warrant must be treated in the same way as an option	

- 7.2.5 G *BIPRU 7.2.3R(1) includes a trading book position in debt security, preference share or convertible that is subsequently repo'd under a repurchase agreement or lent under a stock lending agreement. Clearly, if the security had initially been obtained via a reverse repurchase agreement or stock borrowing agreement, the security would not have been included in the PRR calculation in the first place.*
- 7.2.6 G *BIPRU 7.2.3R(1) includes net underwriting positions or reduced net underwriting positions in debt securities.*
- 7.2.7 G *Firms are reminded that the table in BIPRU 7.6.5R (Table: Appropriate PRR calculation for an option or warrant) divides options and warrants on interest rates, debt securities and interest rate futures and swaps into:*
- (1) those which must be treated under *BIPRU 7.6 (Option PRR)*; and
 - (2) those which must be treated under either *BIPRU 7.2* or *BIPRU 7.6*, the *firm* being able to choose whether *BIPRU 7.2* or *BIPRU 7.6* is used.
- 7.2.8 G *Cliquets on equities, baskets of equities or equity indices do not attract an interest rate PRR. The table in BIPRU 7.2.4R excludes them from the scope of the interest rate PRR calculation in BIPRU 7.2 and BIPRU 7.3.45R excludes them from the basic interest rate PRR calculation in BIPRU 7.3 (Equity PRR and basic interest rate PRR for equity derivatives).*

7.2.9 G The table in *BIPRU 7.2.4R* shows that *equity derivatives* are excluded from *BIPRU 7.2's PRR* calculation if they have been included in the basic *interest rate PRR* calculation in *BIPRU 7.3* (see *BIPRU 7.3.45R*).

Derivation of notional positions: General approach

7.2.10 G *BIPRU 7.2.11R - BIPRU 7.2.35R* convert the instruments listed in the table in *BIPRU 7.2.4R* into notional *positions* in:

- (1) the underlying debt *security*, where the instrument depends on the price (or yield) of a specific debt *security*; or
- (2) notional debt *securities* to capture the pure interest rate risk arising from future payments and receipts of cash (including notional payments and receipts) which, because they are designed to represent pure *general market risk* (and not *specific risk*), are called *zero-specific-risk securities*; or
- (3) both (1) and (2).

7.2.11 R (1) For the purposes of calculating *interest rate PRR*, unless specified otherwise, a *firm* must derive the value of notional *positions* as follows:

- (a) notional *positions* in actual debt *securities* must be valued as the nominal amount underlying the contract at the current market price of the debt *security*; and
- (b) *positions* in *zero-specific-risk securities* must be valued using one of the two methods in (2).

(2) A *firm* must use one of the following two methods for all *positions* arising under (1)(b) and must use the same method for all *positions* denominated in the same currency:

- (a) the present value approach, under which the *zero-specific-risk security* is assigned a value equal to the present value of all the future cash flows that it represents; or
- (b) the alternative approach, under which the *zero-specific-risk security* is assigned a value equal to:
 - (i) the market value of the underlying notional *equity position* in the case of an *equity derivative*;
 - (ii) the notional principal amount in the case of an interest rate or *foreign currency swap*; or
 - (iii) the notional amount of the future cash flow that it represents in the case of any other *CRD financial instrument*.

7.2.12 R A *firm* must use *BIPRU 7.2.11R(2)(a)* in respect of any *positions* that it includes in the *interest rate duration method*.

Derivation of notional positions: Futures, forwards or synthetic futures on a debt security

7.2.13 R *Futures, forwards* or *synthetic futures* on a single debt *security* must be treated as follows:

(1) a purchased *future, synthetic future* or *forward* is treated as:

- (a) a notional long *position* in the underlying debt *security* (or the cheapest to deliver (taking into account the conversion factor) where the contract can be satisfied by delivery of one from a range of *securities*); and
- (b) a notional short *position* in a zero coupon *zero-specific-risk security* with a maturity equal to the expiry date of the *future* or *forward*; and

(2) a sold *future, synthetic future* or *forward* is treated as:

- (a) a notional short *position* in the underlying *security* (or the cheapest to deliver (taking into account the conversion factor) where the contract can be satisfied by delivery of one from a range of *securities*); and
- (b) a notional long *position* in a zero coupon *zero-specific-risk security* with a maturity equal to the expiry date of the *future, synthetic future* or *forward*.

Derivation of notional positions: Futures, forwards or synthetic futures on a basket or index of debt securities

7.2.14 R *Futures, forwards* or *synthetic futures* on a basket or index of debt *securities* must be converted into *forwards* on single debt *securities* as follows (and then the resulting *positions* must be treated under *BIPRU 7.2.13R*):

(1) *futures, synthetic futures* or *forwards* on a single currency basket or index of debt *securities* must be treated as either:

- (a) a series of *forwards*, one for each of the constituent debt *securities* in the basket or index, of an amount which is a proportionate part of the total underlying the contract according to the weighting of the relevant debt *security* in the basket; or
- (b) a single *forward* on a notional debt *security*; and

(2) *futures, synthetic futures* or *forwards* on multiple currency baskets or indices of debt *securities* must be treated as either:

- (a) a series of *forwards* (using the method described in (1)(a)); or
- (b) a series of *forwards*, each one on a notional debt *security* to represent one of the currencies in the basket or index, of an amount which is a proportionate part of the total underlying the contract according to the weighting of the relevant currency in the basket.

7.2.15 G Under *BIPRU 7.2.14R(2)(b)*, a *forward* on basket of three Euro denominated debt *securities* and two Dollar denominated debt *securities* would be treated as a *forward* on a single notional Euro denominated debt *security* and a *forward* on a single notional Dollar denominated debt *security*.

7.2.16 R The notional debt *securities* in *BIPRU 7.2.14R* are assigned a *specific risk PRA* and a *general market risk PRA* equal to the highest that would apply to the debt *securities* in the basket or index.

7.2.17 G The debt *security* with the highest *specific risk PRA* within the basket might not be the same as the one with the highest *general market risk PRA*. *BIPRU 7.2.16R* requires a *firm* to select the highest percentages even where they relate to different debt *securities* in the basket or index, and regardless of the proportion of those debt *securities* in the basket or index.

Derivation of notional positions: Interest rate futures and forward rate agreements (FRAs)

7.2.18 R Interest rate *futures* or *FRAs* must be treated as the two notional *positions* (one long, one short) shown in the table in *BIPRU 7.2.19R*.

7.2.19 R Table: Interest rate futures and FRAs
This table belongs to *BIPRU 7.2.18R*

	A short <i>position</i> in a zero coupon <i>zero-specific-risk-security</i>	A long <i>position</i> in a zero coupon <i>zero-specific-risk-security</i>
Where the <i>firm</i> buys an interest rate <i>future</i> or sells an <i>FRA</i>	Maturity equals the expiry date of the <i>future</i> (or settlement date of the <i>FRA</i>)	Maturity equals the expiry date of the <i>future</i> (or settlement date of the <i>FRA</i>) plus the maturity of the notional borrowing/deposit

Where the <i>firm</i> sells an interest rate <i>future</i> or buys an <i>FRA</i>	Maturity equals the expiry date of the <i>future</i> (or settlement date of the <i>FRA</i>) plus the maturity of the notional borrowing/deposit	Maturity equals the expiry date of the <i>future</i> (or settlement date of the <i>FRA</i>)
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- 7.2.20 G (1) The following example illustrates *BIPRU* 7.2.18R and *BIPRU* 7.2.19R in conjunction with *BIPRU* 7.2.11R (the last *rule* determines the value of notional *positions*). A *firm* sells £1mn notional of a 3v6 *FRA* at 6%. This results in:
- (a) a short *position* in a *zero-specific-risk-security* with a zero coupon, three month maturity, and a nominal amount of £1million; and
 - (b) a long *position* in a *zero-specific-risk-security* with a zero coupon, six month maturity, and nominal amount of £1,015,000 (i.e. notional plus interest at 6% over 90 days).
- (2) If a *firm* were to apply the approach in *BIPRU* 7.2.11R(2)(a) the two nominal amounts would have to be present valued.

Derivation of notional positions: Interest rate swaps or foreign currency swaps

7.2.21 R Interest rate *swaps* or *foreign currency swaps* without deferred starts must be treated as the two notional *positions* (one long, one short) shown in the table in *BIPRU* 7.2.22R.

7.2.22 R Table: Interest rate and foreign currency swaps
This table belongs to *BIPRU* 7.2.21R

	Paying leg (which must be treated as a short <i>position</i> in a <i>zero-specific-risk security</i>)	Receiving leg (which must be treated as a long <i>position</i> in a <i>zero-specific-risk security</i>)
Receiving fixed and paying floating	Coupon equals the floating rate and maturity equals the reset date	Coupon equals the fixed rate of the <i>swap</i> and maturity equals the maturity of the <i>swap</i>

Paying fixed and receiving floating	Coupon equals the fixed rate of the <i>swap</i> and maturity equals the maturity of the <i>swap</i>	Coupon equals the floating rate and maturity equals the reset date
Paying floating and receiving floating	Coupon equals the floating rate and maturity equals the reset date	Coupon equals the floating rate and maturity equals the reset date

- 7.2.23 G For a *foreign currency swap*, the two notional *zero-specific-risk securities* would be denominated in different currencies. A *foreign currency swap* is also included in the *foreign exchange PRR* calculation.

Derivation of notional positions: Deferred start interest rate swaps or foreign currency swaps

- 7.2.24 R Interest rate *swaps* or *foreign currency swaps* with a deferred start must be treated as the two notional *positions* (one long, one short) shown in the table in *BIPRU 7.2.25R*.

- 7.2.25 R Table: Deferred start interest rate and foreign currency swaps
This table belongs to *BIPRU 7.2.24R*

	Paying leg (which must be treated as a short <i>position</i> in a <i>zero-specific-risk security</i> with a coupon equal to the fixed rate of the <i>swap</i>)	Receiving leg (which must be treated as a long <i>position</i> in a <i>zero-specific-risk security</i> with a coupon equal to the fixed rate of the <i>swap</i>)
Receiving fixed and paying floating	maturity equals the start date of the <i>swap</i>	maturity equals the maturity of the <i>swap</i>
Paying fixed and receiving floating	maturity equals the maturity of the <i>swap</i>	maturity equals the start date of the <i>swap</i>

- 7.2.26 G An example of *BIPRU 7.2.24R* is as follows. A *firm* enters into a five year *swap* which starts in two year's time. The *firm* has contracted to receive 6% and pay six month Libor on a principal amount of £1million. This results in a long *position* in a 7 year debt *security* and a short *position* in a 2 year debt *security*. Both have a coupon of 6%. *BIPRU 7.2.24R* deals with the capital treatment of the delayed start date; once the *swap* has started, *BIPRU 7.2.21R* applies.

Derivation of notional positions: Swaps where only one leg is an interest rate leg (e.g. equity swaps)

- 7.2.27 R A *firm* must treat a *swap* with only one interest rate leg as a notional *position* in a *zero-specific-risk security*:
- (1) with a coupon equal to that on the interest rate leg;
 - (2) with a maturity equal to the date that the interest rate will be reset; and
 - (3) which is a long *position* if the *firm* is receiving interest payments and short if making interest payments.

- 7.2.28 G *BIPRU 7.2.27R* includes *equity swaps*, *commodity swaps* and any other *swap* where only one leg is an interest rate leg.

Derivation of notional positions: Cash legs of repurchase agreements and reverse repurchase agreements

- 7.2.29 G *Firms* are reminded that for the purposes of *BIPRU 7.2.30R*, a *repurchase agreement* includes a sell/buy back or stock lending; and a *reverse repurchase agreement* includes a buy/sell back or a stock borrowing.

- 7.2.30 R The forward cash leg of a *repurchase agreement* or *reverse repurchase agreement* must be treated as a notional *position* in a *zero-specific-risk security* which:
- (1) is a short notional *position* in the case of a *repurchase agreement*; and a long notional *position* in the case of a *reverse repurchase agreement*;
 - (2) has a value equal to the market value of the cash leg;
 - (3) has a maturity equal to that of the *repurchase agreement* or *reverse repurchase agreement*; and
 - (4) has a coupon equal to:
 - (a) zero, if the next interest payment date coincides with the maturity date; or
 - (b) the interest rate on the contract, if any interest is due to be paid before the maturity date.

Derivation of notional positions: Cash borrowings and deposits

- 7.2.31 R A cash borrowing or deposit must be treated as a notional *position* in a zero coupon *zero-specific-risk security* which:

- (1) is a short *position* in the case of a borrowing and a long *position* in the case of a deposit;
- (2) has a value equal to the market value of the borrowing or deposit;
- (3) has a maturity equal to that of the borrowing or deposit, or the next date the interest rate is reset (if earlier); and
- (4) has a coupon equal to:
 - (a) zero, if the next interest payment date coincides with the maturity date; or
 - (b) the interest rate on the borrowing or deposit, if any interest is due to be paid before the maturity date.

Derivation of notional positions: Options and warrants

- 7.2.32 R
- (1) Where included in the *PRR* calculation in *BIPRU* 7.2 (see the table in *BIPRU* 7.2.4R), *options* and *warrants* must be treated in accordance with this *rule*.
 - (2) An *option* or *warrant* on a debt *security*, a basket of debt *securities* or a debt *security* index must be treated as a *position* in that debt *security*, basket or index.
 - (3) An *option* on an interest rate must be treated as a *position* in a zero coupon *zero-specific-risk security* with a maturity equal to the sum of the time to expiry of the *option* and the length of the period for which the interest rate is fixed.
 - (4) An *option* on a *future* – where the *future* is based on an interest rate or debt *security* – must be treated as:
 - (a) a long *position* in that *future* for purchased call *options* and written put *options*; and
 - (b) a short *position* in that *future* for purchased put *options* and written call *options*.
 - (5) An *option* on a *swap* must be treated as a deferred starting *swap*.

Derivation of notional positions: Bonds where the coupons and principal are paid in different currencies

- 7.2.33 R
- Where a debt *security* pays coupons in one currency, but will be redeemed in a different currency, it must be treated as:
- (1) a debt *security* denominated in the coupon's currency; and

- (2) a *foreign currency forward* to capture the fact that the debt *security's* principal will be repaid in a different currency from that in which it pays coupons, specifically:
- (a) a notional forward sale of the coupon currency and purchase of the redemption currency, in the case of a long *position* in the debt *security*; or
 - (b) a notional forward purchase of the coupon currency and sale of the redemption currency, in the case of a short *position* in the debt *security*.

Derivation of notional positions: Interest rate risk on other futures, forwards and options

7.2.34 R Other *futures, forwards, options* and *swaps* treated under *BIPRU 7.2* must be treated as *positions* in *zero-specific-risk securities*, each of which:

- (1) has a zero coupon;
- (2) has a maturity equal to that of the relevant contract; and
- (3) is long or short according to the table in *BIPRU 7.2.35R*.

7.2.35 R Table: Interest rate risk on other futures, forwards, options and swaps
This table belongs to *BIPRU 7.2.34R*.

Instrument	Notional <i>positions</i>	
<i>Foreign currency forward</i> or <i>future</i>	a long <i>position</i> denominated in the currency purchased	and a short <i>position</i> denominated in the currency sold
<i>Gold forward</i> or <i>future</i>	a long <i>position</i> if the <i>forward</i> or <i>future</i> involves an actual (or notional) sale of gold	or a short <i>position</i> if the <i>forward</i> or <i>future</i> involves an actual (or notional) purchase of gold
<i>Equity forward</i> or <i>future</i> , or <i>option</i> (unless the <i>interest rate PRR</i> is calculated under the basic <i>interest rate PRR</i> calculation in <i>BIPRU 7.3</i>)	A long <i>position</i> if the contract involves an actual (or notional) sale of the underlying <i>equity</i>	or A short <i>position</i> if the contract involves an actual (or notional) purchase of the underlying <i>equity</i>

Deriving the net position in each debt security: General

- 7.2.36 R The net *position* in a debt *security* is the difference between the value of the *firm's* long *positions* (including notional *positions*) and the value of its short *positions* (including notional *positions*) in the same debt *security*.

Deriving the net position in each debt security: Netting positions in the same debt security

- 7.2.37 R (1) A *firm* must not net *positions* (including notional *positions*) unless those *positions* are in the same debt *security*. This *rule* sets out the circumstances in which debt *securities* may be treated as the same for these purposes.
- (2) Subject to (3) long and short *positions* are in the same debt *security*, and a debt *security* is the same as another if and only if:
- (a) they enjoy the same rights in all respects; and
 - (b) are fungible with each other.
- (3) Long and short *positions* in different tranches of the same debt *security* may be treated as being in the same debt *security* for the purpose of (1) where:
- (a) the tranches enjoy the same rights in all respects; and
 - (b) the tranches become fungible within 180 days and thereafter the debt *security* of one tranche can be delivered in settlement of the other tranche.

Deriving the net position in each debt security: Netting the cheapest to deliver security with other deliverable securities

- 7.2.38 R A *firm* may net a short notional *position* in the cheapest to deliver *security* arising from a short *future* or *forward* (see *BIPRU* 7.2.13R(2)(a)) under which the seller has a choice of which debt *security* it may use to settle its obligations against a long *position* in any deliverable *security* up to a maximum of 90% of the common nominal amounts. The residual long and short nominal amounts must be treated as separate long and short *positions*.

- 7.2.39 R The netting permitted by *BIPRU* 7.2.38R only relates to where the *firm* has sold the *future* or *forward*. It does not relate to where the *firm* has bought a *future* or *forward*.

Deriving the net position in each debt security: Netting zero-specific-risk securities with different maturities

- 7.2.40 R A *firm* may net a notional long *position* in a *zero-specific-risk security* against a notional short *position* in a *zero-specific-risk security* if:

- (1) they are denominated in the same currency;
- (2) their coupons do not differ by more than 15 basis points; and
- (3) they mature:
 - (a) on the same day, if they have residual maturities of less than one month;
 - (b) within 7 days of each other, if they have residual maturities of between one month and one year; and
 - (c) within 30 days of each other, if they have residual maturities in excess of one year.

Deriving the net position in each debt security: Reduced net underwriting positions in debt securities

7.2.41 R A *firm* must not net a *reduced net underwriting position* in a *debt security* with any other *debt security position*.

7.2.42 G *BIPRU 7.2.41R* only relates to *reduced net underwriting positions*.

Specific risk calculation

7.2.43 R (1) A *firm* must calculate the *specific risk* portion of the *interest rate PRR* for each *debt security* by multiplying the market value of the individual net *position* (ignoring the sign) by the *appropriate PRA* from the table in *BIPRU 7.2.44R* or as specified by *BIPRU 7.2.45R - BIPRU 7.2.47R*.

(2) Notional *positions* in *zero-specific-risk securities* do not attract *specific risk*.

7.2.44 R Table: specific risk PRAs
This table belongs to *BIPRU 7.2.43R*.

Issuer	Residual maturity	<i>PRA</i>
Debt <i>securities</i> issued or guaranteed by central governments, issued by <i>central banks, international organisations, multilateral development banks</i> or <i>EEA States'</i> regional governments or local authorities which would qualify for <i>credit quality step 1</i> or which would receive a <i>0% risk weight</i> under the <i>standardised approach</i> to credit risk.	Any	0%

Issuer	Residual maturity	PRA
<p>(A) Debt <i>securities</i> issued or guaranteed by central governments, issued by <i>central banks, international organisations, multilateral development banks</i> or <i>EEA States'</i> regional governments or local authorities which would qualify for <i>credit quality step 2</i> or <i>3</i> under the <i>standardised approach</i> to credit risk.</p>	Zero to six months	0.25%
	over 6 and up to and including 24 months	1%
<p>(B) Debt <i>securities</i> issued or guaranteed by <i>institutions</i> which would qualify for <i>credit quality step 1</i> or <i>2</i> under the <i>standardised approach</i> to credit risk.</p>	Over 24 months	1.6%
<p>(C) Debt <i>securities</i> issued or guaranteed by <i>institutions</i> which would qualify for <i>credit quality step 3</i> under <i>BIPRU 3.4.34R</i> (Exposures to institutions: Credit assessment based method) or which would do so if it had an original effective maturity of three months or less.</p>		
<p>(D) Debt <i>securities</i> issued or guaranteed by <i>corporates</i> which would qualify for <i>credit quality step 1</i> or <i>2</i> under the <i>standardised approach</i> to credit risk.</p>		
<p>(E) Other <i>qualifying debt securities</i> (see <i>BIPRU 7.2.49R</i>)</p>		

Issuer	Residual maturity	<i>PRA</i>
<p>(A) Debt <i>securities</i> issued or guaranteed by central governments, issued by <i>central banks, international organisations, multilateral development banks</i> or <i>EEA States'</i> regional governments or local authorities or <i>institutions</i> which would qualify for <i>credit quality step 4</i> or <i>5</i> under the <i>standardised approach</i> to credit risk.</p> <p>(B) Debt <i>securities</i> issued or guaranteed by <i>corporates</i> which would qualify for <i>credit quality step 3</i> or <i>4</i> under the <i>standardised approach</i> to credit risk.</p> <p>(C) Exposures for which a credit assessment by a <i>nominated ECAI</i> is not available.</p>	Any	8%
<p>(A) Debt <i>securities</i> issued or guaranteed by central governments, issued by <i>central banks, international organisations, multilateral development banks</i> or <i>EEA States'</i> regional governments or local authorities or <i>institutions</i> which would qualify for <i>credit quality step 6</i> under the <i>standardised approach</i> to credit risk.</p> <p>(B) Debt <i>securities</i> issued or guaranteed by <i>corporates</i> which would qualify for <i>credit quality step 5</i> or <i>6</i> under the <i>standardised approach</i> to credit risk.</p> <p>(C) An instrument that shows a particular risk because of the insufficient solvency of the issuer or liquidity. This paragraph applies even if the instrument would otherwise qualify for a lower <i>PRA</i> under this table.</p>	Any	12%
<p>Note: The question of what a <i>corporate</i> is and of what category a debt <i>security</i> falls into must be decided under the <i>rules</i> relating to the <i>standardised approach</i> to credit risk.</p>		

- 7.2.45 R To the extent that a *firm* applies the *IRB approach*, to qualify for a *credit quality step* for the purpose of the table in *BIPRU 7.2.44R* the obligor of the exposure must have an internal rating with a *PD* equivalent to or lower than that associated with the appropriate *credit quality step* under the *standardised approach* to credit risk.
- 7.2.46 R A debt *security* issued by a non-qualifying issuer must receive a *specific risk PRA* of 8% or 12% according to the table in *BIPRU 7.2.44R*. However a *firm* must apply a higher *specific risk PRA* to such a *debt security* and/or not recognise offsetting for the purposes of defining the extent of *general market risk* between such a *security* and any other debt *securities* to the extent that doing otherwise would not be a prudent treatment of *specific risk* or *general market risk*.
- 7.2.47 R A *securitisation exposures* that would be subject to a deduction treatment under the treatment set out in *GENPRU 2.2* (Capital resources) or *risk weighted* at 1250% as set out in *BIPRU 9* (Securitisation) is subject to a capital charge that is no less than that set out under those treatments. *Unrated* liquidity facilities are subject to a capital charge that is no less than that set out in *BIPRU 9*.
- 7.2.48 G *BIPRU 7.2.43R* includes both actual and notional *positions*. However, notional *positions* in *zero-specific-risk securities* do not attract *specific risk*. For example:
- (1) interest rate *swaps*, *foreign currency swaps*, *FRAs*, interest rate *futures*, *foreign currency forwards*, *foreign currency futures*, and the cash leg of *repurchase agreements* and *reverse repurchase agreements* create notional *positions* which will not attract *specific risk*; whilst
 - (2) *futures*, *forwards* and *swaps* which are based on the price (or yield) of one or more debt *securities* will create at least one notional *position* that attracts *specific risk*.

Definition of a qualifying debt security

- 7.2.49 R A debt *security* is a *qualifying debt security* if:
- (1) it qualifies for a *credit quality step* under the *standardised approach* to credit risk corresponding at least to investment grade; or
 - (2) it has a *PD* which, because of the solvency of the issuer, is not higher than that of the debt *securities* referred to under (1) under the *IRB approach*; or
 - (3) it is a debt *security* for which a credit assessment by a *nominated ECAI* is unavailable and which meets the following conditions:
 - (a) it is considered by the *firm* to be sufficiently liquid;

- (b) it is of investment quality, according to the *firm's* own discretion, at least equivalent to that of the debt *securities* referred to under (1); and
 - (c) it is listed on at least one *regulated market* or *designated investment exchange*; or
 - (4) it is a debt *security* issued by an *institution* subject to the capital adequacy requirements set out in the *Banking Consolidation Directive* that satisfies the following conditions:
 - (a) it is considered by the *firm* to be sufficiently liquid;
 - (b) its investment quality is, according to the *firm's* own discretion, at least equivalent to that of the assets referred to under (1) above; or
 - (5) it is a debt *security* issued by an *institution* that is deemed to be of equivalent or higher credit quality than that associated with *credit quality step 2* under the *standardised approach* to credit risk and that is subject to supervision and regulatory arrangements comparable to those under the *Capital Adequacy Directive*.
- 7.2.50 R A *firm* must not treat a *debt security* as a *qualifying debt security* if it would be prudent to consider that the *debt security* concerned is subject to too high a degree of *specific risk* for it to be treated as a *qualifying debt security*.
- 7.2.51 G The manner in which a *firm* assesses a *debt security* for the purpose of treatment as a *qualifying debt security* will be subject to scrutiny by the *FSA*. The *FSA* may take action to overturn the *firm's* judgement if it considers that the *debt security* should not be treated as a *qualifying debt security*.
- General market risk calculation: General
- 7.2.52 R A *firm* must calculate the *general market risk* portion of the *interest rate PRR* for each currency using either:
- (1) the *interest rate simplified maturity method*;
 - (2) the *interest rate maturity method*; or
 - (3) the *interest rate duration method*.
- 7.2.53 R *BIPRU 7.2.52R(3)* is subject to *BIPRU 7.2.54R*.
- 7.2.54 R A *firm* must not use the *interest rate duration method* for index-linked *securities*. Instead, these *securities* must:
- (1) be attributed a coupon of 3%; and

- (2) be treated separately under either the *interest rate simplified maturity method* or the *interest rate maturity method*.

General market risk calculation: Simplified maturity method

- 7.2.55 G The *interest rate simplified maturity method* weights individual net *positions* to reflect their price sensitivity to changes in interest rates. The weights are related to the coupon and the residual maturity of the instrument (or the next interest rate re-fix date for floating rate items).
- 7.2.56 R Under the *interest rate simplified maturity method*, the portion of the *interest rate PRR* for *general market risk* equals the sum of each individual net *position* (long or short) multiplied by the *appropriate PRA* in the table in *BIPRU 7.2.57R*. A *firm* must assign its net *positions* to the appropriate maturity bands in the table in *BIPRU 7.2.57R* on the basis of residual maturity in the case of fixed-rate instruments and on the basis of the period until the interest rate is next set in the case of instruments on which the interest rate is variable before final maturity.
- 7.2.57 R Table: general market risk PRAs
This table belongs to *BIPRU 7.2.56R*).

Zone	Maturity band		PRA
	Coupon of 3% or more	Coupon of less than 3%	
One	0 ≤ 1 month	0 ≤ 1 month	0.00%
	> 1 ≤ 3 months	> 1 ≤ 3 months	0.20%
	> 3 ≤ 6 months	> 3 ≤ 6 months	0.4%
	> 6 ≤ 12 months	> 6 ≤ 12 months	0.7%
Two	> 1 ≤ 2 years	> 1.0 ≤ 1.9 years	1.25%
	> 2 ≤ 3 years	> 1.9 ≤ 2.8 years	1.75%
	> 3 ≤ 4 years	> 2.8 ≤ 3.6 years	2.25%
Three	> 4 ≤ 5 years	> 3.6 ≤ 4.3 years	2.75%
	> 5 ≤ 7 years	> 4.3 ≤ 5.7 years	3.25%
	> 7 ≤ 10 years	> 5.7 ≤ 7.3 years	3.75%
	> 10 ≤ 15 years	> 7.3 ≤ 9.3 years	4.5%
	> 15 ≤ 20 years	> 9.3 ≤ 10.6 years	5.25%

Zone	Maturity band		PRA
	Coupon of 3% or more	Coupon of less than 3%	
	> 20 years	> 10.6 ≤ 12.0 years	6.00%
		> 12.0 ≤ 20.0 years	8.00%
		> 20 years	12.50%

General market risk calculation: The maturity method

- 7.2.58 G The *interest rate maturity method* builds on the *interest rate simplified maturity method* by partially recognising offsetting *positions*. *BIPRU 7.2.61G* provides an illustration of the *interest rate maturity method*.
- 7.2.59 R Under the *interest rate maturity method*, the portion of the *interest rate PRR* for *general market risk* is calculated as follows:
- (1) Step 1: each net *position* is allocated to the appropriate maturity band in the table in *BIPRU 7.2.57R* and multiplied by the corresponding *PRA*;
 - (2) Step 2: weighted long and short *positions* are matched within:
 - (a) the same maturity band;
 - (b) the same zone (using unmatched *positions* from (a)); and
 - (c) different zones (using unmatched *positions* from (b) and matching between zones 1 and 2 and 2 and 3 before zone 1 and 3); and
 - (3) Step 3: the portion of the *interest rate PRR* for *general market risk* is the sum of:
 - (a) 10% of the total amount matched within maturity bands;
 - (b) 40% of the amount matched within zone 1 under (2)(b);
 - (c) 30% of the amount matched within zones 2 & 3 under (2)(b);
 - (d) 40% of the amounts matched between zones 1 and 2, and between zones 2 and 3;
 - (e) 150% of the amount matched between zones 1 and 3; and
 - (f) 100% of the weighted *positions* remaining unmatched after (2)(c).

7.2.60 G The table in *BIPRU 7.2.57R* distinguishes between debt *securities* with a coupon of less than 3% and those with coupon in excess of 3%. However, this does not mean that the *firm* has to do a separate *general market risk* calculation for each; it merely ensures that when allocating debt *securities* to a particular band, their coupons are taken into account as well as their maturities. So for example, a 21 year 6% debt *security* falls into the same band as an 11 year 2% debt *security*. They are both weighted at 6%, and can be matched under *BIPRU 7.2.59R(2)(a)* (the first part of step two of the *interest rate maturity method* calculation) because they fall within the same band.

7.2.61 G This paragraph sets out an example of a calculation under the *interest rate maturity method*. In this example, a firm with a £ sterling base currency is processing its euro denominated positions.

Weight each position

Zone	Totals of:		PRA		Weighted longs within each band	Weighted shorts within each band
	net longs within the band	net shorts within the band				
1	€100	€50	0.00%		0	0
	€250	€0	0.20%		0.50	0
	€200	€0	0.40%		0.80	0
	€0	€0	0.70%		0	0
2	€140	€0	1.25%		1.75	0
	€200	€300	1.75%		3.50	5.25
	€0	€400	2.25%		0	9
3	€0	€0	2.75%		0	0
	€200	€200	3.25%		6.50	6.50
	€300	€0	3.75%		11.25	0
	€200	€300	4.50%		9	13.50
	€0	€14.30	5.25%		0	0.75
	€300	€0	6.00%		18.00	0
	€0	€0	8.00%		0	0
	€0	€0	12.50%		0	0

Match weighted positions

same band		same zones		different zones	
Long	Short	Long	Short	Long	Short
0.50		0.50		1.30	
0.80		0.80			
1.75		1.75	1.75		
3.50	5.25		9		9.00
	9				
6.50	6.50				
11.25		11.25	4.50		
9	13.50		0.75		
	0.75				
18.00		18.00			
19 matched		7 matched		9 matched	

Calculate the general market risk

Matched within bands	19	@	10%	=	1.9
Matched within zone 1	0	@	40%	=	0
Matched within zones 2&3	7	@	30%	=	2.1
Matched between zones 1&2 and 2&3	9	@	40%	=	3.6
Matched between zones 1&3	0	@	150%	=	0
Unmatched after 2(c)	16.30	@	100%	=	16.30
total = € 23.90					
<i>general market risk PRR (if €1=£0.60) = £14.34</i>					

General market risk calculation: Duration method

7.2.62 G The *interest rate duration method* produces a more accurate measure of interest rate risk than the maturity methods but it is also more complex to calculate.

7.2.63 R (1) A *firm* must use the following formula to calculate modified duration for the purpose of the *interest rate duration method*:

$$\text{Modified duration} = \frac{D}{(1+r)}$$

(2) For the purposes of the formula in (1):

$$D = \frac{\sum_{t=1}^m \frac{tC_t}{(1+r)^t}}{\sum_{t=1}^m \frac{C_t}{(1+r)^t}}$$

(3) For the purpose of the formulae in (1) and (2):

(a) C_t = cash payment at time t

(b) m = total maturity

(c) r = yield to maturity. In the case of a fixed-rate debt *security* a *firm* must take the current mark to market of the debt *security* and thence calculate its yield to maturity, which is the implied discount rate for that instrument. In the case of a floating rate instrument, a *firm* must take the current mark to market of the debt *security* and thence calculate its yield on the assumption that the principal is due on the date that the interest rate can next be changed.

(d) t = time

7.2.64 R Under the *interest rate duration method*, the portion of the *interest rate PRR* for *general market risk* is calculated as follows:

(1) Step 1: allocate each net *position* to the appropriate duration zone in the table in *BIPRU 7.2.65R* and multiply it by:

(a) its modified duration (using the formula in *BIPRU 7.2.63R*); and

(b) the appropriate assumed interest rate change in the table in *BIPRU 7.2.65R*;

- (2) Step 2: match weighted long and short *positions*:
 - (a) within zones; and
 - (b) across zones (using unmatched *positions* from (2)(a) and following the process in *BIPRU 7.2.59R(2)(c)*); and
- (3) Step 3: calculate the portion of the *interest rate PRR* for *general market risk* as the sum of:
 - (a) 100% of the weighted *positions* remaining unmatched after (2)(b);
 - (b) 2% of the matched weighted *position* in each zone;
 - (c) 40% of the matched weighted *position* between zones 1 and 2, and between zones 2 and 3; and
 - (d) 150% of the matched weighted *position* between zones 1 and 3.

7.2.65 R Table: Assumed interest rate change in the interest rate duration method
This table belongs to *BIPRU 7.2.64R*

Zone	Modified Duration	Assumed interest rate change (percentage points)
1	$0 \leq 12$ months	1.00
2	> 12 months ≤ 3.6 years	0.85
3	> 3.6 years	0.70

7.2.66 R If a *firm* uses the *interest rate duration method* it must do so on a consistent basis.

7.3 Equity PRR and basic interest rate PRR for equity derivatives

General rule

- 7.3.1 R (1) A *firm* must calculate its *equity PRR* by:
- (a) identifying which *positions* must be included within the *PRR* calculation (see *BIPRU 7.3.2R*);
 - (b) deriving the net *position* in each *equity* in accordance with *BIPRU 7.3.23R*;
 - (c) including each of those net *positions* in either the *simplified equity method* (see *BIPRU 7.3.29R*) or, subject to *BIPRU 7.3.27R*, the *standard equity method* (see *BIPRU 7.3.32R*); and
 - (d) summing the *PRR* on each net *position* as calculated under the *simplified equity method* and *standard equity method*.
- (2) All net *positions*, irrespective of their signs, must be converted on a daily basis into the *firm's base currency* at the prevailing spot exchange rate before their aggregation.

Scope of the equity PRR calculation

- 7.3.2 R A *firm's equity PRR* calculation must:
- (1) include all *trading book positions* in *equities*, unless:
 - (a) the *position* is fully deducted as a *material holding* under the calculations under the *capital resources table*, in which case the *firm* may exclude it; or
 - (b) the *position* is hedging an *option* or *warrant* which is being treated under *BIPRU 7.6.26R* (Table: Appropriate treatment for equities, debt securities or currencies hedging options);
 - (2) include notional *positions* arising from *trading book positions* in the instruments listed in the table in *BIPRU 7.3.3R*; and
 - (3) (if the *firm* is the transferor of *equities* or guaranteed rights relating to title to *equities* in a *repurchase agreement* or the lender of *equities* in an *equities* lending agreement) include such *equities* if those *equities* meet the criteria for inclusion in the *trading book*.

7.3.3 R Table: Instruments which result in notional positions
This table belongs to *BIPRU 7.3.2R(2)*

Instrument		See
Depository receipts		<i>BIPRU 7.3.12R</i>
<i>Convertibles</i> where:	(a) the <i>convertible</i> is trading at a market price of less than 110% of the underlying <i>equity</i> ; and the first date at which conversion can take place is less than three months ahead, or the next such date (where the first has passed) is less than a year ahead; or	<i>BIPRU 7.3.13R</i>
	(b) the conditions in (a) are not met but the <i>firm</i> includes the <i>convertible</i> in its <i>equity PRR</i> calculation rather than including it in its <i>interest rate PRR</i> calculation set out in <i>BIPRU 7.2</i> (Interest rate PRR).	
<i>Futures, forwards, CFDs</i> and <i>synthetic futures</i> on a single <i>equity</i>		<i>BIPRU 7.3.14R</i>
<i>Futures, forwards, CFDs</i> and <i>synthetic futures</i> on a basket of <i>equities</i> or <i>equity</i> index		<i>BIPRU 7.3.15R</i>
<i>Equity</i> legs of an <i>equity swap</i>		<i>BIPRU 7.3.19R</i>
<i>Options</i> or <i>warrants</i> on a single <i>equity</i> , an <i>equity future</i> , a basket of <i>equities</i> or an <i>equity</i> index (unless the <i>firm</i> calculates a <i>PRR</i> on the <i>option</i> or <i>warrant</i> under <i>BIPRU 7.6</i>).		<i>BIPRU 7.3.21R</i>

- 7.3.4 G *BIPRU 7.3.2R(1)* includes a *trading book position* in an *equity* that is subsequently repo'd under a *repurchase agreement* or lent under a stock lending agreement. Clearly, if the *equity* had initially been obtained via a *reverse repurchase agreement* or stock borrowing agreement, the *equity* would not have been included in the *trading book* in the first place.
- 7.3.5 G *BIPRU 7.3.2R(1)* includes *net underwriting positions* or *reduced net underwriting positions* in *equities*. *BIPRU 7.3.27R* requires a *firm* to use the *simplified equity method* in the case of *reduced net underwriting positions*. In the case of *net underwriting positions* that have not been reduced according to *BIPRU 7.8.27R* (Calculating the reduced net underwriting position), there is no such restriction; a *firm* can choose which of the two *equity* methods to use.
- 7.3.6 G *Firms* are reminded that the table in *BIPRU 7.6.5R* (Table: Appropriate PRR calculation for an option or warrant) divides *equity options* and *warrants* into:
- (1) those which must be treated under *BIPRU 7.6* (Option PRR); and
 - (2) those which must be treated under either *BIPRU 7.3* or *BIPRU 7.6*, the *firm* being able to choose whether *BIPRU 7.3* or *BIPRU 7.6* is used.
- 7.3.7 G The table in *BIPRU 7.3.3R* does not require every *convertible* to be included in *BIPRU 7.3's* PRR calculation. Where a *convertible* is not included in this PRR calculation, *BIPRU 7.2.3R(1)* (Scope of the interest rate PRR calculation) requires that it be included in the *BIPRU 7.2* PRR calculation.
- 7.3.8 G Some of the instruments listed in the table in *BIPRU 7.3.3R* are also included in a *firm's* interest rate PRR calculation. For simplicity, a *firm* may use the *interest rate PRR* calculation in *BIPRU 7.3* rather than the calculation in *BIPRU 7.2* (Interest rate PRR). *BIPRU 7.3.44G* explains this in more detail.
- Derivation of notional positions: General approach
- 7.3.9 G *BIPRU 7.3.10R - BIPRU 7.3.21R* convert the instruments listed in the table in *BIPRU 7.3.3R* into notional *positions* in individual *equities*, *equity* baskets or *equity* indices.
- 7.3.10 R Unless specified otherwise, the value of each notional *equity position* equals the quantity of that *equity* underlying the instrument multiplied by the current market value of the *equity*.
- 7.3.11 G (1) An example of *BIPRU 7.3.10R* is as follows. The current market value of a particular *equity* is £2.50. If a *firm* contracts to sell this *equity* in five year's time for £3 it would treat the notional short *equity position* as having a value of £2.50 when calculating the *equity PRR*.

- (2) In effect, the forward *position* has been treated as being equivalent to a spot *position* for the purposes of calculating *equity PRR*. To capture the risk that the forward price changes relative to the spot price, forward *equity positions* are included in the *firm's interest rate PRR* calculation (see *BIPRU 7.3.45R* or the table in *BIPRU 7.2.4R* (Table: Instruments which result in notional positions)).

Derivation of notional positions: Depository receipts

- 7.3.12 R A depository receipt must be treated as a notional *position* in the underlying *equity*.

Derivation of notional positions: Convertibles

- 7.3.13 R Where a *convertible* is included in *BIPRU 7.3's PRR* calculation (see the table in *BIPRU 7.3.3R*):

- (1) it must be treated as a *position* in the *equity* into which it converts; and
- (2) the *firm's equity PRR* must be adjusted by making:
- (a) an addition equal to the current value of any loss which the *firm* would make if it did convert to *equity*; or
- (b) a deduction equal to the current value of any profit which the *firm* would make if it did convert to *equity* (subject to a maximum deduction equal to the *PRR* on the notional *position* underlying the *convertible*).

Derivation of notional positions: Futures, forwards and CFDs on a single equity

- 7.3.14 R A *future* (including a *synthetic future*), *forward* or *CFD* on a single *equity* must be treated as a notional *position* in that *equity*.

Derivation of notional positions: Futures, forwards and CFDs on equity indices or baskets

- 7.3.15 R A *future* (including a *synthetic future*), *forward* or *CFD* on an *equity* index or basket must be treated as either:

- (1) a *position* in each of the underlying *equities*; or
- (2) the *positions* shown in the table in *BIPRU 7.3.16R*.

7.3.16 R Table: Instruments which result in notional positions
This table belongs to *BIPRU 7.3.15R(2)*

	Under the <i>simplified equity method (BIPRU 7.3.29R)</i>	Under the <i>standard equity method (BIPRU 7.3.32R)</i>
Only one country in the index or basket (see <i>BIPRU 7.3.32R</i>)	One <i>position</i> in the index or basket	One <i>position</i> in the index or basket
More than one country in the index or basket	One <i>position</i> in the index or basket	Several notional basket <i>positions</i> , one for each country or One notional basket <i>position</i> in a separate, notional country

7.3.17 G An example of *BIPRU 7.3.16R* is as follows. A *firm* decides to treat a FTSE Eurotop 300 *future* under the *standard equity method*, and furthermore, chooses to treat it as one notional *position*. The table in *BIPRU 7.3.16R* requires that this notional *position* be treated as if it were from a separate notional country rather than any of the countries to which the underlying *equities* are from.

7.3.18 R The notional *positions* created under *BIPRU 7.3.15R* have the following values:

- (1) where only one notional *position* is created, it has a value equal to the total market value of the *equities* underlying the contract; or
- (2) where more than one notional *position* is created, each one has a value which reflects the relevant *equity's* or country's contribution to the total market value of the *equities* underlying the contract.

Derivation of notional positions: Equity legs of equity swaps

7.3.19 R The *equity* leg of an *equity swap* must be treated as a *position* in the underlying *equity*, *equity* basket or *equity* index, which is:

- (1) long, if the *firm* has contracted to receive any increase and pay any decrease in the value of the underlying *equities* or *equity* index; and
- (2) short, if the *firm* has contracted to receive any decrease and pay any increase in the value of the underlying *equities* or *equity* index.

- 7.3.20 G The interest rate leg of an *equity swap* is included in a *firm's interest rate PRR* calculation (see the table in *BIPRU 7.2.4R* (Table: Instruments which result in notional positions)) unless it is treated under *BIPRU 7.3.45R*.
- Derivation of notional positions: Options
- 7.3.21 R If included in *BIPRU 7.3's PRR* calculation (see the table in *BIPRU 7.3.3R*), *options* must be treated as follows:
- (1) an *option* on a single *equity* must be treated as a notional *position* in that *equity*;
 - (2) an *option* on a basket of *equities* or *equity* index must be treated as a *future* on that basket or index; and
 - (3) an *option* on an *equity future* must be treated as:
 - (a) a long *position* in that *future*, for purchased call *options* and written put *options*; and
 - (b) a short *position* in that *future*, for purchased put *options* and written call *options*.
- Deriving the net position in each equity
- 7.3.22 R The net *position* in each *equity* is the difference between the value of the *firm's long positions* (including notional *positions*) and the value of its short *positions* (including notional *positions*) in the same *equity*.
- 7.3.23 R
- (1) When deriving the net *position* in each *equity*, a *firm* must not net long and short *positions* except in accordance with this *rule*.
 - (2) Subject to (3), a *firm* may net long and short *positions* in the same *equity*. Two *equities* are the same if and only if they:
 - (a) enjoy the same rights in all respects; and
 - (b) are fungible with each other.
 - (3) Long and short *positions* in different tranches of the same *equity* may be treated as being in the same *equity* for the purpose of (1), where:
 - (a) the tranches enjoy the same rights in all respects; and
 - (b) the tranches become fungible with each other within 180 days, and thereafter the *equity* of one tranche can be delivered in settlement of the other tranche.
- 7.3.24 R A *firm* must not net a *reduced net underwriting position* with any other *equity position*.
- 7.3.25 G *BIPRU 7.3.24R* only relates to *reduced net underwriting positions*.

Simplified and standard equity methods

- 7.3.26 G *BIPRU 7.3.1R(1)* requires that the net *position* in each *equity* be included in either the *simplified equity method* or the *standard equity method*, subject to the restriction in *BIPRU 7.3.27R*. A *firm* does not have to use the same method for all *equities*.
- 7.3.27 R A *firm* must use the *simplified equity method* for *reduced net underwriting positions*.
- 7.3.28 G A *firm* may use either method for a *net underwriting position*; *BIPRU 7.3.27R* only relates to *reduced net underwriting positions*.

Simplified equity method

- 7.3.29 R Under the *simplified equity method*, the *PRR* for each *equity*, *equity index*, or *equity basket* equals the market value of the net *position* (ignoring the sign) multiplied by the *appropriate PRA* from the table in *BIPRU 7.3.30R*. The result must be converted into the *firm's base currency* at current spot *foreign currency* rates.
- 7.3.30 R Table: simplified equity method PRAs
This table belongs to *BIPRU 7.3.29R*

Instrument	<i>PRA</i>
Single <i>equities</i>	12%
<i>Qualifying equity indices</i> (see <i>BIPRU 7.3.38R</i>)	8%
All other <i>equity indices</i> or baskets	12%
If it is necessary to distinguish between the <i>specific risk PRA</i> and the <i>general market risk PRA</i> , the <i>specific risk PRA</i> for the first and third rows is 4% and that for the second row is 0%. The rest of the <i>PRA</i> in the second column is the <i>general market risk PRA</i> .	

Standard equity method

- 7.3.31 G The *standard equity method* divides the risk of loss from a *firm's equity positions* into the risk of loss from a general move in a country's *equity market* and the risk of loss from an individual *equity's price* changing relative to that country's *equity market*. These are called *general market risk* and *specific risk* respectively.
- 7.3.32 R Under the *standard equity method*, a *firm* must:

- (1) group *equity positions* into country portfolios as follows:
 - (a) a *position* in an individual *equity* belongs to:
 - (i) the country it is listed in;
 - (ii) any of the countries it is listed in, if more than one; or
 - (iii) the country it was issued from, if unlisted;
 - (b) a *position* in an *equity* basket or index that is treated under *BIPRU 7.3.15R(2)*, is allocated to one or more country portfolios based on the countries to which the underlying *equities* belong to under (a) or a notional country provided for in the table in *BIPRU 7.3.16R*; and
- (2) sum:
 - (a) the *PRRs* for *specific risk* calculated under *BIPRU 7.3.33R*; and
 - (b) the *PRRs* for *general market risk* for each country portfolio as calculated under *BIPRU 7.3.41R* and *BIPRU 7.3.42R*.

Standard equity method: Specific risk

7.3.33 R Under the *standard equity method*, a *firm* must calculate a *PRR* for *specific risk* based on the net *position* in each *equity*, *equity* index or *equity* basket by multiplying its market value (ignoring the sign) by the *appropriate PRA* from the table in *BIPRU 7.3.34R*.

7.3.34 R Table: PRAs for specific risk under the standard equity method
This table belongs to *BIPRU 7.3.33R(1)*

Instrument	<i>PRA</i>
<i>Qualifying equities</i>	2%
<i>Qualifying equity indices</i> (see <i>BIPRU 7.3.38R</i>)	0%
All other <i>equities</i> , <i>equity</i> indices or <i>equities</i> baskets	4%

Definition of a qualifying equity

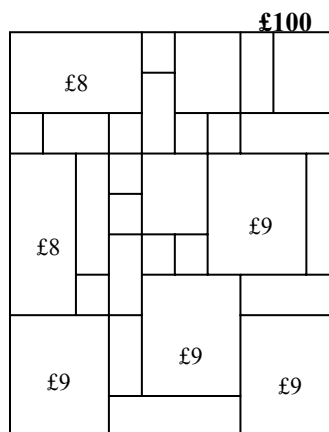
7.3.35 R A *qualifying equity* is one that satisfies the following conditions:

- (1) it belongs to a country portfolio that satisfies the following conditions:

- (a) no individual *position* exceeds 10% of the portfolio's gross value; and
 - (b) the sum of *positions* (ignoring the sign) which individually represent between 5% and 10% of the portfolio's gross value, does not exceed 50% of the portfolio's gross value;
- (2) it is not of an issuer that has issued only traded debt *securities* that currently attracts an 8% or 12% *PRA* in the table in *BIPRU 7.2.44R* (Specific risk *PRA*) or that attract a lower requirement only because they are guaranteed or secured; and
- (3) it is a constituent of an index in the table in *BIPRU 7.3.39R*.

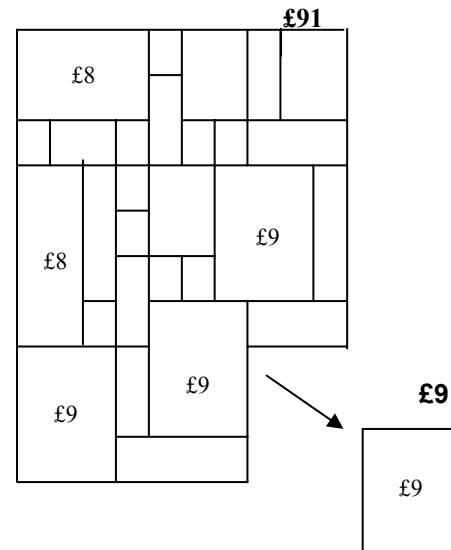
7.3.36 G

- (1) The following example illustrates *BIPRU 7.3.35R(1)*.
- (2) A country portfolio has a gross value of £100 and is made up of *positions* in 29 different *equities* (some are long *positions*, others are short *positions*). Not all the *equities* are constituents of an index used to create the FT All-World Index (this criterion only becomes relevant once a *firm* has determined whether the country portfolio meets the test in *BIPRU 7.3.35R(1)*).
- (3) Six *positions* exceed the 5% threshold. The following diagram shows the *composition* of the portfolio.



- (4) Part (a): the portfolio meets the first part of the test because no individual *position* is worth more than 10% of the portfolio's value.
- (5) Part (b): the portfolio fails the second part of the test because the sum (ignoring the sign) of the six relevant *positions* is £52; this exceeds 50% of the portfolio's value.

- 7.3.37 G (1) A country portfolio can be split into two sub-portfolios if this enables one sub-portfolio to meet the requirements in *BIPRU* 7.3.35R(1). Individual *positions* may be sub-divided between sub-portfolios.
- (2) Continuing the example above, one of the largest *positions* is taken out of the portfolio and put into a new portfolio. The new portfolio fails the two tests, but the amended portfolio meets both tests:
- (a) Part (a): no single remaining *position* exceeds £9.10.
- (b) Part (b): the sum of the five relevant *positions* is £43, this is less than 50% of the new portfolio's value of £91.



Definition of a qualifying equity index

- 7.3.38 R A *qualifying equity index* is one which is traded on a *recognised investment exchange* or a *designated investment exchange* and:
- (1) is listed in the table in *BIPRU* 7.3.39R; or
- (2) is not listed in the table in *BIPRU* 7.3.39R, but is constructed in such a way that:
- (a) it contains at least 20 *equities*;
- (b) no single *equity* represents more than 20% of the total index; and

(c) no five *equities* combined represent more than 60% of the total index.

7.3.39 R Table: Qualifying equity indices
This table belongs to *BIPRU 7.3.38R*

Country or territory	Name of index
Australia	All Ordinaries
Austria	Austrian Traded Index
Belgium	BEL 20
Canada	TSE 35, TSE 100, TSE 300
France	CAC 40, SBF 250
Germany	DAX
European	Dow Jones Stoxx 50 Index, FTSE Eurotop 300, MSCI Euro Index
Hong Kong	Hang Seng 33
Italy	MIB 30
Japan	Nikkei 225, Nikkei 300, TOPIX
Korea	Kospi
Netherlands	AEX
Singapore	Straits Times Index
Spain	IBEX 35
Sweden	OMX
Switzerland	SMI
UK	FTSE 100, FTSE Mid 250, FTSE All Share
US	S&P 500, Dow Jones Industrial Average, NASDAQ Composite, Russell 2000

Standard equity method: General market risk: General

- 7.3.40 R Under the *standard equity method*, a *firm* must apply approach one, as set out in *BIPRU 7.3.41R*, to each country portfolio (or part portfolio) unless the conditions in *BIPRU 7.3.42R(3)* are met, in which case the *firm* may instead apply approach two, as set out in *BIPRU 7.3.42R*, to the relevant country portfolios (or part portfolios).

Standard equity method: General market risk: Approach One: No offset between different country portfolios

- 7.3.41 R Under approach one as referred to in *BIPRU 7.3.40R*, the *PRR* for *general market risk* equals the net value (ignoring the sign) of the country portfolio multiplied by 8%.

Standard equity method: General market risk: Approach Two: Limited offset between different country portfolios

- 7.3.42 R (1) Under approach two as referred to in *BIPRU 7.3.40R*, the *PRR* for *general market risk* is calculated using the following formula:

$$\sqrt{(8\% * CP_1)^2 + (8\% * CP_2)^2 + (8\% * CP_3)^2 \dots \dots \dots (8\% * CP_n)^2}$$

- (2) In the formula in (1) CP_i denotes the net value of *i*th country portfolio (converted to the *firm's base currency* using current spot *foreign currency* rates).

- (3) The conditions referred to in *BIPRU 7.3.40R* that must be met for a *firm* to be able to use approach two as referred to in *BIPRU 7.3.40R* are as follows:

- (a) at least four country portfolios are included (that is: $n \geq 4$);
- (b) only country portfolios for countries which are full members of the *OECD*, Hong Kong or Singapore are included;
- (c) no individual country portfolio comprises more than 30% of the total gross value of country portfolios included; and
- (d) the total net value of country portfolios included equals zero, that is:

$$\sum_1^n CP_i = 0$$

- 7.3.43 G In order to meet *BIPRU 7.3.42R(3)(d)*, it is likely that part of a country portfolio will have to be excluded from approach two under *BIPRU 7.3.42R* (and therefore included in approach one under *BIPRU 7.3.41R*), even if that country portfolio meets *BIPRU 7.3.42R(3)(a) - (c)*.

Basic interest rate calculation for equity instruments

- 7.3.44 G A basic *interest rate PRR* calculation is included in *BIPRU 7.3* for a *firm* that does not wish to use the calculation in *BIPRU 7.2* (Interest rate PRR). However, it tends to result in higher charges than the methods in *BIPRU 7.2*, largely because the *interest rate PRR* is calculated on each notional *equity position* separately and then summed without offsetting long and short *positions*.
- 7.3.45 R This *rule* applies to a *firm* that does not include a *forward, future, option* or *swap* on an *equity, basket of equities* or *equity index* in the calculation of its *interest rate PRR* calculation under *BIPRU 7.2* (Interest rate PRR). However it does not apply to *cliquet* as defined in *BIPRU 7.6.18R* (Table: Option PRR: methods for different types of option). A *firm* must calculate the *interest rate PRR* for a *position* being treated under this *rule* as follows:
- (1) multiply the market value of the notional *equity position* underlying the instrument by the appropriate percentage from the table in *BIPRU 7.3.47R*; and
 - (2) sum the results from (1), ignoring the sign.
- 7.3.46 G Cliquets on *equities, baskets of equities* or *equity indices* do not attract an *interest rate PRR*. *BIPRU 7.3.45R* excludes them from the basic *interest rate PRR* calculation and the table in *BIPRU 7.2.4R* (Table: Instruments which result in notional positions) excludes them from the scope of the *interest rate PRR* calculation in *BIPRU 7.2* (Interest rate PRR).
- 7.3.47 R Table: Percentages used in the basic interest rate PRR calculation for equity instruments
This table belongs to *BIPRU 7.3.45R(1)*

Time to expiration	Percentage (%)
$0 \leq 3$ months	0.20
$> 3 \leq 6$ months	0.40
$> 6 \leq 12$ months	0.70
$> 1 \leq 2$ years	1.25
$> 2 \leq 3$ years	1.75
$> 3 \leq 4$ years	2.25
$> 4 \leq 5$ years	2.75
$> 5 \leq 7$ years	3.25

Time to expiration	Percentage (%)
$> 7 \leq 10$ years	3.75
$> 10 \leq 15$ years	4.50
$> 15 \leq 20$ years	5.25
> 20 years	6.00

Additional capital charge in relation to equity indices

- 7.3.48 R If a *firm* nets off *positions* in one or more of the *equities* constituting an *equity index future, forward* or *CFD* against one or more *positions* in the *equity index future, forward* or *CFD* itself, the *firm* must apply an additional *equity PRR* to the netted *position* to cover the risk of loss caused by the value of the *future, forward* or *CFD* not moving fully in line with that of its constituent *equities*. The same applies if a *firm* holds opposite *positions* in a *future, forward* or *CFD* on an *equity index* that are not identical in respect of either their maturity or their composition or both.

7.4 Commodity PRR

General rule

- 7.4.1 R A *firm* must calculate its *commodity PRR* by:
- (1) identifying which *commodity positions* must be included within the scope of the *PRR* calculation (see *BIPRU 7.4.2R*);
 - (2) expressing each such *position* in terms of the standard unit of measurement of the *commodity* concerned;
 - (3) expressing the spot price in each *commodity* in the *firm's base currency* at current spot foreign exchange rates;
 - (4) calculating an individual *PRR* for each *commodity* (see *BIPRU 7.4.20R*); and
 - (5) summing the resulting individual *PRRs*.

Scope of the commodity PRR calculation

- 7.4.2 R A *firm's commodity PRR* calculation must, regardless of whether the *positions* concerned are *trading book* or *non-trading book positions*:
- (1) include *physical commodity positions*;
 - (2) (if the *firm* is the transferor of *commodities* or guaranteed rights relating to title to *commodities* in a *repurchase agreement* or the lender of *commodities* in a *commodities* lending agreement) include such *commodities*;
 - (3) include notional *positions* arising from *positions* in the instruments listed in the table in *BIPRU 7.4.4R*; and
 - (4) exclude *positions* constituting a *stock financing* transaction.
- 7.4.3 R Gold *positions* are excluded from the scope of the *commodity PRR*. Instead, they are included within the scope of the *foreign exchange PRR* (*BIPRU 7.5*).

- 7.4.4 R Table: Instruments which result in notional positions
This table belongs to *BIPRU 7.4.2R(3)*

Instrument	See
<i>Forwards, futures, CFDs, synthetic futures and options on a single commodity (unless the firm calculates a PRR on the option under BIPRU 7.6 (Option PRR))</i>	<i>BIPRU 7.4.8R</i>
A commitment to buy or sell a single <i>commodity</i> at an average of spot prices prevailing over some future period	<i>BIPRU 7.4.10R</i>
<i>Forwards, futures, CFDs, synthetic futures and options on a commodity index (unless the firm calculates an PRR on the option under BIPRU 7.6)</i>	<i>BIPRU 7.4.13R - BIPRU 7.4.14R</i>
<i>Commodity swaps</i>	<i>BIPRU 7.4.16R - BIPRU 7.4.17R</i>
A warrant relating to a <i>commodity</i> must be treated as an <i>option</i> on a <i>commodity</i> .	

- 7.4.5 G *BIPRU 7.4.2R* includes a *trading book position* in a *commodity* that is subsequently repo'd under a *repurchase agreement* or lent under a stock lending agreement. Clearly, if the *commodity* had initially been obtained via a *reverse repurchase agreement* or stock borrowing agreement, the *commodity* would not have been included in the *trading book* in the first place.

- 7.4.6 G *Firms* are reminded that the table in *BIPRU 7.6.5R* (Table: Appropriate PRR calculation for an option or warrant) divides *commodity options* into:

- (1) those which must be treated under *BIPRU 7.6*; and
- (2) those which must be treated under either *BIPRU 7.4* or *BIPRU 7.6 (Option PRR)*, the *firm* being able to choose whether *BIPRU 7.4* or *BIPRU 7.6* is used.

Derivation of notional positions: General

7.4.7 G *BIPRU 7.4.8R - BIPRU 7.4.19G* convert the instruments listed in the table in *BIPRU 7.4.4R* into notional *positions* in the relevant *commodities*. These notional *positions* are expressed in terms of quantity (tonnes, barrels, etc), not value. The maturity of the *position* is only relevant where the *firm* is using the *commodity maturity ladder approach* or the *commodity extended maturity ladder approach*.

Derivation of notional positions: Futures, forwards, CFDs and options on a single commodity

7.4.8 R Where a *forward, future, CFD, synthetic future* or *option* (unless already included in the *firm's option PRR* calculation) settles according to:

- (1) the difference between the price set on trade date and that prevailing at contract expiry, the notional *position*:
 - (a) equals the total quantity underlying the contract; and
 - (b) has a maturity equal to the expiry date of the contract; and
- (2) the difference between the price set on trade date and the average of prices prevailing over a certain period up to contract expiry, there is a notional *position* for each of the reference dates used in the averaging period to calculate the average price, which:
 - (a) equals a fractional share of the total quantity underlying the contract; and
 - (b) has a maturity equal to the relevant reference date.

7.4.9 G (1) The following example illustrates *BIPRU 7.4.8R(2)*.

(2) A *firm* buys a Traded Average Price Option (TAPO - a type of Asian option) allowing it to deliver 100 tonnes of Grade A copper and receive \$1,750 in June. If there were 20 *business days* in June the short notional *positions* will each:

- (a) equal 5 tonnes per day (1/20 of 100 tonnes); and
- (b) have a maturity equal to one of the *business days* in June (one for each day).

(3) In this example as each *business day* in June goes by the quantity per day for the remaining days does not change (5 tonnes per day) only the days remaining changes. Therefore, halfway through June there are ten, 5 tonne short notional *positions* remaining each for the ten remaining *business days* in June.

Derivation of notional positions: Buying or selling a single commodity at an average of spot prices prevailing in the future

7.4.10 R Commitments to buy or sell at the average spot price of the *commodity* prevailing over some period between trade date and maturity must be treated as a combination of:

- (1) a *position* equal to the full amount underlying the contract with a maturity equal to the maturity date of the contract which is:
 - (a) long, where the *firm* will buy at the average price; or
 - (b) short, where the *firm* will sell at the average price; and
- (2) a series of notional *positions*, one for each of the reference dates where the contract price remains unfixed, each of which:
 - (a) is long if the *position* under (1) is short, or short if the *position* under (1) is long;
 - (b) equals a fractional share of the total quantity underlying the contract; and
 - (c) has a maturity date of the relevant reference date.

7.4.11 G The following guidance provides an example of *BIPRU* 7.4.10R. In January, a *firm* agrees to buy 100 tonnes of copper for the average spot price prevailing during the 20 *business days* in February, and will settle on 30 June. After entering into this agreement, the *firm* faces the risk that the average price for February increases relative to that for 30 June. Therefore, as highlighted in the table below:

- (1) the short *positions* reflect the fact that this could occur because any one of the remaining forward prices for February increase; and
- (2) the long *position* reflects the fact that this loss could occur because the forward price for 30 June falls.

7.4.12 G Table: Example of buying at the average spot price prevailing in the future
This table belongs to *BIPRU* 7.4.11G

	Application of <i>BIPRU</i> 7.4.10R(1)	Application of <i>BIPRU</i> 7.4.10R(2)
From trade date to start of averaging period	Long <i>position</i> in 100 tonnes of copper with a maturity of 30 June.	A series of 20 notional short <i>positions</i> each equal to 5 tonnes of copper. Each <i>position</i> is allocated a maturity equal to one of the <i>business days</i> in February (one for each day).

	Application of <i>BIPRU</i> 7.4.10R(1)	Application of <i>BIPRU</i> 7.4.10R(2)
During averaging period	Long <i>position</i> in 100 tonnes of copper with a maturity of 30 June.	As each <i>business day</i> goes by in February the price for 5 tonnes of copper is fixed and so there will be one less notional short <i>position</i> .
After averaging period	Long <i>position</i> in 100 tonnes of copper with a maturity of 30 June.	No short <i>positions</i> .

Derivation of notional positions: CFDs and options on a commodity index

7.4.13 R *Commodity index futures and commodity index options* (unless the *option* is included in the *firm's option PRR* calculation), must be treated as follows:

- (1) Step 1: the total quantity underlying the contract must be either:
 - (a) treated as a single notional *commodity position* (separate from all other *commodities*); or
 - (b) divided into notional *positions*, one for each of the constituent *commodities* in the index, of an amount which is a proportionate part of the total underlying the contract according to the weighting of the relevant *commodity* in the index;
- (2) Step 2: each notional *position* determined in Step 1 must then be included:
 - (a) when using the *commodity simplified approach* (*BIPRU* 7.4.24R), without adjustment; or
 - (b) when using the *commodity maturity ladder approach* (*BIPRU* 7.4.25R) or the *commodity extended maturity ladder approach* (*BIPRU* 7.4.32R), with the adjustments in *BIPRU* 7.4.14R.

7.4.14 R Table: Treatment of commodity index futures and commodity index options
This table belongs to *BIPRU* 7.4.13R(2)(b)

Construction of index	Notional <i>position</i> (or <i>positions</i>) and maturity

Construction of index	Notional <i>position</i> (or <i>positions</i>) and maturity
Spot level of index is based on the spot price of each constituent <i>commodity</i>	Each quantity determined in Step 1 as referred to in <i>BIPRU 7.4.13R</i> is assigned a maturity equal to the expiry date of the contract.
Spot level of index is based on an average of the forward prices of each constituent <i>commodity</i>	Each quantity determined in Step 1 as referred to in <i>BIPRU 7.4.13R</i> is divided (on a pro-rata basis) into a series of forward <i>positions</i> to reflect the impact of each forward price on the level of the index. The maturity of each forward <i>position</i> equals the maturity of the relevant forward price determining the level of the index when the contract expires.

- 7.4.15 G (1) An example of using *BIPRU 7.4.13R* and the table in *BIPRU 7.4.14R* is as follows.
- (2) A *firm* is long a three-month *commodity index future* where the spot level of the index is based on the one, two and three month forward prices of aluminium, copper, tin, lead, zinc and nickel (18 prices in total).
- (3) Step 1: the *firm* should decide whether to treat the full quantity underlying the contract as a single notional *commodity position* or disaggregate it into notional *positions* in aluminium, copper, tin, lead, zinc and nickel. In this case the *firm* decides to disaggregate the contract into notional *positions* in aluminium, copper, tin, lead, zinc and nickel.
- (4) Step 2: if the *firm* uses the *commodity simplified method*, nothing more need be done to arrive at the notional *position*. In this case the *firm* uses the *commodity maturity ladder approach* and so subdivides each *position* in each metal into three because the level of the index is based on the prevailing one, two and three month forward prices. Since the *future* will be settled in three months' time at the prevailing level of the index, the three *positions* for each metal will have maturities of four, five and six months respectively.

Derivation of notional positions: Commodity swaps

- 7.4.16 R A *firm* must treat a *commodity swap* as a series of notional *positions*, one *position* for each payment under the *swap*, each of which:

- (1) equals the total quantity underlying the contract;
- (2) has a maturity corresponding to the payment date; and
- (3) is long or short according to *BIPRU 7.4.17R*.

7.4.17 R Table: Treatment of commodity swaps
This table belongs to *BIPRU 7.4.16R*

	Receiving amounts which are unrelated to any <i>commodity's</i> price	Receiving the price of <i>commodity 'b'</i>
Paying amounts which are unrelated to any <i>commodity's</i> price	N/A	Long <i>positions</i> in <i>commodity 'b'</i>
Paying the price of <i>commodity 'a'</i>	Short <i>positions</i> in <i>commodity 'a'</i>	Short <i>positions</i> in <i>commodity 'a'</i> and long <i>positions</i> in <i>commodity 'b'</i>

7.4.18 G The table in *BIPRU 7.4.17R* shows that where the legs of the *swap* are in different *commodities*, a series of forward *positions* are created for each *commodity* (that is, a series of short *positions* in *commodity 'a'* and a series of long *positions* in *commodity 'b'*).

7.4.19 G The table in *BIPRU 7.4.17R* also covers the case where one leg is unrelated to any *commodity's* price. This leg may be subject to a *PRR* under another part of *BIPRU 7*; for example, an interest rate based leg would have to be included in a *firm's interest rate PRR* calculation.

Calculating the *PRR* for each commodity: General

7.4.20 R A *firm* must calculate a *commodity PRR* for each *commodity* separately using either the *commodity simplified approach* (*BIPRU 7.4.24R*), the *commodity maturity ladder approach* (*BIPRU 7.4.25R*) or the *commodity extended maturity ladder approach* (*BIPRU 7.4.32R*).

7.4.21 R A *firm* must use the same approach for a particular *commodity* but need not use the same approach for all *commodities*.

7.4.22 R (1) A *firm* must treat *positions* in different grades or brands of the same *commodity-class* as different *commodities* unless they:

- (a) can be delivered against each other; or

(b) are close substitutes and have price movements which have exhibited a stable correlation coefficient of at least 0.9 over the last 12 months.

(2) If a *firm* relies on (1)(b) it must then monitor compliance with the conditions in that paragraph on a continuing basis.

7.4.23 R If a *firm* intends to rely on the approach in *BIPRU 7.4.22R*(1)(b):

(1) it must notify the *FSA* in writing at least 20 *business days* prior to the date the *firm* starts relying on it; and

(2) the *firm* must, as part of the notification under (1), provide to the *FSA* the analysis of price movements on which it relies.

Calculating the PRR for each commodity: Simplified approach

7.4.24 R A *firm* which calculates a *commodity PRR* using the *commodity simplified approach* must do so by summing:

(1) 15% of the net *position* multiplied by the spot price for the *commodity*; and

(2) 3% of the gross *position* (long plus short, ignoring the sign) multiplied by the spot price for the *commodity*;

(and for these purposes the excess of a *firm's* long (short) *positions* over its short (long) *positions* in the same *commodity* (including notional *positions* under *BIPRU 7.4.4R*) is its net *position* in each *commodity*).

Calculating the PRR for each commodity: Maturity ladder approach

7.4.25 R A *firm* using the *commodity maturity ladder approach* must calculate the *commodity PRR* following the steps in *BIPRU 7.4.26R* and then sum all spread charges, carry charges and outright charges that result. A *firm* must use a separate maturity ladder for each *commodity*.

7.4.26 R (1) A *firm* must calculate the charges referred to in *BIPRU 7.4.25R* as follows.

(2) Step 1: offset long and short *positions* maturing:

(a) on the same day; or

(b) (in the case of *positions* arising under contracts traded in markets with daily delivery dates) within 10 *business days* of each other.

(3) Step 2: allocate the *positions* remaining after step 1 to the appropriate maturity band in the table in *BIPRU 7.4.28R* (*physical commodity positions* are allocated to band 1).

- (4) Step 3: match long and short *positions* within each band. In each instance, calculate a spread charge equal to the matched amount multiplied first by the spot price for the *commodity* and then by the spread rate of 3%.
- (5) Step 4: carry unmatched *positions* remaining after step 3 to another band where they can be matched, then match them. Do this until all matching possibilities are exhausted. In each instance, calculate:
 - (a) a carry charge equal to the carried *position* multiplied by the spot price for the *commodity*, the carry rate of 0.6% and the number of bands by which the *position* is carried; and
 - (b) a spread charge equal to the matched amount multiplied by the spot price for the *commodity* and the spread rate of 3%.
- (6) Step 5: calculate the outright charge on the remaining *positions* (which will either be all long *positions* or all short *positions*). The outright charge equals the remaining *position* (ignoring the sign) multiplied by the spot price for the *commodity* and the outright rate of 15%.

7.4.27 G The matched amount in *BIPRU* 7.4.26R is the lesser (ignoring the sign) of either the total long *position* or the total short *position*. For example, a band with 1000 long and 700 short results in a matched amount of 700. The unmatched amount would be 300.

7.4.28 R Table: Maturity bands for the maturity ladder approach
This table belongs to *BIPRU* 7.4.26R

Band	Maturity of <i>position</i>
Band 1	$0 \leq 1$ month
Band 2	> 1 month ≤ 3 months
Band 3	> 3 months ≤ 6 months
Band 4	> 6 months ≤ 1 year
Band 5	> 1 year ≤ 2 years
Band 6	> 2 years ≤ 3 years
Band 7	> 3 years

7.4.29 G *BIPRU 7.4.30G* is an example illustrating the calculation of the *commodity PRR* on an individual *commodity* using the *commodity maturity ladder approach* (*BIPRU 7.4.26R*). After the *firm* has carried out the pre-processing required by *BIPRU 7.4.26R(2)* (that is, step 1), it follows steps 2 to 5 as shown below. Because the *firm* is using the *commodity maturity ladder approach* the spread rate is 3%, the carry rate is 0.6% and the outright rate is 15%. The example assumes that the spot price for the *commodity* is £25.

7.4.30 G Table: Example illustrating the commodity maturity ladder approach
This table belongs to *BIPRU 7.4.29G*

Band	Step 2	Step 3	Step 4a	Step 4b	Step 6
	Allocate remaining <i>positions</i> to appropriate maturity bands	Match within bands. Each matched amount incurs a spread charge.	Carry across bands. Each carried amount incurs a carry charge.	Match within band. Each matched amount incurs a spread charge.	Remaining <i>position(s)</i> incur an outright charge.
$0 \leq 1$ month					
>1 month ≤ 3 months	1000 long 700 short	700 matched	300 carried		
>3 months ≤ 6 months					
>6 months ≤ 1 year					
>1 year ≤ 2 years	600 short	Nothing matched	100 carried	400 matched	200 short remains
>2 years ≤ 3 years					
> 3 years	100 long	Nothing matched			
Spread charges	$700 * \pounds 25 * 3\% + 400 * \pounds 25 * 3\%$		=	£825	
Carry charges	$300 * \pounds 25 * 0.6\% * 3 + 100 * \pounds 25 * 0.6\% * 2$		=	£165	
Outright charge	$200 * \pounds 25 * 15\%$		=	£750	
				£1740	

Calculating the PRR for each commodity: Extended maturity ladder approach

- 7.4.31 R A *firm* may use the *commodity extended maturity ladder approach* to calculate the *commodity PRR* for a particular *commodity* provided the *firm*:
- (1) has a diversified *commodities* portfolio;
 - (2) undertakes significant *commodities* business;
 - (3) is not yet in a position to use the *VaR model approach* to calculate *commodity PRR*; and
 - (4) at least twenty *business days* before the date the *firm* uses that approach notifies the *FSA* in writing of:
 - (a) its intention to use the *commodity extended maturity ladder method*; and
 - (b) the facts and matters relied on to demonstrate that the *firm* meets the criteria in (1) - (3).
- 7.4.32 R A *firm* using the *commodity extended maturity ladder approach* must calculate its *commodity PRR* by:
- (1) following the same steps as in *BIPRU 7.4.26R* but using the rates from the table in *BIPRU 7.4.33R* rather than those in *BIPRU 7.4.26R*; and
 - (2) summing all spread charges, carry charges and outright charge that result.
- 7.4.33 R Table: Alternative spread, carry and outright rates
This table belongs to *BIPRU 7.4.32R*

	Precious metals (excluding gold)	Base metals	Softs (agricultural)	Other (including energy)
Spread rate (%)	2	2.4	3	3
Carry rate (%)	0.3	0.5	0.6	0.6

	Precious metals (excluding gold)	Base metals	Softs (agricultural)	Other (including energy)
Outright rate (%)	8	10	12	15

- 7.4.34 G For the purposes of *BIPRU 7.4.31R(1)* a *firm* has a diversified *commodity* portfolio where it holds *positions* in more than one *commodity* in each of the categories set out in the table in *BIPRU 7.4.33R* and holds *positions* across different maturities in those individual *commodities*. A *firm* would not have a diversified *commodity* portfolio if it held *positions* in only one *commodity* in each of the categories set out in the table in *BIPRU 7.4.33R*. This is because the rates in the table in *BIPRU 7.4.33R* assume *firms* have *positions* in more than one of that category's *commodities*. Different *commodities* within a given category are likely to exhibit different volatilities, so where a *firm* does not have a diversified *commodity* portfolio in that category, the rates applying to that category might underestimate the regulatory capital required for a certain *commodity* at certain times.
- 7.4.35 G What constitutes significant business in *BIPRU 7.4.31R(2)* will vary from *firm* to *firm*. The more regularly the *firm* undertakes trades in *commodities* and the more consistently it has *positions* in the relevant *commodity*, the more likely it is to be undertaking significant business for the purposes of *BIPRU 7.4.31R(2)*.
- 7.4.36 R Where a *firm* is:
- (1) treating a *commodity* index derivative as if it was based on a single separate *commodity* (see *BIPRU 7.4.13R(1)(a)*); and
 - (2) using the *commodity extended maturity ladder approach* to calculate the *commodity PRR* for that *commodity*;
- it must determine which index constituent incurs the highest rate in the table in *BIPRU 7.4.33R* and apply that rate to the notional *position* for the purposes of *BIPRU 7.4.32R*.
- 7.4.37 G Where an index is only based on precious metals, *BIPRU 7.4.13R* and *BIPRU 7.4.36R* allow the *firm* to treat the single notional *position* as precious metal for the purposes of *BIPRU 7.4.32R*. However, if the index contained a mix of precious metals and base metals the *firm* would have to treat the notional *position* under *BIPRU 7.4.36R* as a base metal because base metals attract a higher rate than precious metals in the table in *BIPRU 7.4.33R*.

Liquidity and other risks

- 7.4.38 R If a short *position* to which *BIPRU 7.4* applies falls due before a long *position* to which *BIPRU 7.4* applies, a *firm* must also guard against the risk of a shortage of liquidity which may exist in some markets.
- 7.4.39 G In particular, where *BIPRU 7.4.38R* applies and the short *position* constitutes a material *position* compared to a *firm's* total *commodity positions*, it should consider a further *commodity PRR* charge in respect of that *position* depending on the likelihood of a shortage of liquidity in that market.
- 7.4.40 R A *firm* must safeguard against other risks, apart from the delta risk, associated with *commodity options*.
- 7.4.41 R The interest-rate and foreign-exchange risks not covered by other provisions of *BIPRU 7.4* or by the provisions of *BIPRU 7.2* (Interest rate PRR) or *BIPRU 7.5* (Foreign currency PRR) must be included in the calculation of *general market risk* for traded debt *securities* and in the calculation of *foreign currency PRR*.

7.5 Foreign currency PRR

General rule

7.5.1 R A *firm* must calculate its *foreign currency PRR* by:

- (1) identifying which *foreign currency* and *gold positions* to include in the *PRR* calculation;
- (2) calculating the net *open position* in each currency in accordance with this section (including where necessary the *base currency* calculated in the same way as it is for *foreign currencies*) and in gold;
- (3) calculating the *open currency position* for *foreign currencies* as calculated under *BIPRU 7.5.19R* and the net gold position (see *BIPRU 7.5.20R*); and
- (4) multiplying the sum of the absolutes of that *open currency position* and that net gold *position* by 8%.

7.5.2 G An example of the operation of *BIPRU 7.5.1R* is as follows. A *firm* has an *open currency position* of £100 and a net gold *position* of £50. The sum (ignoring the sign) is £150, and so the *foreign currency PRR* is £12.

Scope of the foreign currency PRR calculation

7.5.3 R A *firm's foreign currency PRR* calculation must include the following items regardless of whether they are *trading book* or *non-trading book positions*:

- (1) all gold *positions*;
- (2) all spot *positions* in *foreign currency* (that is, all asset items less all liability items, including accrued interest, in the *foreign currency* in question);
- (3) all forward *positions* in *foreign currency*;
- (4) all *CRD financial instruments* and other items which are denominated in a *foreign currency*;
- (5) irrevocable guarantees (and similar instruments) that are certain to be called and likely to be irrecoverable to the extent they give rise to a *position* in gold or *foreign currency*; and
- (6) notional *positions* arising from the instruments listed in the table in *BIPRU 7.5.5R*.

7.5.4 R (1) The following are excluded from a *firm's foreign currency PRR* calculation:

- (a) *foreign currency* assets which have been deducted in full from the *firm's capital resources* under the calculations under the *capital resources table*;
 - (b) *positions* hedging (a);
 - (c) *positions* that a *firm* has deliberately taken in order to hedge against the adverse effect of the exchange rate on the ratio of its *capital resources* to its *capital resources requirement*; and
 - (d) transactions to the extent that they fully hedge net future *foreign currency* income or expenses which are known but not yet accrued.
- (2) If a *firm* uses an exclusion under (1) it must:
- (a) notify the *FSA* before it makes use of it;
 - (b) include in the notification in (a) the terms on which the relevant item will be excluded;
 - (c) not change the terms of the exclusion under (b); and
 - (d) document its policy on the use of that exclusion in its *trading book policy statement*.
- (3) A *position* may only be excluded under (1)(b) or (c) if it is of a non-trading or structural nature.

7.5.5 R Table: instruments which result in notional foreign currency positions
This table belongs to *BIPRU 7.5.3R(6)*.

Instruments	See
<i>Foreign currency futures, forwards, synthetic futures and CFDs</i>	<i>BIPRU 7.5.11R</i>
<i>Foreign currency swaps</i>	<i>BIPRU 7.5.13R</i>
<i>Foreign currency options or warrants</i> (unless the <i>firm</i> calculates a <i>PRR</i> on the <i>option</i> or <i>warrant</i> under <i>BIPRU 7.6</i> (Option <i>PRR</i>)).	<i>BIPRU 7.5.15R</i>
<i>Gold futures, forwards, synthetic futures and CFDs</i>	<i>BIPRU 7.5.16R</i>
<i>Gold options</i> (unless the <i>firm</i> calculates a <i>PRR</i> on the <i>option</i> under <i>BIPRU 7.6</i>).	<i>BIPRU 7.5.17R</i>
<i>Positions in CIUs</i>	<i>BIPRU 7.5.18R</i>

- 7.5.6 G *Firms* are reminded that the table in *BIPRU 7.6.5R* (Table: Appropriate PRR calculation for an option or warrant) divides *foreign currency options* and *warrants* into:
- (1) those which must be treated under *BIPRU 7.6* (Option PRR); and
 - (2) those which must be treated under either *BIPRU 7.5* or *BIPRU 7.6*, the *firm* being able to choose whether *BIPRU 7.5* or *BIPRU 7.6* is used.
- 7.5.7 R When determining the currency of denomination *firms* must:
- (1) use the currency in which the *firm* accounts for the instrument where an instrument is quoted in more than one currency; and
 - (2) treat depository receipts as *positions* in the underlying *security*.
- 7.5.8 G Instruments denominated in a foreign currency include, amongst other things, assets and liabilities (including accrued interest); *non-foreign currency derivatives*; *net underwriting positions*; *reduced net underwriting positions*; and irrevocable guarantees (or similar instruments) that are certain to be called.
- 7.5.9 R Where a contract is based on a basket of currencies, the *firm* can choose either to derive notional *positions* in each of the constituent currencies or treat it as a single notional *position* in a separate notional currency.
- Derivation of notional positions: General
- 7.5.10 G *BIPRU 7.5.11 - BIPRU 7.5.18R* derive notional currency *positions* for the instruments listed in the table in *BIPRU 7.5.5R*.
- Derivation of notional positions: Foreign exchange forwards, futures, CFDs and synthetic futures
- 7.5.11 R
- (1) A *firm* must treat a *foreign currency forward, future, synthetic future* or *CFD* as two notional currency *positions* as follows:
 - (a) a long notional *position* in the currency which the *firm* has contracted to buy; and
 - (b) a short notional *position* in the currency which the *firm* has contracted to sell.
 - (2) In (1) the notional *positions* have a value equal to either:
 - (a) the contracted amount of each currency to be exchanged in the case of a *forward, future, synthetic future* or *CFD* held in the *non-trading book*; or

- (b) the present value of the amount of each currency to be exchanged in the case of a *forward, future, synthetic future* or *CFD* held in the *trading book*.

- 7.5.12 G (1) The following example illustrates *BIPRU 7.5.11R*. In this example, a *firm* contracts to sell \$106 for €108 in one year's time and the present values of each cash flow are \$100 and €100 respectively.



- (2) In the *non-trading book*, this *forward* would be treated as a combination of a €108 long *position* and a \$106 short *position*.
- (3) In the *trading book*, this *forward* would be treated as a combination of a €100 long *position* and a \$100 short *position*.
- (4) *Firms* are reminded that *foreign currency forwards* held in the *trading book* should also be included in the *firm's interest rate PRR* calculation (see *BIPRU 7.2.4R* (Instruments which result in notional *positions* for the purpose of the *interest rate PRR*)).

Derivation of notional positions: Foreign currency swaps

- 7.5.13 R (1) A *firm* must treat a *foreign currency swap* as:
- (a) a long notional *position* in the currency in which the *firm* has contracted to receive interest and principal; and
- (b) a short notional *position* in the currency in which the *firm* has contracted to pay interest and principal.
- (2) In (1) the notional *positions* have a value equal to either:
- (a) the nominal amount of each currency underlying the *swap* if it is held in the *non-trading book*; or
- (b) the present value amount of all cash flows in the relevant currency in the case of a *swap* held in the *trading book*.

- 7.5.14 G (1) The following example illustrates *BIPRU 7.5.13R*. In this example a *firm* enters into a five year *foreign currency swap* where it contracts to pay six month US\$ Libor on \$100 in return for receiving 6% fixed on €100. The present values of each leg are \$100 and €98 respectively.
- (2) In the *non-trading book*, this *swap* would be treated as a combination of a €100 long *position* and a \$100 short *position*.
- (3) In the *trading book*, this *swap* would be treated as a combination of a €98 long *position* and a \$100 short *position*.
- (4) *Firms* are reminded that *foreign currency swaps* held in the *trading book* should also be included in the *firm's interest rate PRR* calculation (see *BIPRU 7.2.4R* (Instruments which result in notional *positions* for the purpose of the *interest rate PRR*)).

Derivation of notional positions: Foreign currency options and warrants

- 7.5.15 R Where included in *BIPRU 7.5's PRR* calculation (see the table in *BIPRU 7.5.5R*), a *foreign currency option* or *warrant* must be treated as a *foreign currency forward*.

Derivation of notional positions: Gold forwards, futures, synthetic futures and CFDs

- 7.5.16 R A *forward, future, synthetic future* or *CFD* on gold must be treated as a notional *position* in gold with a value equal to the amount of gold underlying multiplied by the current spot price for gold.

Derivation of notional positions: Gold options

- 7.5.17 R If included in the *PRR* calculation under *BIPRU 7.5* (see the table in *BIPRU 7.5.5R*), a gold *option* must be treated as a gold *forward*.

Derivation of notional positions: CIUs

- 7.5.18 R (1) This *rule* deals with *positions* in *CIUs*.
- (2) The actual *foreign currency positions* of a *CIU* must be included in a *firm's foreign currency PRR* calculation under *BIPRU 7.5.2R*.
- (3) A *firm* may rely on third party reporting of the *foreign currency positions* in the *CIU*, where the correctness of this report is adequately ensured.

- (4) If a *firm* is not aware of the *foreign currency positions* in a *CIU*, the *firm* must assume that the *CIU* is invested up to the maximum extent allowed under the *CIU's* mandate in *foreign currency* and the *firm* must, for *trading book positions*, take account of the maximum indirect exposure that it could achieve by taking leveraged *positions* through the *CIU* when calculating its *foreign currency PRR*. This must be done by proportionally increasing the *position* in the *CIU* up to the maximum exposure to the underlying investment items resulting from the investment mandate.
- (5) The assumed *position* of the *CIU* in *foreign currency* calculated in accordance with BIPRU 7.5.18(4) must be treated as a separate currency according to the treatment of investments in gold, subject to the modification that, if the direction of the *CIU's* investment is available, the total long *position* may be added to the total long open *foreign currency position* and the total short *position* may be added to the total short open *foreign currency position*. No netting is allowed between such *positions* prior to this calculation.

Open currency position

7.5.19 R A *firm* must calculate its *open currency position* by:

- (1) calculating the net *position* in each *foreign currency*;
- (2) converting each such net *position* into its *base currency* equivalent at current spot rates;
- (3) summing all short net *positions* and summing all long net *positions* calculated under (1) and (2); and
- (4) selecting the larger sum (ignoring the sign) from (3).

Net gold position

7.5.20 R A *firm* must calculate its net gold *position* by:

- (1) valuing all gold *positions* using the prevailing spot price for gold (regardless of the maturity of the *positions*);
- (2) offsetting long and short *positions*; and
- (3) converting the resulting net *position* into the *base currency* equivalent using the current spot *foreign currency* rate.

7.6 Option PRR

Option PRR calculation

7.6.1 R A *firm* must calculate its *option PRR* by:

- (1) identifying which *option positions* must be included within the scope of the *option PRR* calculation under *BIPRU 7.6.3R - BIPRU 7.6.5R*;
- (2) calculating the derived *position* in each *option* in accordance with *BIPRU 7.6.9R - BIPRU 7.6.15R*;
- (3) calculating the *PRR* for each derived *position* in accordance with *BIPRU 7.6.16R - BIPRU 7.6.31R*;
- (4) summing all of the *PRRs* calculated in accordance with (3).

7.6.2 G *Firms* are reminded that the table in *BIPRU 7.2.4R* (Instruments which result in notional *positions* for the purposes of the *interest rate PRR*) and the table in *BIPRU 7.3.3R* (Instruments which result in notional *positions* for the purposes of the *equity PRR*) also require an *interest rate PRR* to be calculated for *options* on *equities*, baskets of *equities* or *equity* indices. The interaction between *BIPRU 7.6* and the rest of Chapter 7 is illustrated in *BIPRU 7.6.33G*.

Scope of the option PRR calculation

7.6.3 R Except as permitted under *BIPRU 7.6.5R*, a *firm's option PRR* calculation must include:

- (1) each *trading book position* in an *option* on an *equity*, interest rate or debt *security*;
- (2) each *trading book position* in a *warrant* on an *equity* or debt *security*;
- (3) each *trading book position* in a *CIU*; and
- (4) each *trading book* and *non-trading book position* in an *option* on a *commodity*, currency or gold.

7.6.4 G *BIPRU 7.6.3R(2)* includes *net underwriting positions* or *reduced net underwriting positions* in *warrants*.

7.6.5 R Table: Appropriate PRR calculation for an option or warrant
This table belongs to *BIPRU 7.6.3R*

<i>Option type (see BIPRU 7.6.18R) or warrant</i>	<i>PRR calculation</i>
<p>American <i>option</i>, European <i>option</i>, Bermudan <i>option</i>, Asian <i>option</i> or <i>warrant</i> for which the <i>in the money</i> percentage (see <i>BIPRU 7.6.6R</i>) is equal to or greater than the <i>appropriate PRA</i> (see <i>BIPRU 7.6.7R</i> and <i>BIPRU 7.6.8R</i>)</p>	<p>Calculate either an <i>option PRR</i>, or the most appropriate to the underlying <i>position</i> of:</p> <ul style="list-style-type: none"> (a) an <i>equity PRR</i>; or (b) an <i>interest rate PRR</i>; or (c) a <i>commodity PRR</i>; or (d) a <i>foreign currency PRR</i>; or (e) a <i>collective investment undertaking PRR</i>.
<p>American <i>option</i>, European <i>option</i>, Bermudan <i>option</i>, Asian <i>option</i> or <i>warrant</i>:</p> <ul style="list-style-type: none"> (a) for which the <i>in the money</i> percentage (see <i>BIPRU 7.6.6R</i>) is less than the <i>appropriate PRA</i> (see <i>BIPRU 7.6.7R</i> and <i>BIPRU 7.6.8R</i>); or (b) that is <i>at the money</i>; or (c) that is <i>out of the money</i>. 	<p>Calculate an <i>option PRR</i></p>
<p>All other types of <i>option</i> listed in <i>BIPRU 7.6.18R</i> (regardless of whether <i>in the money</i>, <i>at the money</i> or <i>out of the money</i>).</p>	

The *in the money* percentage

7.6.6 R (1) The *in the money* percentage is calculated in accordance with this *rule*.

- (2) For a call *option*:
- $$\frac{\text{Current market price of underlying} - \text{Strike price of the } \textit{option}}{\text{Strike price of the } \textit{option}} * 100$$
- (3) For a put *option*:
- $$\frac{\text{Strike price of } \textit{option} - \text{Current market price of underlying}}{\text{Strike price of the } \textit{option}} * 100$$
- (4) In the case of an *option* on a basket of *securities* a *firm* may not treat the *option* as being *in the money* by the relevant percentage so as to enable the *firm* not to apply an *option PRR* under *BIPRU 7.6.5R* unless the conditions in *BIPRU 7.6.5R* are satisfied with respect to each kind of underlying investment.
- (5) (4) also applies to an *option* on a *CIU* if a *firm* is using one of the *CIU look through methods*.

The appropriate PRA

- 7.6.7 R (1) The *appropriate PRA* for a *position* is that listed in the table in *BIPRU 7.6.8R* against the relevant underlying *position*.
- (2) If the *firm* uses the *commodity extended maturity ladder approach* or the *commodity maturity ladder approach* for a particular *commodity* under *BIPRU 7.4* (Commodity PRR) the *appropriate PRA* for an *option* on that *commodity* is the outright rate applicable to the underlying *position* (see *BIPRU 7.4.26R* (Calculating the PRR for each commodity: Maturity ladder approach) and *BIPRU 7.4.33R* (Table: Alternative spread, carry and outright rates)).
- (3) If a *firm* does not have *commodity positions* treated under *BIPRU 7.4* or does not have *positions* in the *commodity* in question treated under *BIPRU 7.4* the restrictions in *BIPRU 7.4* that regulate when a *firm* can and cannot use a particular method of calculating the *commodity PRR* apply for the purpose of establishing the *appropriate PRR* for the purposes of *BIPRU 7.6*.
- (4) If a *firm* is using one of the *CIU look through methods* for an *option* on a *CIU* the leveraging requirements in *BIPRU 7.7* (Position risk requirements for collective investment undertakings) apply (see *BIPRU 7.7.11R*). For this purpose the amount of the *appropriate PRAs* under *BIPRU 7.6.6R(5)* is increased by the amount of that leveraging (expressed as a percentage) as calculated under *BIPRU 7.7*, subject to a maximum *appropriate PRA* of 32%.

- 7.6.8 R Table: Appropriate PRA
This table belongs to *BIPRU 7.6.7R*

<i>Underlying position</i>	<i>Appropriate PRA</i>
<i>Equity</i>	The <i>PRA</i> applicable to the underlying <i>equity</i> or <i>equity</i> index in the table in <i>BIPRU 7.3.30R</i> (Simplified equity method)
Interest rate	The sum of the <i>specific risk PRA</i> (see <i>BIPRU 7.2.43R</i> to <i>BIPRU 7.2.51G</i> (Specific risk calculation)) and the <i>general market risk PRA</i> (as set out in <i>BIPRU 7.2.57R</i> (General market risk PRAs)) applicable to the underlying <i>position</i>
<i>Debt securities</i>	The sum of the <i>specific risk PRA</i> (see <i>BIPRU 7.2.43R</i> to <i>BIPRU 7.2.51G</i> (Specific risk calculation)) and the <i>general market risk PRA</i> (as set out in the table in <i>BIPRU 7.2.57R</i> (General market risk PRAs)) applicable to the underlying <i>position</i>
<i>Commodity</i>	18% (unless <i>BIPRU 7.6.7R</i> requires otherwise)
Currency	8%
Gold	8%
<i>CIU</i>	32% (subject to <i>BIPRU 7.6.6R</i> and <i>BIPRU 7.6.7R</i>)

Calculating derived positions

- 7.6.9 R A *firm* must calculate the derived *position* specified in the table in *BIPRU 7.6.13R* for each *position* included in its *option PRR* calculation.

Netting positions

- 7.6.10 R A *firm* may calculate a derived *position* for its net *position* in an *option* or a *warrant*, if the relevant *options* or *warrants* are identical or may be treated as identical under *BIPRU 7.6.11R* or *BIPRU 7.6.12R*.
- 7.6.11 R A *firm* may treat *options* or *warrants* as identical if they have the same strike price, maturity (except for an interest rate cap or floor – see *BIPRU 7.6.12R*) and underlying.
- 7.6.12 R A *firm* may treat as identical a purchased interest rate cap (or floor) and a written interest rate cap (or floor) only if they mature within 30 days of each other and all other terms are identical (a cap may not be netted against a floor).

Derived positions

7.6.13 R Table: Derived positions
This table belongs to *BIPRU 7.6.9R*

Underlying	Option (or warrant)	Derived <i>position</i>
<i>Equity</i>	<i>Option (warrant) on a single equity or option on a future/forward on a single equity</i>	A notional <i>position</i> in the actual <i>equity</i> underlying the contract valued at the current market price of the <i>equity</i> .
	<i>Option (warrant) on a basket of equities or option on a future/forward on a basket of equities</i>	A notional <i>position</i> in the actual <i>equities</i> underlying the contract valued at the current market price of the <i>equities</i> .
	<i>Option (warrant) on an equity index or option on a future/forward on an equity index</i>	A notional <i>position</i> in the index underlying the contract valued at the current market price of the index.
Interest rate	<i>Option on an interest rate or an interest rate future/FRA</i>	A zero coupon <i>zero-specific-risk security</i> in the currency concerned with a maturity equal to the sum of the time to expiry of the contract and the length of the period on which the settlement amount of the contract is calculated valued at the notional amount of the contract.
	<i>Option on an interest rate swap</i>	A zero coupon <i>zero-specific-risk security</i> in the currency concerned with a maturity equal to the length of the <i>swap</i> valued at the notional principal amount.
	Interest rate cap or floor	A zero coupon <i>zero-specific-risk security</i> in the currency concerned with a maturity equal to the remaining period of the cap or floor valued at the notional amount of the contract.

Underlying	Option (or warrant)	Derived <i>position</i>
Debt securities	<i>Option (warrant) on a debt security or option on a future/forward on a debt security</i>	The underlying debt <i>security</i> with a maturity equal to the time to expiry of the <i>option</i> valued as the nominal amount underlying the contract at the current market price of the debt <i>security</i> .
	<i>Option (warrant) on a basket of debt securities or option on a future/forward on a basket of debt securities</i>	A notional <i>position</i> in the actual debt <i>securities</i> underlying the contract valued at the current market price of the debt <i>securities</i> .
	<i>Option (warrant) on an index of debt securities or option on a future/forward on an index of debt securities</i>	A notional <i>position</i> in the index underlying the contract valued at the current market price of the index.
Commodity	<i>Option on a commodity or option on a future/forward on a commodity</i>	An amount equal to the tonnage, barrels or kilos underlying the <i>option</i> with (in the case of a <i>future/forward</i> on a <i>commodity</i>) a maturity equal to the expiry date of the <i>forward</i> or <i>futures</i> contract underlying the <i>option</i> . In the case of an <i>option</i> on a <i>commodity</i> the maturity of the <i>position</i> falls into Band 1 in the table in BIPRU 7.4.28R (Table: Maturity bands for the maturity ladder approach).
	<i>Option on a commodity swap</i>	An amount equal to the tonnage, barrels or kilos underlying the <i>option</i> with a maturity equal to the length of the <i>swap</i> valued at the notional principal amount.

Underlying	Option (or warrant)	Derived <i>position</i>
<i>CIU</i> (These provisions about <i>CIUs</i> are subject to <i>BIPRU</i> 7.6.35R)	<i>Option (warrant)</i> on a single <i>CIU</i> or <i>option</i> on a <i>future/forward</i> on a single <i>CIU</i>	A notional <i>position</i> in the actual <i>CIU</i> underlying the contract valued at the current market price of the <i>CIU</i> .
	<i>Option (warrant)</i> on a basket of <i>CIUs</i> or <i>option</i> on a <i>future/forward</i> on a basket of <i>CIUs</i>	A notional <i>position</i> in the actual <i>CIUs</i> underlying the contract valued at the current market price of the <i>CIUs</i> .
Gold	<i>Option</i> on gold or <i>option</i> on a <i>future/forward</i> on gold	An amount equal to the troy ounces underlying the <i>option</i> with (in the case of a <i>future/forward</i> on gold) a maturity equal to the expiry date of the <i>forward</i> or <i>futures</i> contract underlying the <i>option</i> .
Currency	Currency <i>option</i>	The amount of the underlying currency that the <i>firm</i> will receive if the <i>option</i> is exercised converted at the spot rate into the currency that the <i>firm</i> will sell if the <i>option</i> is exercised.

Combinations of options which can be treated as one option

7.6.14 R A *firm* may treat (for the purpose of calculating an *option PRR* under *BIPRU* 7.6) an *option* strategy listed in the table in *BIPRU* 7.6.15R as the single *position* in a notional *option* specified against that strategy in the table in *BIPRU* 7.6.15R, if:

- (1) each element of the strategy is transacted with the same *counterparty*;
- (2) the strategy is documented as a single structure;
- (3) the underlying for each part of the composite *position* (including any actual holding of the underlying) is the same under the *PRR identical product netting rules*;
- (4) the netting achieved does not result overall in a greater degree of netting in the calculation of the *market risk capital component* than would be permitted under the other *standard market risk PRR rules*;

- (5) each *option* in the structure has the same maturity and underlying; and
- (6) the constituent parts of the structure form an indivisible single contract, so that neither party can unwind or default on one part of the structure without doing so for the contract as a whole;

except that (1) and (6) only apply to the extent possible with respect to any part of the composite *position* held by the *firm* that consists of an actual holding of the underlying.

7.6.15 R Table: Option strategies
This table belongs to *BIPRU 7.6.14R*

Option strategy (and an example)	Notional option (and rule it must be treated under)
Bull Spread (e.g. buy 100 call and sell 101 call)	One purchased <i>option</i> (treat under <i>BIPRU 7.6.20R</i>)
Bear Spread (e.g. sell 100 put and buy 101 put)	One written <i>option</i> (treat under <i>BIPRU 7.6.21R</i>)
Synthetic Long Call (e.g. long underlying and buy 100 put)	One purchased <i>option</i> (treat under <i>BIPRU 7.6.20R</i> or <i>BIPRU 7.6.24R</i>)
Synthetic Short Call (e.g. short underlying and sell 100 put)	One written <i>option</i> (treat under <i>BIPRU 7.6.21R</i> or <i>BIPRU 7.6.24R</i>)
Synthetic Long Put (e.g. short underlying and buy 100 call)	One purchased <i>option</i> (treat under <i>BIPRU 7.6.20R</i> or <i>BIPRU 7.6.24R</i>)
Synthetic Short Put (e.g. buy underlying and sell 100 call)	One written <i>option</i> (treat under <i>BIPRU 7.6.21R</i> or <i>BIPRU 7.6.24R</i>)
Long Straddle (e.g. buy 100 call and buy 100 put)	One purchased <i>option</i> (treat under <i>BIPRU 7.6.20R</i>)

Option strategy (and an example)	Notional option (and rule it must be treated under)
Short Straddle (e.g. sell 100 call and sell 100 put)	One written <i>option</i> (treat under <i>BIPRU 7.6.21R</i> but with no reduction for the amount the <i>option</i> is out of the money)
Long Strangle (e.g. buy 101 call and buy 99 put)	One purchased <i>option</i> (treat under <i>BIPRU 7.6.20R</i>)
Short Strangle (e.g. sell 99 call and sell 101 put)	One written <i>option</i> (treat under <i>BIPRU 7.6.21R</i> but with no reduction for the amount the <i>option</i> is out of the money)
Long Butterfly (e.g. buy one 100 call, sell two 101 calls, and buy one 102 call)	One purchased <i>option</i> (treat under <i>BIPRU 7.6.20R</i>)
Short Butterfly (e.g. sell one 100 put, buy two 101 puts, and sell one 102 put)	One written <i>option</i> (treat under <i>BIPRU 7.6.21R</i> but with no reduction for the amount the <i>option</i> is out of the money)

The option PRR for an individual positions

- 7.6.16 R A *firm* must calculate the *option PRR* for each individual derived *option position* using the method specified in the table in *BIPRU 7.6.18R*, or, if more than one method is permitted, using one of those methods.
- 7.6.17 R A *firm* must convert its *positions* into its *base currency* in accordance with the procedures that apply for whichever of the other *PRR charges* is appropriate (see *BIPRU 7.2.1R(3)*, *BIPRU 7.3.1R(2)*, *BIPRU 7.4.1R(3)*, *BIPRU 7.5.19R(2)*, *BIPRU 7.5.20R(3)* and *BIPRU 7.7.1R(3)*).

7.6.18 R Table: Option PRR: methods for different types of option
This table belongs to *BIPRU 7.6.16R*

Option	Description	Method
American option	An <i>option</i> that may be exercised at any time over an extended period up to its expiry date.	<i>Option standard method</i> or <i>option hedging method</i> if appropriate
European option	An <i>option</i> that can only be exercised at expiry.	
Bermudan option	A cross between an American <i>option</i> and European <i>option</i> . The Bermudan <i>option</i> can only be exercised at specific dates during its life.	
Asian option	The buyer has the right to exercise at the average rate or price of the underlying over the period (or part of the period) of the <i>option</i> . One variant is where the payout is based on the average of the underlying against a fixed strike price; another variant is where the payout gives at expiry the price of the underlying against the average price over the <i>option</i> period.	<i>Option standard method</i> or <i>option hedging method</i> if appropriate
Barrier option	An <i>option</i> which is either cancelled or activated if the price of the underlying reaches a pre-set level regardless of the price at which the underlying may be trading at the expiry of the <i>option</i> . The knock-out type is cancelled if the underlying price or rate trades through the trigger; while the knock-in becomes activated if the price moves through the trigger.	
Corridor option	Provides the holder with a pay-out for each day that the underlying stays within a defined range chosen by the investor.	

Option	Description	Method
Ladder <i>option</i>	Provides the holder with guaranteed pay-outs if the underlying trades through a pre-agreed price(s) or rate(s) at a certain point(s) in time, regardless of future performance.	
Lock-in <i>option</i>	An <i>option</i> where the pay-out to the holder is locked in at the maximum (or minimum) value of the underlying that occurred during the life of the <i>option</i> .	
Look-back <i>option</i>	A European style <i>option</i> where the strike price is fixed in retrospect, that is at the most favourable price (i.e. the lowest (highest) price of the underlying in the case of a call (put)) during the life of the <i>option</i> .	
Forward starting <i>option</i>	An <i>option</i> that starts at a future date.	
Compound <i>option</i>	An <i>option</i> where the underlying is itself an <i>option</i> (i.e. an <i>option</i> on an <i>option</i>).	<i>Option standard method</i> or <i>option hedging method</i> if appropriate
Interest rate cap	An interest rate <i>option</i> or series of <i>options</i> under which a counterparty contracts to pay any interest costs arising as a result of an increase in rates above an agreed rate: the effect being to provide protection to the holder against a rise above that agreed interest rate.	<i>Option standard method</i> , but no reduction for the amount the <i>option</i> is <i>out of the money</i> is permitted
Interest rate floor	An interest rate <i>option</i> or series of <i>options</i> under which a counterparty contracts to pay any lost income arising as a result of a fall in rates below an agreed rate: the effect being to provide protection to the holder against a fall below that agreed interest rate.	

Option	Description	Method
Performance <i>option</i>	An <i>option</i> based on a reference basket comprising any number of assets, where the pay-out to the holder could be one of the following: the maximum of the worst performing asset, or 0; the maximum of the best performing asset, or 0; the maximum of the spreads between several pairs of the assets, or 0.	<i>Option standard method</i> or <i>option hedging method</i> - using the highest <i>PRA</i> of the individual assets in the basket
Quanto	Quanto stands for “Quantity Adjusted <i>Option</i> ”. A quanto is an instrument where two currencies are involved. The payoff is dependent on a variable that is measured in one of the currencies and the payoff is made in the other currency.	Subject to <i>BIPRU 7.6.31R</i> , the <i>option standard method</i>
Cliquet <i>option</i>	A cliquet <i>option</i> consists of a series of forward starting <i>options</i> where the strike price for the next exercise date is set equal to a positive constant times the underlying price as of the previous exercise date. It initially acts like a vanilla <i>option</i> with a fixed price but as time moves on, the strike is reset and the intrinsic value automatically locked in at pre-set dates. If the underlying price is below the previous level at the reset date no intrinsic value is locked in but the strike price will be reset to the current price attained by the underlying. If the underlying price exceeds the current level at the next reset the intrinsic value will again be locked in.	<i>Option standard method</i> for a purchased cliquet, or the method specified in <i>BIPRU 7.6.30R</i> for a written cliquet
Digital <i>option</i>	A type of <i>option</i> where the pay-out to the holder is fixed. The most common types are all-or-nothing and one-touch <i>options</i> . All-or-nothing will pay out the fixed amount if the underlying is above (call) or below (put) a set value at expiry. The one-touch will pay the fixed amount if the underlying reaches a fixed point any time before expiry.	The method specified in <i>BIPRU 7.6.29R</i>

Option	Description	Method
Any other <i>option</i> or <i>warrant</i>		The method specified for the type of instrument whose description it most closely resembles.

7.6.19 G (1) The *option standard method* is described in *BIPRU 7.6.20R - BIPRU 7.6.22R*.

(2) The *option hedging method* is described in *BIPRU 7.6.23G - BIPRU 7.6.28R*.

The standard method: Purchased options and warrants

7.6.20 R Under the *option standard method*, the *PRR* for a purchased *option* or *warrant* is the lesser of:

(1) the market value of the derived *position* (see *BIPRU 7.6.9R*) multiplied by the *appropriate PRA* (see *BIPRU 7.6.8R*); and

(2) the market value of the *option* or *warrant*.

The standard method: Written options and warrants

7.6.21 R Under the *option standard method*, the *PRR* for a written *option* or *warrant* is the market value of the derived *position* (see *BIPRU 7.6.9R*) multiplied by the *appropriate PRA* (see *BIPRU 7.6.8R*). This result may be reduced by the amount the *option* or *warrant* is *out of the money* (subject to a maximum reduction to zero).

The standard method: Underwriting or sub-underwriting an issue of warrants

7.6.22 R Under the *option standard method*, the *PRR* for *underwriting* or *sub-underwriting* an issue of *warrants* is the *net underwriting position* (or *reduced net underwriting position*) multiplied by the current market price of the underlying *securities* multiplied by the *appropriate PRA*, but the result can be limited to the value of the *net underwriting position* (or *reduced net underwriting position*) calculated using the issue price of the *warrant*.

The hedging method

7.6.23 G The *option hedging method* involves the *option PRR* being calculated on a combination of the *option* and its hedge.

- 7.6.24 R Under the *option hedging method* a *firm* must calculate the *option PRR* for individual *positions* as follows:
- (1) for an *option* or *warrant* on an *equity*, basket of *equities* or *equity* index and its *equity* hedge(s), the *firm* must, to the extent specified or permitted in the table in *BIPRU 7.6.26R*, use the calculation in the table in *BIPRU 7.6.27R*;
 - (2) for an *option* or *warrant* on a *debt security*, basket of *debt securities* or *debt security* index and its *debt security* hedge(s), the *firm* must, to the extent specified or permitted in the table in *BIPRU 7.6.26R*, use the calculation in the table in *BIPRU 7.6.27R*;
 - (3) for an *option* on gold and its gold hedge, the *firm* must, to the extent specified or permitted in the table in *BIPRU 7.6.26R*, use the calculation in the table in *BIPRU 7.6.27R*; and
 - (4) for an *option* on a currency and its currency hedge, the *firm* must, to the extent specified or permitted in the table in *BIPRU 7.6.26R*, use the calculation in the table in *BIPRU 7.6.28R*.
- 7.6.25 R (1) A *firm* may not use the *option hedging method* for:
- (a) an interest rate *option* and its hedge; or
 - (b) a *commodity option* and its hedge; or
 - (c) a *CIU option* and its hedge.
- (2) A *firm* may only use the *option hedging method* if the item underlying the *option* or *warrant* is the same as the hedge of the *option* or *warrant* under the *PRR identical product netting rules*.

7.6.26 R Table: Appropriate treatment for equities, debt securities or currencies hedging options
This table belongs to *BIPRU 7.6.24R*

Hedge	PRR calculation for the hedge	Limits (if hedging method is used)	Naked position
An <i>equity</i> (hedging an <i>option</i> or <i>warrant</i>)	The <i>equity</i> must be treated in either <i>BIPRU 7.3</i> (equity <i>PRR</i>) or the <i>option hedging method</i> (see the table in <i>BIPRU 7.6.27R</i>)	The <i>option hedging method</i> must only be used up to the amount of the hedge that matches the notional amount underlying the <i>option</i> or <i>warrant</i>	To the extent that the amount of the hedge (or <i>option</i> or <i>warrant</i>) exceeds the notional amount underlying the <i>option</i> or <i>warrant</i> (or hedge), a <i>firm</i> must apply an <i>equity PRR</i> , interest rate <i>PRR</i> or <i>foreign currency PRR</i> (or the <i>option standard method</i>)
A debt <i>security</i> (hedging an <i>option</i> or <i>warrant</i>)	The debt <i>security</i> must be treated in <i>BIPRU 7.2</i> (interest rate <i>PRR</i>) or the <i>option hedging method</i> (see the table in <i>BIPRU 7.6.27R</i>)	As for the first row	As for the first row
Gold (hedging a gold <i>option</i>)	The gold must be treated in either <i>BIPRU 7.5</i> (Foreign currency <i>PRR</i>) or the <i>option hedging method</i> (see the table in <i>BIPRU 7.6.27R</i>)	As for the first row	As for the first row

Hedge	PRR calculation for the hedge	Limits (if hedging method is used)	Naked <i>position</i>
A currency or currencies (hedging a currency <i>option</i>)	The currency must be treated in either <i>BIPRU 7.5</i> (Foreign currency PRR) or the <i>option hedging method</i> (see the table in <i>BIPRU 7.6.28R</i>)	As for the first row	As for the first row

7.6.27 R Table: The hedging method of calculating the PRR (equities, debt securities and gold)
This table belongs to *BIPRU 7.6.24R(1) - (3)*

	PRR			
	<i>Option or warrant position</i>	<i>In the money by more than the PRA</i>	<i>In the money by less than the PRA</i>	<i>Out of the money or at the money</i>
Long in <i>security</i> or gold	Long put	Zero	Wp	X
	Short call	Y	Y	Z
Short in <i>security</i> or gold	Long call	Zero	Wc	X
	Short put	Y	Y	Z
Where:				
Wp means	$\left\{ (PRA-100\%) \times \text{The underlying position valued at strike price} \right\} + \text{The market value of the underlying position}$			
Wc means	$\left\{ (100\% + PRA) \times \text{The underlying position valued at strike price} \right\} - \text{The market value of the underlying position}$			
X means	The market value of the underlying <i>position</i> multiplied by the <i>appropriate PRA</i>			

Y means	The market value of the underlying <i>position</i> multiplied by the <i>appropriate PRA</i> . This result may be reduced by the market value of the <i>option</i> or <i>warrant</i> , subject to a maximum reduction to zero.
Z means	The <i>option hedging method</i> is not permitted; the <i>option standard method</i> must be used.

7.6.28 R Table: The hedging method of calculating the PRR (currencies)
This table belongs to *BIPRU 7.6.24R(4)*

<i>PRR</i>			
<i>Option position</i>	<i>In the money</i> by more than 8%	<i>In the money</i> by less than 8%	<i>Out of the money</i> or <i>at the money</i>
Long calls & long puts	Zero	W_L	X
Short calls & short puts	Zero	Y	X
Where:			
W_L means	$(1.08\% \times U)$ - The market value of the underlying <i>position</i>		
U means	The amount of the underlying currency that the <i>firm</i> will receive if the <i>option</i> is exercised, converted at the strike price into the currency that the <i>firm</i> will sell if the <i>option</i> is exercised		
X means	The market value of the underlying <i>position</i> multiplied by 8%.		
Y means	The market value of the underlying <i>position</i> multiplied by 8%. This result may be reduced by the market value of the <i>option</i> , subject to a maximum reduction to zero.		

Specific methods and treatments: Digital options

7.6.29 R The *option PRR* for a digital *option* is the maximum loss of the *option*.

Specific methods and treatments: Written cliquet options

7.6.30 R The *option PRR* for a written cliquet *option* is the market value of the derived *position* (see *BIPRU 7.6.9R*) multiplied by the *appropriate PRA* (see *BIPRU 7.6.8R*) multiplied by F+1 (see the following provisions of this paragraph). This result may be reduced by the amount the *option* is *out of the money* (subject to a maximum reduction to zero). The *option PRR* for a written cliquet *option* is therefore defined by the following formula:

$$[PRA * \text{underlying} * (F + 1)] - OTM$$

where:

$$(1) \quad F = \min \left[FR, \max \left(\frac{FR}{2}, Y \right) \right]$$

(2) FR= Number of forward re-sets

(3) Y= Years to maturity

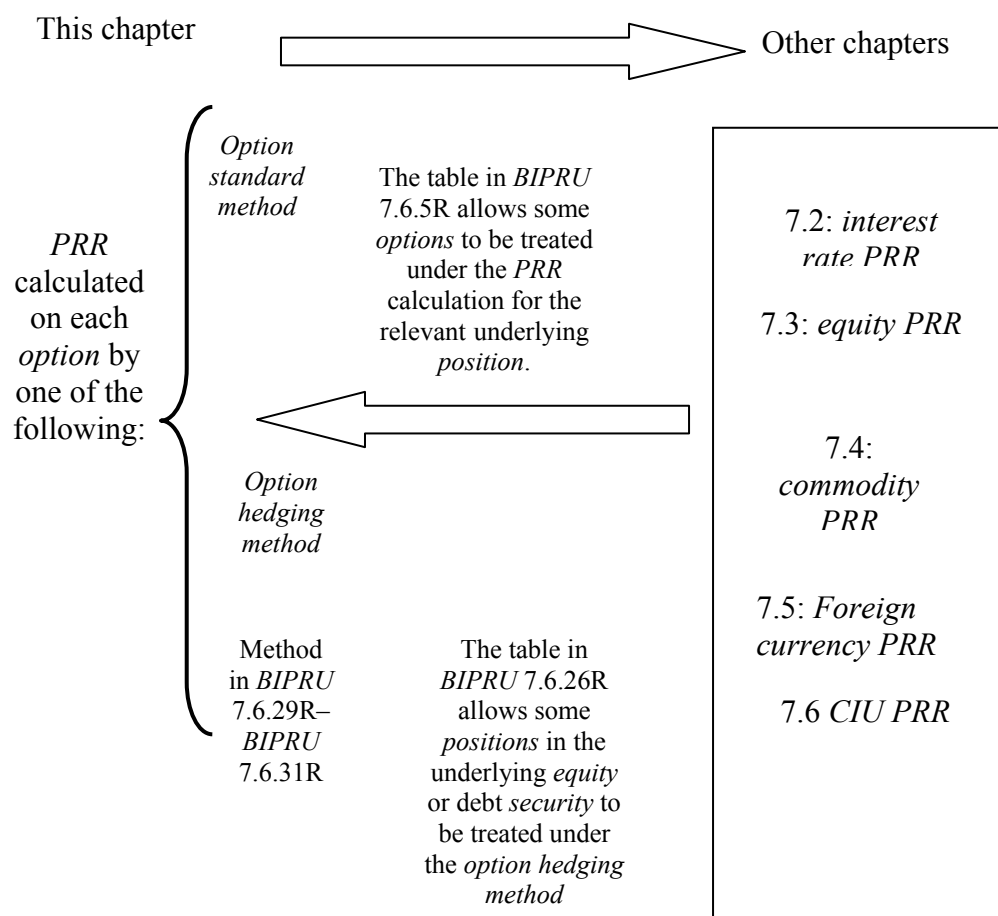
(4) OTM= the amount by which the *option* is *out of the money*

Specific methods and treatments: Quantos

7.6.31 R If the pay-out to the holder of a quanto *option* is fixed at the inception of the transaction a *firm* must add 8% to the *PRA* when applying the *option standard method*.

Interaction with other chapters

- 7.6.32 G The application of an *option PRR* to a *position* does not prevent any of the other *PRR charges* from applying if they would otherwise do so. In particular if a *firm* applies an *option PRR* to an *equity derivative* an *interest rate PRR* will also generally apply.
- 7.6.33 G The following diagram illustrates the relationship between *BIPRU 7.6* and the rest of *BIPRU 7*.



Options on a commodity

- 7.6.34 R *BIPRU 7.4.38R* to *BIPRU 7.4.41R* (Liquidity and other risks) apply to *commodity options* treated under *BIPRU 7.6* as well as to those treated under *BIPRU 7.4* (Commodity PRR).

Options on a CIU

- 7.6.35 R For the purpose of identifying the appropriate treatment for the purpose of *BIPRU 7.6.5R*, the underlying *position* for the purpose of *BIPRU 7.6.8R* and the derived *position* under *BIPRU 7.6.13R* a *firm* may choose between treating an *option* on a *CIU* as being:
- (1) a *position* in the *CIU* itself; or
 - (2) (if the conditions in *BIPRU 7.7* (Position risk requirements for collective investment undertakings) for the use of the method in question are satisfied) *positions* in the underlying investments or assumed *positions* arising through the use of the *standard CIU look through method* or the *modified CIU look through method*.
- 7.6.36 G (1) This paragraph gives an example of how the *appropriate PRA* should be calculated for the purpose of deciding whether or not an *option* on a *CIU* is sufficiently *in the money* for the *firm* to have a choice whether or not to apply an *option PRR*. This example assumes that there is no leveraging (see *BIPRU 7.7.11R* (CIU modified look through method)).
- (2) Say that the *CIU* contains underlying *equity positions* and the *firm* is using one of the *CIU look through methods*. The *appropriate PRA* for some is 8% and for the others is 12%. The *firm* should identify the highest *appropriate PRA* for the underlyings. In this case it is 12%. Therefore in this case the *option* would need to be *in the money* by more than 12% in order for the *firm* to have a choice between applying the *option PRR* or one of the other *PRR charges*.
 - (3) However if the *firm* is not using one of the *CIU look through methods* the *option* would need to be *in the money* by more than 32% in order for the *firm* to have a choice between applying the *option PRR* or the *CIU PRR*.
- 7.6.37 G *BIPRU 7.6.10R - BIPRU 7.6.12R* are subject to *BIPRU 7.7.3R* (netting). *BIPRU 7.7.4R* (use of third party) applies for the purpose of *BIPRU 7.6*.

7.7 Position risk requirements for collective investment undertakings

Collective investment undertaking PRR calculation

- 7.7.1 R A *firm* must calculate its *CIU PRR* by:
- (1) identifying which *CIU positions* must be included within the scope of the *PRR* calculation (see *BIPRU 7.7.2R*);
 - (2) identifying which *CIU positions* are to be subject to the *CIU PRR* and which *positions* are to be subject to one of the other *PRR charges*;
 - (3) converting on a daily basis net *positions* into the *firm's base currency* at the prevailing spot exchange rate before their aggregation;
 - (4) calculating an individual *PRR* for each *position* in a *CIU* (see *BIPRU 7.7.5R*);
 - (5) summing the resulting individual *PRRs*.

Scope of the PRR calculation for collective investment undertakings

- 7.7.2 R (1) A *firm's PRR* calculation must include all *trading book positions* in *CIUs*.
- (2) A *firm's CIU PRR* calculation must include all *trading book positions* in *CIUs* unless they are treated under one of the *CIU look through methods* and included in the *PRR* calculations for the relevant underlying investments or subject to an *option PRR*.
- (3) A *firm's PRR* calculation for *CIUs* must include notional *positions* arising from *trading book positions* in *options* or *warrants* on *collective investment undertakings*.

General rules

- 7.7.3 R Unless noted otherwise, no netting is permitted between the underlying investments of a *CIU* and other *positions* held by a *firm* for the purposes of calculating the *PRR charge* for a *position* in a *CIU*.
- 7.7.4 R A *firm* may rely on a third party to calculate and report *PRR* capital requirements for *position risk* (*general market risk* and *specific risk*) for *positions* in *CIUs* falling within *BIPRU 7.7.9R* and *BIPRU 7.7.11R*, in accordance with the methods set out in *BIPRU 7.7*, provided that the correctness of the calculation and the report is adequately ensured.

Calculation of the collective investment undertaking PRR

- 7.7.5 R Without prejudice to other provisions in *BIPRU 7.7*, a *position* in a *CIU* is subject to a *collective investment undertaking PRR* (*general market risk* and *specific risk*) of 32%. Without prejudice to provisions in *BIPRU 7.5.18R* (*Foreign currency PRR* for *CIUs*) or, if the *firm* has a *VaR model permission*, *BIPRU 7.10.44R* (*Commodity risks* and *VaR models*) taken together with *BIPRU 7.5.18R*, where the modified gold treatment set out in those *rules* is used, a *position* in a *CIU* is subject to a *securities PRR* requirement for *position risk* (*general market risk* and *specific risk*) and a *foreign-exchange PRR* of no more than 40%.

Look through methods: General criteria

- 7.7.6 R A *firm* may determine the *securities PRR* requirement for *positions* in *CIUs* which meet the criteria set out in *BIPRU 7.7.7R*, by one of the following methods:
- (1) the *standard CIU look through method* (*BIPRU 7.7.4R* and *BIPRU 7.7.7R - BIPRU 7.7.10R*); or
 - (2) the *modified CIU look through method* (*BIPRU 7.7.4R*, *BIPRU 7.7.7R - BIPRU 7.7.8R* and *BIPRU 7.7.11R - BIPRU 7.7.12R*).
- 7.7.7 R The general eligibility criteria for using the methods in *BIPRU 7.7.4R* and *BIPRU 7.7.9R - BIPRU 7.7.11R*, for *CIUs* issued by *companies* supervised or incorporated within the *EEA* are that:
- (1) the *CIU's* prospectus or equivalent document must include:
 - (a) the categories of assets the *CIU* is authorised to invest in;
 - (b) if investment limits apply, the relative limits and the methodologies to calculate them;
 - (c) if leverage is allowed, the maximum level of leverage; and
 - (d) if investment in OTC financial derivatives or repo-style transactions are allowed, a policy to limit counterparty risk arising from these transactions;
 - (2) the business of the *CIU* must be reported in half-yearly and annual reports to enable an assessment to be made of the assets and liabilities, income and operations over the reporting period;
 - (3) the units/shares of the *CIU* are redeemable in cash, out of the *undertaking's* assets, on a daily basis at the request of the unit holder;
 - (4) investments in the *CIU* must be segregated from the assets of the *CIU* manager; and

- (5) there must be adequate risk assessment, by the investing *firm*, of the *CIU*.

7.7.8 R Third country *CIUs* are eligible if the requirements in *BIPRU 7.7.7R(1) - BIPRU 7.7.7R(5)* are met.

Standard *CIU* look through method: General

- 7.7.9 R
- (1) Where a *firm* is aware of the underlying investments of the *CIU* on a daily basis the *firm* may look through to those underlying investments in order to calculate the *securities PRR* for *position* risk (*general market risk* and *specific risk*) for those *positions* in accordance with the methods set out in the *securities PRR* requirements or, if the *firm* has a *VaR model permission*, in accordance with the methods set out in *BIPRU 7.10* (Use of a Value at Risk Model).
 - (2) Under this approach, *positions* in *CIUs* must be treated as *positions* in the underlying investments of the *CIU*. Netting is permitted between *positions* in the underlying investments of the *CIU* and other *positions* held by the *firm*, as long as the *firm* holds a sufficient quantity of units to allow for redemption/creation in exchange for the underlying investments.

Standard *CIU* look through method: Index or basket funds

- 7.7.10 R
- (1) A *firm* may calculate the *securities PRR* for *position* risk (*general market risk* and *specific risk*) for *positions* in *CIUs* in accordance with the methods set out in the *securities PRR* requirements or, if the *firm* has a *VaR model permission*, in accordance with the methods set out in *BIPRU 7.10* (Use of a Value at Risk Model), to assumed *positions* representing those necessary to replicate the composition and performance of the externally generated index or fixed basket of *equities* or *debt securities* referred to in (a), subject to the following conditions:
 - (a) the purpose of the *CIU's* mandate is to replicate the composition and performance of an externally generated index or fixed basket of *equities* or *debt securities*; and
 - (b) a minimum correlation of 0.9 between daily price movements of the *CIU* and the index or basket of *equities* or *debt securities* it tracks can be clearly established over a minimum period of six months.
 - (2) Correlation as referred to in (1)(b) means the correlation coefficient between daily returns on the *CIU* and the index or basket of *equities* or *debt securities* it tracks.

CIU modified look through method

- 7.7.11 R Where a *firm* is not aware of the underlying investments of the *CIU* on a daily basis, the *firm* may calculate the *securities PRR* for *position* risk (*general market risk* and *specific risk*) in accordance with the methods set out in the *securities PRR* requirements, subject to the following conditions:
- (1) it must be assumed that the *CIU* first invests to the maximum extent allowed under its mandate in the asset classes attracting the highest *securities PRR* for *position* risk (*general market risk* and *specific risk*), and then continues making investments in descending order until the maximum total investment limit is reached;
 - (2) the *firm* must take account of the maximum indirect exposure that it could achieve by taking leveraged *positions* through the *CIU* when calculating its *securities PRR* for *position* risk, by proportionally increasing the *position* in the *CIU* up to the maximum exposure to the underlying investment items resulting from the investment mandate; and
 - (3) should the *securities PRR* for *position* risk (*general market risk* and *specific risk*) under this approach exceed that set out in *BIPRU 7.7.5R*, the *PRR charge* must be capped at that level.
- 7.7.12 R For the purpose of *BIPRU 7.7.11R(1)* the *position* in the *CIU* must be treated as a direct holding in the assumed *position*.

CAD 1 models and VaR models

- 7.7.13 G Where *BIPRU 7.7* permits a *firm* to calculate the *PRR charge* for a *position* in a *CIU* using the *rules* in *BIPRU 7* relating to the underlying investment, a *firm* that has:
- (1) a *CAD 1 model waiver* that covers *positions* in *CIUs* may use the *rules* as modified by that *waiver*; and
 - (2) a *VaR model permission* that covers *positions* in *CIUs* may use its *VaR model*.

Options on a CIU

- 7.7.14 G An *option* on a *CIU* should be treated in accordance with *BIPRU 7.6.35R* to *BIPRU 7.6.37G* (Options on a *CIU*).

7.8 Securities underwriting

General rules

- 7.8.1 G *BIPRU 7.8 sets out the method for calculating a net underwriting position or reduced net underwriting position, which is then included in the PRR calculation in other parts of BIPRU 7. It also deals with concentration risk. BIPRU 7.8 only relates to new securities, which is defined in BIPRU 7.8.12R.*
- 7.8.2 R *A firm which underwrites or sub-underwrites an issue of securities must, for the purposes of calculating its market risk capital component and its concentration risk capital component:*
- (1) *identify commitments to underwrite or sub-underwrite which give rise to an underwriting position (see BIPRU 7.8.8R);*
 - (2) *identify the time of initial commitment (see BIPRU 7.8.13R); and*
 - (3) *calculate the net underwriting position (set out in BIPRU 7.8.17R), reduced net underwriting position or the net underwriting exposure.*
- 7.8.3 R *A firm must include the net underwriting position or reduced net underwriting position in whichever one or more of the following is or are relevant:*
- (1) *BIPRU 7.2.3R(1) where debt securities are being underwritten;*
 - (2) *BIPRU 7.3.2R(1) where equities are being underwritten;*
 - (3) *BIPRU 7.6.22R where warrants are being underwritten; and*
 - (4) *BIPRU 7.5.3R where the equities, debt securities or warrants being underwritten are denominated in a foreign currency.*
- 7.8.4 R *A firm must comply with BIPRU 7.8.3R from initial commitment (as determined under BIPRU 7.8.8R) until the end of the fifth business day after working day 0 (as determined under BIPRU 7.8.23R).*
- 7.8.5 G *Sub-underwriting is a commitment given by one firm to someone other than the issuer or seller of the securities to sub-underwrite all or part of an issue of securities.*
- 7.8.6 G *The net underwriting position calculated in BIPRU 7.8.17R will also be used in calculating the net underwriting exposure under BIPRU 7.8.34R.*

- 7.8.7 G The *net underwriting position* or *reduced net underwriting position* arising from *underwriting* or *sub-underwriting* a rights or *warrants* issue should be calculated using the current market price of the underlying *security* for the purposes of the *equity PRR* or *option PRR*. However, the *PRR* will be limited to the value of the *net underwriting position* calculated using the initial issue price of the rights or *warrants*. Where there is no market price because the rights or *warrants* are in relation to a new class of *securities* and the initial price has not been set the *net underwriting position* or *reduced net underwriting* is the amount of the commitment.

Commitment to underwriting securities

- 7.8.8 R (1) For the purpose of *BIPRU 7.8.2R(1)*, a *firm* has a commitment to *underwrite* or *sub-underwrite* an issue of *securities* where:
- (a) it gives a commitment to an issuer of *securities* to *underwrite* an issue of *securities*; or
 - (b) (where *BIPRU 7.8.12R(2)* applies) it gives a commitment to a seller of *securities* to *underwrite* a sale of those *securities*;
 - (c) it gives a commitment to a *person*, other than the issuer of *securities* or, if *BIPRU 7.8.12R(2)* applies, the seller of the *securities*, to *sub-underwrite* an issue of *securities*; or
 - (d) it is a member of a syndicate or group that gives a commitment of the type described in (1)(a)-(c).
- (2) Unless a *rule* deals with them separately or the context otherwise requires, a provision of *BIPRU 7.8* that deals with *underwriting* also applies to *sub-underwriting*.

Exclusions from *BIPRU 7.8*

- 7.8.9 G (1) Block trades, including bought deals, and private placements are not within the scope of *BIPRU 7.8* because they involve an outright purchase by the *firm* of the relevant *securities*.
- (2) For the purpose of *BIPRU 7.8* *securities* include debt and *equity* instruments and *convertibles* but excludes loans.

Grey market transactions

- 7.8.10 R (1) A *firm* that buys and sells *securities* before issue is dealing in the grey market for the purposes of *BIPRU 7.8*.
- (2) *BIPRU 7.8* does not apply to a *firm* with respect to its dealings in the grey market unless the *firm*:
- (a) has an *underwriting* commitment to the issuer in respect of those *securities*; or

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- (b) has a sub-*underwriting* commitment in respect of those *securities* and is using the grey market solely for the purpose of reducing that sub-*underwriting* commitment.
 - (3) *BIPRU 7.8* does not apply to a *firm* with respect to its dealings in the grey market if the transaction is undertaken by the proprietary trading part of the *firm* or is undertaken for proprietary trading purposes.
 - (4) *BIPRU 7.8* does not apply to a *firm* with respect to its dealings in the grey market except as described in *BIPRU 7.8.17R*.
- 7.8.11 G In *BIPRU 7.8* the grey market is the market in which dealers "buy" and "sell" *securities* ahead of issue. In reality the dealers are buying and selling promises to deliver the *securities* when issued.

New securities

- 7.8.12 R For the purposes of *BIPRU 7.8*, a *firm* must treat *securities* as being new for the purposes of the definition of *underwriting* if they are:
- (1) *securities* that, prior to the allotment following the *underwriting*, were not in issue; or
 - (2) *securities* that do not fall within (1) but that have not previously been offered for sale or subscription to the public and have not been admitted to trading on a market operated by a *recognised investment exchange* or an *overseas investment exchange*.

Time of initial commitment

- 7.8.13 R Subject to *BIPRU 7.8.14R*, the time of *initial commitment* is the earlier of:
- (1) (in the case of *underwriting*) the time the *firm* agrees with the issuer of *securities* to *underwrite* those *securities*; or
 - (2) (in the case of *underwriting* falling under *BIPRU 7.8.12R(2)*) the time the *firm* agrees with the seller of *securities* to *underwrite* those *securities*; or
 - (3) (in the case of sub-*underwriting*) the time the *firm* agrees with the *person* referred to *BIPRU 7.8.8R(1)(c)* to sub-*underwrite* those *securities*; or
 - (4) (in the case of *BIPRU 7.8.8R(1)(d)*) the time the group or syndicate in question (or a member of that group or syndicate on behalf of the others) agrees with the issuer or other *person* to whom the commitment is given as referred to in *BIPRU 7.8.8R(1)(d)* to *underwrite* or sub-*underwrite* the *securities* in question; or

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- (5) (if the *firm* at that time has a commitment, whether legally or binding or not) the time the price and allocation of the issue or offer are set.
- 7.8.14 R If a *firm* has an irrevocable and unfettered right to withdraw from an *underwriting* commitment, exercisable within a certain period, the commitment commences (and thus the time of *initial commitment* occurs) when that right expires.
- 7.8.15 G Subject to the existence of a right described in *BIPRU 7.8.14R* an *underwriting* commitment commences even if it is subject to formal, legal or other conditions that would normally be expected to be satisfied.
- 7.8.16 G A force majeure or material adverse change clause would not be a right of the sort referred to in *BIPRU 7.8.14R*.

Calculating the net underwriting position

- 7.8.17 R A *firm* must calculate a *net underwriting position* by adjusting the gross amount it has committed to *underwrite* for:
- (1) any sales or sub-*underwriting* commitments received that have been confirmed in writing at the time of *initial commitment* (but excluding any sales in the grey market as defined in *BIPRU 7.8.10R(1)*);
 - (2) any *underwriting* or sub-*underwriting* commitments obtained from others since the time of *initial commitment*;
 - (3) any purchases or sales of the *securities* since the time of *initial commitment* (other than purchases or sales in the grey market as defined in *BIPRU 7.8.10R(1)*);
 - (4) (in the case of sales in the grey market as defined in *BIPRU 7.8.10R(1)*) any sales of the *securities* as at the time of *initial commitment* or since the time of *initial commitment* subject, in both cases, to the following conditions:
 - (a) any sales of the *securities* as at the time of *initial commitment* must be confirmed in writing at the time of *initial commitment*; and
 - (b) sales must be net of any purchases in the grey market as defined in *BIPRU 7.8.10R(1)*; and
 - (5) any allocation of *securities* granted or received, arising from the commitment to *underwrite* the *securities*, since the time of *initial commitment*.
- 7.8.18 R If the allocation of *securities* has not been fixed a *firm* must calculate the gross amount of its commitment, for the purposes of *BIPRU 7.8.17R*, by reference to the maximum amount it has committed to *underwrite* until the time the allocation is set.

- 7.8.19 R An *underwriting* commitment may only be reduced under *BIPRU 7.8.17R* on the basis of a formal agreement.
- 7.8.20 G Allocations may arise, after date of *initial commitment*, from the agreement to *underwrite*. For example obligations or rights may be allocated to or from the issuer, the *underwriting* group or syndicate.

Over-allotment options

- 7.8.21 R (1) This *rule* deals with the treatment of short *positions* that arise when a *firm* commits to distribute *securities* that it is *underwriting* in an amount that exceeds the allocation to the *firm* made by the issuer of the *securities* being *underwritten*.
- (2) When calculating its *net underwriting position*, a *firm* may use an over-allotment option granted to it by the issuer of the *securities* being *underwritten* to reduce the short *positions* in (1).
- (3) A *firm* may also use an over-allotment option granted to another member of the *underwriting* syndicate for the purpose in (2).
- (4) (2) and (3) only apply from *working day 0*.
- (5) (2) and (3) only apply to the extent that the treatment is consistent with the terms of the over-allotment option.
- 7.8.22 R Except as provided in *BIPRU 7.8.21R*, a *firm* must not take into account an over-allotment option granted to it or another member of the *underwriting* syndicate in calculating its *net underwriting position*.

Working day 0

- 7.8.23 R For the purposes of *BIPRU 7.8* *working day 0* is the *business day* on which a *firm* that is *underwriting* or sub-*underwriting* becomes unconditionally committed to accepting a known quantity of *securities* at a specified price.
- 7.8.24 G For debt issues and *securities* which are issued in a similar manner, *working day 0* is the later of the date on which the *securities* are allotted and the date on which payment for them is due.
- 7.8.25 G For *equity* issues and *securities* which are issued in a similar manner, *working day 0* is the later of the date on which the offer becomes closed for subscriptions and the date on which the allocations are made public.
- 7.8.26 G For rights issues, *working day 0* is the first day after the date on which the offer becomes closed to acceptances for subscription.

Calculating the reduced net underwriting position

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7.8.27 R To calculate the *reduced net underwriting position* a firm must apply the reduction factors in the table in BIPRU 7.8.28R to the *net underwriting position* (calculated under BIPRU 7.8.17R) as follows:

- (1) in respect of debt *securities*, a firm must calculate two *reduced net underwriting positions*; one for inclusion in the firm's interest rate PRR *specific risk* calculation (BIPRU 7.2.43R), the other for inclusion in its interest rate PRR *general market risk* calculation (BIPRU 7.2.52R); and
- (2) in respect of *equities*, a firm must calculate only one *reduced net underwriting position*, and then include it in the *simplified equity method* (see BIPRU 7.3.29R).

7.8.28 R Table: Net underwriting position reduction factors
This table belongs to BIPRU 7.8.27R

Underwriting timeline	Debt		Equity
	<i>General market risk</i>	<i>Specific risk</i>	
Time of <i>initial commitment</i> until <i>working day 0</i>	0%	100%	90%
<i>Working day 1</i>	0%	90%	90%
<i>Working day 2</i>	0%	75%	75%
<i>Working day 3</i>	0%	75%	75%
<i>Working day 4</i>	0%	50%	50%
<i>Working day 5</i>	0%	25%	25%
<i>Working day 6 and onwards</i>	0%	0%	0%

7.8.29 G The table in BIPRU 7.8.30G gives an example of the *reduced net underwriting position* calculation. The example is based on the firm starting with a commitment to underwrite £100 million of a new *equity* issue. Firms are reminded that in the case of an *equity*, the *reduced net underwriting position* should be treated under the *simplified equity method* (see BIPRU 7.3.27R (Simplified and standard equity methods) and BIPRU 7.8.27R).

7.8.30 G Table: Example of the reduced net underwriting position calculation
This table belongs to *BIPRU 7.8.29G*

Time	<i>Net underwriting position</i> (see <i>BIPRU 7.8.17R</i>)	Percentage reduction (see <i>BIPRU 7.8.28R</i>)	Reduced net underwriting position
At initial commitment 9.00am Monday	£100m gross amount is reduced by £20m due to sales/sub-underwriting commitments confirmed in writing at the time of initial commitment (see <i>BIPRU 7.8.17R(1)</i> and (4)). = £80m	90%	£8m
Post initial commitment 9.02am Monday	Remaining £80m is reduced by £40m due to further sales, sub-underwriting commitments obtained and allocations granted (see <i>BIPRU 7.8.17R(2) – (5)</i>). = £40m	90%	£4m
At the end of working day 1	Remaining £40m is reduced to £20m due to further sales. = £20m	90%	£2m
End of working day 3	Remaining £20m is reduced to £5m due to further sales. = £5m	75%	£1.25 m
End of working day 4	Remaining £5m is reduced to £2m due to further sales. = £2m	50%	£1m
End of working day 5	Remaining £2m is reduced to £1m due to further sales. = £1m	25%	£0.75 m

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Time	<i>Net underwriting position</i> (see <i>BIPRU 7.8.17R</i>)	Percentage reduction (see <i>BIPRU 7.8.28R</i>)	Reduced net underwriting <i>position</i>
Start of <i>working day 6</i>	£1m remaining = £1m	0%	£1m

Large exposure risk from underwriting securities: Calculating the net underwriting exposure

- 7.8.31 R For the purposes of calculating the total amount of its *trading book exposures* to a *person* for concentration risk purposes, a *firm* must include *net underwriting exposures* to that *person*.
- 7.8.32 R A *firm* must include any other *exposures* arising out of *underwriting* (including any counterparty *exposures* to any sub-*underwriters*) for the purposes of calculating the total amount of its *trading book exposures* to a *person* for concentration risk purposes .
- 7.8.33 R A *firm*, before entering into a new *underwriting* commitment, must be able to recalculate the *concentration risk capital component* to the level of detail necessary to ensure that the *firm's capital resources requirement* does not exceed the *firm's capital resources*.
- 7.8.34 R Except where otherwise specified by a *requirement* on its *Part IV permission*, a *firm* must calculate the *net underwriting exposure* to an issuer by applying the relevant reduction factors in the table in *BIPRU 7.8.35R* to its *net underwriting position* calculated under *BIPRU 7.8.17R*.
- 7.8.35 R Table: Calculation of net underwriting exposure
This table belongs to *BIPRU 7.8.34R*

Time	Reduction factor to be applied to net underwriting <i>position</i>
<i>Initial commitment to working day 0</i>	100%
<i>Working day 0</i>	100%
<i>Working day 1</i>	90%
<i>Working day 2</i>	75%
<i>Working day 3</i>	75%

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Time	Reduction factor to be applied to net underwriting <i>position</i>
<i>Working day 4</i>	50%
<i>Working day 5</i>	25%
<i>Working day 6 onwards</i>	0%

- 7.8.36 G The effect of *BIPRU 7.8.34R* is that there is no concentration limit for *net underwriting exposures* between *initial commitment* and the end of *working day 0*, except where specified by a *requirement* on a *firm's Part IV permission*.

Large exposure risk from underwriting securities: Monitoring and reporting concentration risk

- 7.8.37 R For the purposes of concentration risk monitoring only, a *firm* must report its *net underwriting exposure* both before and after the application of the reduction factors in the table in *BIPRU 7.8.35R*.

Risk management

- 7.8.38 R A *firm* must take reasonable steps to establish and maintain such systems and controls to monitor and manage its *underwriting* and *sub-underwriting* business as are appropriate to the nature, scale and complexity of its *underwriting* and *sub-underwriting* business. In particular, a *firm* must have systems to monitor and control its *underwriting exposures* between the time of the *initial commitment* and *working day one* in the light of the nature of the risks incurred in the markets in question.
- 7.8.39 G A *firm* should take reasonable steps to:
- (1) allocate responsibility for the management of its *underwriting* and *sub-underwriting* business;
 - (2) allocate adequate resources to monitor and control its *underwriting* and *sub-underwriting* business;
 - (3) satisfy itself that its systems to monitor *exposure* to counterparties will calculate, revise and update its *exposure* to each counterparty arising from its *underwriting* or *sub-underwriting* business;
 - (4) satisfy itself of the suitability of each *person* who performs functions for it in connection with the *firm's underwriting* and *sub-underwriting* business having regard to the *person's* skill and experience; and

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- (5) satisfy itself that its procedures and controls to monitor and manage its *underwriting* business address, on an on-going basis, the capacity of sub-*underwriters* to meet sub-*underwriting* commitments.

7.9 Use of a CAD 1 model

Introduction

- 7.9.1 G A *firm* is required under *GENPRU 2.1.52R* (Calculation of the market risk capital requirement) to calculate its *market risk capital requirement* using the rules in *BIPRU 7*. However, the *FSA* may at the *firm's* request modify *GENPRU 2.1.52R* to allow the *firm* to calculate all or part of the *PRR* for the *positions* covered by that model by using a *CAD 1 model* (for *options* risk aggregation and/or interest rate pre-processing) or a *VaR model* (value at risk model) instead. *BIPRU 7.10* (Use of a Value at Risk Model) deals with *VaR model permissions*.
- 7.9.2 G The purpose of *BIPRU 7.9* is to provide *guidance* on the *FSA's* policy for granting *CAD 1 model waivers* under section 148 of the *Act* (Modification or waiver of rules). The policy recognises that *CAD 1 models* may vary across *firms* but, as a minimum, the *FSA* will need to be satisfied:
- (1) about the quality of the internal controls and risk management relating to the model (see *BIPRU 7.9.19G - BIPRU 7.9.23G* for further details);
 - (2) about the quality of the model standards; and
 - (3) that the *CAD 1 model* captures and produces an accurate measure of the risks inherent in the portfolio covered by the *CAD 1 model* (see *BIPRU 7.9.25G - BIPRU 7.9.53G* for further details).
- 7.9.3 G *BIPRU 7.9* also explains how the output from the *CAD 1 model* is fed into the *market risk capital requirement* calculation.
- 7.9.4 G If a *CAD 1 model waiver* is granted by the *FSA*, the *waiver* will contain certain requirements. In order adequately to address individual circumstances, these may differ from what is set out in *BIPRU 7.9*. The *waiver* will also identify the *rules* to which the *waiver* applies and the scope of model recognition granted to the *firm*.
- 7.9.5 G *Waivers* permitting the use of models in the calculation of *PRR* will not be granted if that would be contrary to the *CAD*. Any *waiver* which is granted will only be granted on terms that are compatible with the *CAD*. Accordingly, the only *waivers* permitting the use of models in calculating *PRR* that the *FSA* is likely to grant are *CAD 1 model waivers* and *VaR model permissions*.

Scope of CAD 1 models

- 7.9.6 G The *FSA* recognises two types of *CAD 1 model*. The table in *BIPRU 7.9.7G* describes them.

7.9.7 G Table: Types of CAD 1 model
 This table belongs to *BIPRU 7.9.6G*

	Options risk aggregation models	Interest rate pre-processing models
Brief description and eligible instruments	<p>Analyse and aggregate <i>options</i> risks for:</p> <ul style="list-style-type: none"> • interest rate <i>options</i>; • <i>equity options</i>; • <i>foreign currency options</i>; • <i>commodity options</i>; and • <i>CIU options</i>. 	<p>May be used to calculate duration weighted <i>positions</i> for:</p> <ul style="list-style-type: none"> • interest rate <i>futures</i>; • <i>forward rate agreements (FRAs)</i>; • forward commitments to buy or sell debt <i>securities</i>; • <i>options, swaps</i> or <i>warrants</i> on interest rates or debt <i>securities</i> and <i>options</i> on such <i>swaps</i>; • amortising bonds; • <i>equity futures, forwards, warrants</i> and <i>options</i> (but only in relation to the interest rate risk inherent in these products); and • <i>foreign currency futures, forwards, swaps</i> and <i>options</i>, but only in relation to the interest rate risk inherent in these products.

	Options risk aggregation models	Interest rate pre-processing models
The output and how it is used in the <i>PRR</i> calculation	Depending on the type of model and the requirements in the <i>CAD 1 model waiver</i> granted, the outputs from an <i>options</i> risk aggregation model are used as an input to the <i>market risk capital requirement</i> calculation.	Depending on the type of model and the requirements in the <i>CAD 1 model waiver</i> granted, the individual sensitivity figures produced by this type of <i>CAD 1 model</i> are either input into the calculation of <i>interest rate PRR</i> under the <i>interest rate duration method</i> (see <i>BIPRU 7.2.63R</i>) or are converted into notional <i>positions</i> and input into the calculation of <i>interest rate PRR</i> under the <i>interest rate maturity method</i> (see <i>BIPRU 7.2.59R</i>).

- 7.9.8 G Currently the *FSA* only envisages allowing recognition for *options* on *CIUs* if the *CIU* satisfies one of the following conditions:
- (1) it is a *regulated collective investment scheme*; or
 - (2) the *firm* can demonstrate that it has characteristics that are similar to or better than an *undertaking* in (1) from the point of view of transparency and liquidity.

The *CAD 1* model waiver application and review process

- 7.9.9 G Details of the general *waiver* process are set out in *SUP 8* (Waiver and modification of rules). Further details of the *waiver* process applicable to certain *waivers* relating to *BIPRU* (including *CAD 1 model waivers*) can be found in *BIPRU 1.3* (Applications for advanced approaches). Because of the complexity of a *CAD 1 model waiver*, it is recommended that, as set out in *SUP 8.3.4G* and *BIPRU 1.3.21G*, a *firm* contact its usual contact at the *FSA* to discuss its proposed application. It should also be noted that the *waiver* recognition process in the case of a *CAD 1 model* may take longer than the timescales indicated in *SUP 8.3.5G*.
- 7.9.10 G In order to consider a *CAD 1 model waiver* request, the *FSA* may undertake a review to ensure that it is adequate and appropriate for the *PRR* calculation.

- 7.9.11 G The model review process may be conducted through a series of visits covering various aspects of the *firm's* control and IT environment. Before these visits the *FSA* may ask the *firm* to provide some information relating to its *waiver* request accompanied by some specified background material. The model review visits are organised on a timetable that allows a *firm* being visited sufficient time to arrange the visit and provide the appropriate pre-visit information.
- 7.9.12 G As part of the model review process, the following may be reviewed: organisational structure and personnel; details of the *firm's* market position in the relevant products; profit and risk information; valuation and reserving policies; operational controls; IT systems; model release and control procedures; risk management and control framework; risk appetite and limit structure and future developments relevant to model recognition.
- 7.9.13 G The *FSA* will normally require meetings with senior management and staff from the front office, financial control, risk management, operations, systems development, information technology and audit areas.
- 7.9.14 G A review by a *skilled person* may be used before a *CAD 1 model waiver* is granted to supplement the *waiver* process or after the *waiver* has been granted to review the *CAD 1 model*.
- 7.9.15 G If the *FSA* grants a *CAD 1 model waiver*, the *waiver* direction will specify the particular *rule* which has been modified, and set out the requirements subject to which the *waiver* has been granted. These requirements may include:
- (1) the details of the calculation of *PRR*;
 - (2) the *CAD 1 model* methodology to be employed;
 - (3) the products covered by the model (e.g. *option* type, maturity, currency); and
 - (4) any notification requirements relating to the *CAD 1 model waiver*.
- 7.9.16 G Where a *firm* operates any part of its *CAD 1 model* outside the *United Kingdom*, the *FSA* may take into account the results of any review of that model carried out by any overseas regulator concerned. The *FSA* may wish to receive information directly from that regulator.

Maintenance of model recognition

- 7.9.17 G No changes should be made to a *CAD 1 model* unless the change is not material. Material changes to a *CAD 1 model* will require a renewed *waiver* to be issued. Materiality is measured from the time that the *waiver* is granted or, if the *waiver* has been varied in accordance with section 148 of the *Act*, any later time that may be specified in the *waiver* for these purposes. If a *firm* is considering making material changes to its *CAD 1 model*, then it should notify the *FSA* at once. If a *firm* wishes to change the products covered by the model it should apply for a variation of its *CAD 1 model waiver*.
- 7.9.18 G If the *CAD 1 model* ceases to meet the requirements of the *waiver*, the *firm* should notify the *FSA* at once. The *FSA* may then revoke the *waiver* unless it is varied in accordance with section 148 of the *Act*. If the *CAD 1 model waiver* contains conditions it is a condition of using the *CAD 1 model approach* that the *firm* should continue to comply with those conditions.

Risk management standards

- 7.9.19 G A *firm* with a complex portfolio is expected to demonstrate more sophistication in its modelling and risk management than a *firm* with a simple portfolio.
- 7.9.20 G A *firm* should be able to demonstrate that the risk management standards set out in *BIPRU 7.9* are satisfied by each legal entity with respect to which the *CAD 1 model approach* is being used (even though they are expressed to refer only to a *firm*). This is particularly important for *subsidiary undertakings* in *groups* subject to matrix management where the business lines cut across legal entity boundaries.
- 7.9.21 G
- (1) A *firm* should have a conceptually sound risk management system which is implemented with integrity and should meet the minimum standards set out in this paragraph.
 - (2) A *firm* should have a risk control unit that is independent of business trading units and reports directly to senior management. The unit should be responsible for designing and implementing the *firm's* risk management system. It should produce and analyse daily reports on the risks run by the business and on the appropriate measures to be taken in terms of the trading limits.
 - (3) A *firm's* senior management should be actively involved in the risk control process and the daily reports produced by the risk control unit should be reviewed by a level of management with sufficient authority to enforce reductions of *positions* taken by individual traders as well as in the *firm's* overall risk exposure.
 - (4) The risk control group should have a sufficient number of staff with appropriate skills in the use of models.

- (5) A *firm* should have established procedures for monitoring and ensuring compliance with a documented set of appropriate internal policies and controls concerning the overall operation of the risk measurement and control framework. This should take into account the front, middle and back office functions.
- (6) A *firm* should conduct, as part of its regular internal audit process, a review of the systems and controls relating to its *CAD 1 model*. This review should include the valuation process, compliance with the *CAD 1 model waiver's* scope and the activities of the business trading units and the risk control units. This review should be undertaken by staff independent of the areas being reviewed.

7.9.22 G In assessing whether the risk management and control framework is implemented with integrity, the *FSA* will consider the IT systems used to run the *CAD 1 model* and associated calculations. The assessment will include, where appropriate:

- (1) feeder systems; risk aggregation systems; the integrity of the data (i.e. whether it is complete, coherent and correct); reconciliations and checks on completeness of capture; and
- (2) system development, change control and documentation; security and audit trails; system availability and contingency procedures; network adequacy.

7.9.23 G A *firm* should take appropriate steps to ensure that it has adequate controls relating to:

- (1) the derivation of the *PRR* from the *CAD 1 model* output;
- (2) *CAD 1 model* development, including independent validation;
- (3) reserving;
- (4) valuation (see *GENPRU* 1.3 (Valuation)), including independent validation; and
- (5) the adequacy of the IT infrastructure.

Model standards

7.9.24 G A *firm* should take appropriate steps to ensure that its *CAD 1 model* captures and produces an accurate measure of the risks inherent in the portfolio covered by the *CAD 1 model*. These risks may include, but are not limited to, gamma, vega and rho.

Options risk aggregation models

7.9.25 G For a *firm* to obtain a *CAD 1 model waiver* for its *options* risk aggregation model, it should have in place an appropriate *options* valuation model.

- 7.9.26 G The *FSA* does not specify the methodology that a *firm* should employ in order to produce the appropriate outputs from its *options* risk aggregation *CAD 1 model*. However, *BIPRU 7.9.27G - BIPRU 7.9.43G* provide details of how a *firm* could meet the requirement to capture gamma, vega and rho risks using a scenario matrix approach. Where a *firm* adopts the scenario matrix approach then the standards set out in *BIPRU 7.9.27G - BIPRU 7.9.43G* should be followed. The *firm* should also take into account other risks not captured by the scenario matrix approach. If a *firm* does not use the scenario matrix approach it should use an equivalent methodology. If a *firm* uses an equivalent methodology it should be able to demonstrate that the approach used meets the requirements of *BIPRU 7.9*.
- 7.9.27 G A scenario matrix is an approach by which an *options* portfolio is revalued given a number of simultaneous shifts in both the spot level of the underlying and the implied volatility.
- 7.9.28 G The scenario matrix approach may be employed for all types of *options* on all types of underlying asset.
- 7.9.29 G
- (1) This paragraph provides an outline of the initial steps to be taken when using the scenario matrix approach.
 - (2) A value for an *option* should be obtained using the *firm's options* valuation model.
 - (3) The inputs into the *options* valuation model for implied volatility of the underlying asset and the price of the underlying asset should then be altered so that a new value for the *option* is obtained (details of the amount by which the implied volatility and the price of the underlying should be amended are set out in *BIPRU 7.9.30G - BIPRU 7.9.36G*).
 - (4) The difference between the original value of the *option* and the new value obtained following the alterations should be input into the appropriate cell in the matrix. The value in the central cell where there is no change in implied volatility or price of the underlying should therefore be zero.
 - (5) The process of obtaining a new price for the *option* should be repeated until the matrix is completed.

- 7.9.30 G The alteration to the implied volatility (known as the implied volatility shift) referred to in *BIPRU 7.9.29G(3)* may be a proportional shift. The size of the shift depends on the remaining life of the *option* and the asset class of the underlying. The table in *BIPRU 7.9.32G* sets out the shifts that should be applied where a proportional shift is used. Alternatively, a *firm* may use a single shift across all maturities or use an absolute rather than a proportional implied volatility shift. Where a single shift or an absolute shift is used it should be at least as conservative as the proportional shifts. Any use of a single shift or an absolute shift should be reviewed and, if necessary updated, on a regular basis.
- 7.9.31 G A *firm* may choose to use a less detailed term structure than that in the table in *BIPRU 7.9.32G*, but the shifts used should be no less conservative than those set out in that table. For example, a *firm* that uses one <3 month band, rather than the two bands (≤ 1 month and 1-3 months) set out in the table, should use the most conservative shift set out in the table for the bands covered. In this example that shift is 30%.
- 7.9.32 G Table: proportional implied volatility shifts
This table belongs to *BIPRU 7.9.30G*

Remaining life of option	Proportional shift	
	<i>Equities, foreign currency and commodities</i>	Interest rates and <i>CIUs</i>
≤ 1 month	30%	30%
$> 1 \leq 3$ months	20%	20%
$> 3 \leq 6$ months	15%	15%
$> 6 \leq 9$ months	12%	12%
$> 9 \leq 12$ months	9%	9%
$> 1 \leq 2$ years	6%	9%
$> 2 \leq 4$ years	4.5%	9%
> 4 years	3%	9%

- 7.9.33 G The size of the underlying price/rate shift depends on the asset class of the underlying as referred to in *BIPRU 7.9.29G(3)* and is set out in the table in *BIPRU 7.9.34G*.

7.9.34 G Table: underlying price/rate shifts
This table belongs to *BIPRU 7.9.33G*

Underlying asset class	Shift
<i>Equities</i>	±8%
<i>Foreign currency</i>	±8%
<i>Commodities</i>	±15%, (but a <i>firm</i> may use the percentages applicable under the <i>commodity extended maturity ladder approach</i> if it would qualify under <i>BIPRU 7.4 (Commodity PRR)</i> to use that approach).
Interest rates	±100bp (but a <i>firm</i> may use the sliding scale of shifts by maturity as applicable to the <i>interest rate duration method</i>).
<i>CIU</i>	±32%, (but a <i>firm</i> may use the percentages applicable to the underlyings if the <i>firm</i> applies one of the <i>CIU look through methods</i> under <i>BIPRU 7.7 (Position risk requirements for collective investment undertakings)</i>).

7.9.35 G The shifts outlined in the table in *BIPRU 7.9.34G* are the maximum shifts required; in addition there will be a number of intermediate shifts as a result of the minimum matrix size criteria set out in *BIPRU 7.9.36G*.

7.9.36 G The minimum size of the scenario matrix should be 3x7, that is, three observations for implied volatility (including the actual implied volatility) and seven observations for the price of the underlying (including the actual price of the underlying). A *firm* should be able to justify its choice of granularity. Greater granularity may be required where the portfolio contains, for example, a large proportion of barrier *options*.

7.9.37 G

- (1) A different scenario matrix should be set up for each underlying asset type in accordance with this paragraph.
- (2) For *equities* (including single *equities*, baskets and indices) there should be a separate matrix for each national market or non-decomposed basket or non-decomposed multi-national index.
- (3) For *foreign currency* products there should be a separate matrix for each currency pair where appropriate.

- (4) For *commodity* products there should be a separate matrix for each *commodity*. The question whether two items are the same *commodity* should be decided in accordance with *BIPRU 7.4* (Commodity PRR).
- (5) For interest rate products there should be a separate matrix for each currency. In addition, a *firm* should not offset the gamma and vega exposures (except in the circumstances set out in *BIPRU 7.9.38G*) arising from any one of the following types of product with the gamma and vega exposures arising from any of the other products in the list:
 - (a) swaptions (*options* on interest rates);
 - (b) interest rate *options* (including *options* on exchange-traded deposit or bill *futures*);
 - (c) bond *options* (including *options* on exchange-traded bond *futures*); and
 - (d) other types of *options* required by the *CAD 1* model *waiver* to form their own separate class of underlying asset.
- (6) The other types of *options* referred to in (5)(d) will generally be exotic *options* that do not fall easily into (5)(a) - (c).
- (7) For *CIUs* there should be a separate matrix for each *CIU* fund. If the *firm* applies one of the *CIU look through methods* under *BIPRU 7.7* (Position risk requirements for collective investment undertakings), then (1) – (6) apply based on what the underlyings are.

- 7.9.38 G A *firm* may offset gamma and vega exposures arising from the products listed in *BIPRU 7.9.37G(5)* where it can demonstrate that it trades different types of interest rate-related *options* as a portfolio and takes steps to control the basis risk between different types of implied volatility. To the extent that this is the case an individual matrix is not required for each of the products listed in *BIPRU 7.9.37G(5)* and a combined scenario matrix may be used.
- 7.9.39 G Where it is imprudent fully to offset long-dated and short-dated vega exposure owing to the risk of non-parallel shifts in the yield curve, a *firm* should use an appropriate number of scenario matrices to take account of non-parallel shifts in the yield curve according to the maturity of the *option* or underlying.
- 7.9.40 G Following the steps outlined in *BIPRU 7.9.29G*, a *firm* then removes the portion of the values in the matrix that can be attributed to the effect that delta has had on the change in the value of the *option* (a process known as delta-stripping).

- 7.9.41 G Once the effect of delta has been removed from the matrix, the values left in the matrix relate to gamma and vega risk. A *firm's PRR* in relation to gamma and vega risk on the individual *option* is the absolute of the most negative cell in the scenario matrix produced. Where all cells are positive the *PRR* is zero. The total *PRR* for the gamma and vega risk on the portfolio of *options* is a simple sum of the individual requirements. This amount should then be fed into a *firm's PRR* calculation.
- 7.9.42 G The values that have been obtained for the delta-equivalent *positions* of instruments included in the scenario matrix should then be treated in the same way as *positions* in the underlying. Where the delta obtained relates to interest rate *position* risk, the delta equivalent *positions* may be fed into the *firm's* interest rate pre-processing model to the extent that the *positions* fall within the scope of interest rate pre-processing models as set out in *BIPRU 7.9.7G* and provided that the *firm's CAD 1 model waiver* allows the *firm's CAD 1 model* to be used in this way. Alternatively, the delta obtained should be fed into the standard *PRR* calculations in *BIPRU 7.2* (Interest rate *PRR*), *BIPRU 7.3* (Equity *PRR* and basic interest rate *PRR* for equity derivatives), *BIPRU 7.4* (Commodity *PRR*) or *BIPRU 7.5* (Foreign currency *PRR*) as appropriate.
- 7.9.43 G In using the scenario matrix approach, none of the steps followed will take specific account of a *firm's* exposure to rho risk. Where a *firm* can demonstrate that for interest rate-related *options* the rho sensitivity is effectively included in the delta sensitivities produced, there is no separate capital requirement relating to rho. For all other *options* except *commodity options*, a *firm* should calculate a rho sensitivity ladder by currency using its *CAD 1 model* and either feed this into the *interest rate maturity method* or *interest rate duration method* calculation or, where the *firm's CAD 1 model waiver* allows the *firm's CAD 1 model* to be used in this way, feed that ladder into an interest rate pre-processing model. Generally a *CAD 1 model* does not need to deal specifically with rho risk for *commodity options*.

Interest rate pre-processing models

- 7.9.44 G To the extent that a *firm's CAD 1 model waiver* is for the use of an interest rate pre-processing model the *firm* should use it for the pre-processing of the instruments set out in *BIPRU 7.9.7G*, from which the residual *positions* are fed into the *interest rate maturity method* or *interest rate duration method* calculation.
- 7.9.45 G There are a number of different methods of constructing pre-processing models but all should comply with *BIPRU 7.9.45G - BIPRU 7.9.53G*. All pre-processing models should generate *positions* that have the same sensitivity to defined interest rate changes as the underlying cash flows.
- 7.9.46 G In an interest rate pre-processing model each transaction is converted into its constituent cash flows. The cash flows are discounted using zero coupon rates derived from the *firm's* own yield curves.

- 7.9.47 G The cash flows are then calculated again using the *firm's* own yield curve shifted by the amount set out in *BIPRU 7.9.49G*.
- 7.9.48 G The difference between the present values calculated using the *firm's* own yield curve and those calculated using the *firm's* curve shifted under *BIPRU 7.9.47G* are known as the sensitivity figures. Alternatively, a *firm* may shift the yield curve by one basis point and multiply up the sensitivity figures by the appropriate amount in order to achieve the shifts set out in *BIPRU 7.9.47G*. These sensitivity figures are then allocated to each of the 15 maturity bands set out in *BIPRU 7.9.49G*.
- 7.9.49 G Table: yield curve shifts
This table belongs to *BIPRU 7.9.47G*

Zone	Modified duration	Assumed interest rate change (percentage points)
1	$0 \leq 1$ months	1.00
	$> 1 \leq 3$ months	1.00
	$> 3 \leq 6$ months	1.00
	$> 6 \leq 12$ months	1.00
2	$> 1.0 \leq 1.9$ years	0.90
	$> 1.9 \leq 2.8$ years	0.85
	$> 2.8 \leq 3.6$ years	0.85
3	$> 3.6 \leq 4.3$ years	0.75
3	$> 4.3 \leq 5.7$ years	0.70
	$> 5.7 \leq 7.3$ years	0.70
	$> 7.3 \leq 9.3$ years	0.70
	$> 9.3 \leq 10.6$ years	0.70
	$> 10.6 \leq 12$ years	0.70
	$> 12.0 \leq 20$ years	0.70
	> 20 years	0.70

- 7.9.50 G Sensitivity figures calculated by a *firm* using an interest rate pre-processing model are usually produced in the format of a net sensitivity by maturity bucket or by discrete gridpoint. These maturity buckets or gridpoints should then be allocated to the 15 bands set out in *BIPRU 7.9.49G*. The number of maturity buckets or gridpoints used to represent a yield curve can be referred to as granularity. The granularity should always be adequate to capture the material curve risk in the portfolio. Curve risk can be defined as the risk associated with holding long and short *positions* at different points along the yield curve.
- 7.9.51 G Positive and negative amounts placed in each of the different maturity bands in *BIPRU 7.9.49G* under the sensitivity calculation in *BIPRU 7.9.50G* should then be netted off to produce one figure for each of the bands. There is no capital requirement for this netting process.
- 7.9.52 G The individual sensitivity figures produced should then be input into the *interest rate duration method* calculation. The individual sensitivity figures for each band should be included with the other *positions* in the appropriate column in the table in *BIPRU 7.2.65R* (Table: Assumed interest rate change in the interest rate duration method).
- 7.9.53 G Instead of using the approach in *BIPRU 7.9.52G* a *firm* may use an approach based on the *interest rate maturity method*, making appropriate adjustments to the sensitivity figures.

7.10 Use of a Value at Risk Model

Application

7.10.1 R *BIPRU 7.10 applies to a firm with a VaR model permission.*

Introduction and purpose

- 7.10.2 G *BIPRU 7.10 provides details of when the FSA expects to allow a firm to use a VaR model (value at risk model) for the purpose of calculating part or all of its PRR. It introduces the concept of a VAR model, the methodology behind it and the link to the standard market risk PRR rules. It then goes on to detail the application and review process. The bulk of BIPRU 7.10 specifies the model standards and risk management standards that firms will be required to meet in order to use a VAR model. It further stipulates requirements for stress testing, backtesting, capital calculations and finally the reporting standards expected by the FSA.*
- 7.10.3 G *The models described in BIPRU 7.10 are described as VaR models in order to distinguish them from CAD 1 models, which are dealt with in BIPRU 7.9 (Use of a CAD 1 model). A VaR model is a risk management model which uses a statistical measure to predict profit and loss movement ranges with a confidence interval. From these results PRR charges can be calculated. The standards described in BIPRU 7.10, and which will be applied by the FSA, are based on and implement Annex V of the Capital Adequacy Directive.*
- 7.10.4 G *The aim of the VaR model approach is to enable a firm with adequate risk management systems to be subject to a PRR requirement that is more closely aligned with the risks to which it is subject than the PRR requirements generated by the standard market risk PRR rules. This provides a firm with an incentive to measure market risks as accurately and comprehensively as possible. It is crucial that those responsible for managing market risk at a firm should be aware of the assumptions and limitations of the firm's VaR model.*
- 7.10.5 G *There are a number of general methodologies for calculating PRR using a VaR model. The FSA does not prescribe any one method of computing VaR measures. Moreover, it does not wish to discourage any firm from developing alternative risk measurement techniques. A firm should discuss the use of any alternative techniques used to calculate PRR with the FSA.*
- 7.10.6 G *A firm should not use the VaR model approach to calculate PRR unless it has a VaR model permission. If a firm does not have such a permission it should use the standard market risk PRR rules. Therefore, a firm needs to apply for a VaR model permission in order to calculate its PRR using a VaR model instead of (or in combination with) the standard market risk PRR rules.*

Conditions for granting a VaR model permission

- 7.10.7 G A *waiver* or other permission allowing the use of models in the calculation of *PRR* will not be granted if that would be contrary to the *Capital Adequacy Directive* and any *VaR model permission* which is granted will only be granted on terms that are compatible with the *Capital Adequacy Directive*. Accordingly, the *FSA* is likely only to grant a *waiver* or other permission allowing the use of models in the calculation of *PRR* if it is a *VaR model permission* or a *CAD 1 model waiver*.
- 7.10.8 G *BIPRU 7.10* sets out the minimum standards that the *FSA* expects *firms* to meet before granting a *VaR model permission*. The *FSA* will not grant a *VaR model permission* unless it is satisfied that the requirements of *BIPRU 7.10* are met and it is satisfied about the procedures in place at a *firm* to calculate the *model PRR*. In particular the *FSA* will not normally grant a *VaR model permission* unless it is satisfied about the quality of:
- (1) the internal controls and risk management relating to the *VaR model* (see *BIPRU 7.10.56G - BIPRU 7.10.82R*);
 - (2) the *VaR model* standards (see *BIPRU 7.10.24R-BIPRU 7.10.55G*); and
 - (3) stress testing and backtesting procedures relating to a *VaR model* (see, in addition to (2), *BIPRU 7.10.83R - BIPRU 7.10.112G*).
- 7.10.9 G The *FSA* recognises that the nature of *VaR models* will vary between *firms*. The scope of and the requirements and conditions set out in a *VaR model permission* may therefore differ in substance or detail from *BIPRU 7.10* in order to address individual circumstances adequately. However any differences will only be allowed if they are compliant with the *Capital Adequacy Directive*. A *VaR model permission* will implement any such variation by modifying *BIPRU 7.10*. A *VaR model permission* may also include additional conditions to meet the particular circumstances of the *firm* or the model.

The VaR model permission application and review process

- 7.10.10 G Details of the general process for applying for a *VaR model permission* are set out in *BIPRU 1.3* (Applications for advanced approaches). Because of the complexity of a *VaR model permission*, it is recommended that a *firm* discuss its proposed application with its usual contact at the *FSA* before it makes the application.
- 7.10.11 G In order for a *VaR model permission* to be granted, the *FSA* is likely to undertake a review to ensure that it is adequate and appropriate for the *PRR* calculation.

- 7.10.12 G The *VaR model* review process may be conducted through a series of visits covering various aspects of a *firm's* control and IT environment. Before these visits the *FSA* may ask the *firm* to provide some information relating to the *firm's VaR model permission* request accompanied by some specified background material. The *VaR model* review visits are organised on a timetable that allows the *firm* being visited sufficient time to arrange the visit and provide the appropriate pre-visit information.
- 7.10.13 G As part of the process for dealing with an application for a *VaR model permission* the following may be reviewed: organisational structure and personnel; details of the *firm's* market position in the relevant products; revenue and risk information; valuation and reserving policies; operational controls; information technology systems; model release and control procedures; risk management and control framework; risk appetite and limit structure; future developments relevant to model recognition.
- 7.10.14 G A visit will usually involve the *FSA* wishing to meet *senior management* and staff from the front office, financial control, risk management, operations, systems development, information technology and internal audit areas.
- 7.10.15 G The *FSA* may complement its own review of a *VaR model permission* request with one or more reviews by a *skilled person* under section 166 of the *Act* (Reports by skilled persons). Such a review may also be used where a *VaR model permission* has been granted to ensure that the requirements *BIPRU 7.10* and of the *VaR model permission* continue to be met.

Conditions for a VaR model outside the United Kingdom

- 7.10.16 G Where a *VaR model* used outside the *United Kingdom* differs from that used in the *United Kingdom* the *FSA* may request details of the reasons for using different models.
- 7.10.17 G Where a *firm* operates any part of its *VaR model* outside the *United Kingdom*, the *FSA* may take into account the results of the home supervisor's review of that model. The *FSA* may wish to receive information directly from the home supervisor.

Scope of VaR models

- 7.10.18 R A *firm* must use the *VaR model approach* to calculate the *PRR* for a *position*:
- (1) to the extent that the risks in relation to that *position* are within the scope of the *VaR model permission* (see *BIPRU 7.10.136R* (Link to standard *PRR* rules: Incorporation of the model output into the capital calculation)); and
 - (2) if the *position* is of a type that comes within the scope of the *VaR model permission*.

- 7.10.19 G In accordance with *BIPRU 7.10.18R(1)* a *VaR model permission* will set out the risk categories that it covers, which are expected to be one or more of the following types:
- (1) interest rate *general market risk*;
 - (2) interest rate *specific risk* (in conjunction with interest rate *general market risk*);
 - (3) *equity general market risk*;
 - (4) *equity specific risk* (in conjunction with *equity general market risk*);
 - (5) *CIU risk*;
 - (6) *foreign currency risk*; and
 - (7) *commodity risk*.
- 7.10.20 G A *VaR model permission* will generally set out the broad classes of *position* within its scope. It may also specify how individual products within one of those broad classes may be brought into or taken out of the scope of the *VaR model permission*.
- 7.10.21 G The broad classes of *position* referred to in *BIPRU 7.10.20G* are as follows:
- (1) linear products, which comprise *securities* with linear pay-offs (e.g. bonds and *equities*) and *derivative* products which have linear pay-offs in the underlying risk factor (e.g. interest rate *swaps*, *FRAs*, total return *swaps*);
 - (2) European, American and Bermudan put and call *options* (including caps, floors and swaptions) and *investments* with these features (see *BIPRU 7.6.18R* (Table: Option PRR: methods for different types of option) for an explanation of some of these terms);
 - (3) *Asian options*, *digital options*, *single barrier options*, *double barrier options*, *lookback options*, *forward starting options*, *compound options* and *investments* with these features (see *BIPRU 7.6.18R* for an explanation of some of these terms); and
 - (4) all other *option* based products (e.g. *basket options*, *quantos*, *outperformance options*, *timing options*) and *investments* with these features (see *BIPRU 7.6.18R* for an explanation of some of these terms).
- 7.10.22 G The categorisation described in *BIPRU 7.10.21G* may be amended or replaced in the case of a particular *firm's VaR model permission*.

- 7.10.23 G It is the *FSA*'s view that, where a *firm* uses a *VaR model* for one risk category as described in *BIPRU 7.10.19G*, it is good practice to extend its model over time to calculate all of its *PRR* risk categories. A *firm* will typically be expected to have a realistic plan in place to do this.

Model standards: General

- 7.10.24 R A *firm* must comply with the minimum standards set out in *BIPRU 7.10.26R* - *BIPRU 7.10.53R* in calculating the *model PRR*.

- 7.10.25 G The *FSA* accepts that the scope and nature of *VaR models* varies across *firms*. This means that different *firms* are likely to calculate different estimates of market risk for the same portfolio. Systematic differences are due to length of data series, choice of methodology (historical or Monte Carlo simulation or variance-covariance method or a hybrid of these), differences in aggregating risks within and across broad risk factors, the treatment of *options* and other non-linear products and the specification of risk factors.

Model standards: Frequency of calculations and confidence level

- 7.10.26 R The *model PRR* must be computed at least once every *business day*, using a 99% one-tailed confidence limit.
- 7.10.27 G A *firm* may meet the requirement in *BIPRU 7.10.26R* by using different model parameters and employing a suitable adjustment mechanism to produce a figure which is equivalent to the figure produced using the parameters set out in *BIPRU 7.10.26R*. For example, a *firm's* model may use a 95% one-tailed confidence limit if the *firm* has a mechanism to convert the output of the model to reflect a 99% one-tailed confidence limit.

Model standards: Holding period

- 7.10.28 R In calculating the *VaR number*, a *firm* must either use a ten *business day* holding period, or use a holding period converted to a ten *business day* holding period. However if the *firm's VaR model permission* specifies that the *firm* must use a specific method, the *firm* must do so.
- 7.10.29 G If a *firm* uses a holding period other than 10 *business days* and converts the resulting *VaR measure* to a ten *business day* equivalent measure, it should be able to justify the choice of conversion technique. For example, the square root of time method will usually be justifiable. The *FSA* considers it good practice ultimately to move towards the application of an actual ten *business day* holding period, rather than using different holding periods.

Model standards: Observation period

- 7.10.30 R Subject to *BIPRU 7.10.31R*, the calculation of *VaR numbers* must be based on an effective historical observation period that is the longest possible consistent with a prudent *VaR number*. That period must be at least one year or such longer period as may be set out in the *firm's VaR model permission*. However if using that prescribed observation period does not result in a sufficiently prudent way of calculating a *VaR measure* or a component of a *VaR measure* the *firm* must shorten this observation period until the observation period is consistent with a prudent *VaR number*.

Model standards: Data series

- 7.10.31 R A *firm* must ensure that the data series used by its *VaR model* is reliable. Where a reliable data series is not available, proxies or any other reasonable value-at-risk measurement technique must be used. A *firm* must be able to demonstrate that the technique is appropriate and does not materially understate the modelled risks.
- 7.10.32 G A data series is unreliable if it has, for example, missing data points, or data points which contain stale data. Reliable data series may be difficult to obtain for new products (for example an instrument of longer dated tenor that did not previously trade) and for less liquid risk factors or *positions*. With regard to less liquid risk factors or *positions*, a *firm* may use a combination of prudent valuation techniques and alternative *VaR* estimation techniques to ensure there is a sufficient cushion against risk over the close out period which takes account of the illiquidity of the risk factor or *position*.
- 7.10.33 R
- (1) If a weighting scheme or other similar method is used to calculate *VaR numbers*, then the effective observation period must be at least one year. Where a weighting scheme is used, the weighted average time lag of the individual observations must not be less than six *Months*.
 - (2) If a specific observation period or weighted average time lag is specified in a *firm's VaR model permission*, the *firm* must comply with that if it is longer than the period specified in (1).
 - (3) However, if a weighting scheme in (1) or (2) would result in imprudent *VaR numbers* then the weighting scheme must be adjusted so that it is consistent with a prudent *VaR number*.
- 7.10.34 R A *firm* must update data sets in accordance with the frequency set out in its *VaR model permission*. If volatility in market prices or rates necessitates more frequent updating in order to ensure a prudent calculation of the *VaR measure* the *firm* must do so.
- 7.10.35 G The minimum updating frequency that can be specified in a *VaR model permission* is quarterly.

Model standards: Aggregation across risk categories

- 7.10.36 R The process for determining and implementing correlations within and across risk categories must be sound, implemented with integrity and consistent with the terms of the *firm's VaR model permission*.
- 7.10.37 R In aggregating *VaR measures* across risk or product categories, a *firm* must not use the square root of the sum of the squares approach unless the assumption of zero correlation between these categories is empirically justified. If correlations between risk categories are not empirically justified, the *VaR measures* for each category must simply be added in order to determine its aggregate *VaR measure*. But to the extent that a *firm's VaR model permission* provides for a different way of aggregating *VaR measures*:
- (1) that method applies instead of this *rule*; and
 - (2) if the correlations between risk categories used for that purpose cease to be empirically justified then the *firm* must notify the *FSA* at once.

Model standards: Risk factors: Introduction

- 7.10.38 G Subject to *BIPRU 7.10.53R* (Model standards: Materiality), a *VaR model* should capture and accurately reflect all material risks arising on the underlying portfolio on a continuing basis insofar as those risks are within the scope of the *VaR model permission*. This should encompass *general market risk* and, to the extent that this comes within the scope of the *VaR model permission*, *specific risk*. A *firm* should ensure that the *VaR model* has sufficient risk factor granularity to be able to capture all such material risks and that these are properly documented and specified.

Model standards: Risk factors: General

- 7.10.39 R In the case of *general market risk* and risks with respect to which the *standard market risk PRR rules* do not distinguish between *general market risk* and *specific risk*, a *firm's VaR model* must capture a sufficient number of risk factors in relation to the level of activity of the *firm* and in particular the risks set out in *BIPRU 7.10.40R - BIPRU 7.10.44R*.
- 7.10.40 R For interest rate risk, a *VaR model* must incorporate a set of risk factors corresponding to the interest rate curves in each currency in which the *firm* has interest rate sensitive *positions*. A *firm* must ensure that it captures the variations of volatility of rates along the yield curve. In order to achieve this, a *firm* must divide the yield curves of, at a minimum, the major currencies and markets in which it has material interest rate exposures into a minimum of six maturity segments. The *VaR model* must also capture the risk of less than perfectly correlated movements between different yield curves.

- 7.10.41 R For *equity* risk, a *VaR model* must use a separate risk factor at least for each of the *equity* markets in which the *firm* has material *positions*.
- 7.10.42 R For *foreign currency* risk, a *VaR model* must incorporate risk factors corresponding to the individual *foreign currencies*, including gold, in which the *firm's positions* are denominated.
- 7.10.43 R For *commodity* risk, the *VaR model* must use a separate risk factor at least for each *commodity* in which the *firm* has material *positions*. The *VaR model* must also capture the risk of less than perfectly correlated movements between similar, but not identical, *commodities* and the exposure to changes in forward prices arising from maturity mismatches. It must also take account of market characteristics, notably delivery dates and the scope provided to traders to close out positions.
- 7.10.44 R
- (1) For *CIUs* the actual *foreign currency positions* of the *CIU* must be taken into account.
 - (2) A *firm* may rely on third party reporting of the *foreign currency position* of the *CIU*, where the correctness of this report is adequately ensured.
 - (3) If a *firm* is not aware of the *foreign currency positions* in a *CIU*, this *position* must be carved out and treated in *BIPRU 7.5.18R* (Derivation of notional *positions* in *CIUs* for the *foreign currency PRR*).
- 7.10.45 G
- (1) This paragraph contains *guidance* on the inclusion of *CIUs* in a *VaR model*.
 - (2) The *FSA* may allow all types of *CIU* to be included within the scope of a *firm's VaR model permission*.
 - (3) *BIPRU 7.10* does not distinguish between *specific risk* and *general market risk* for *positions* in *CIUs*. Therefore even if *specific risk* is not otherwise included within the scope of a *firm's VaR model permission*, a *firm* should be able to demonstrate that its *VaR model* captures *specific risk*.
 - (4) A *firm* should also be able to demonstrate that its *VaR model* adequately captures correlations, concentration risk and risks associated with the illiquidity of the *CIU* itself should this be deemed necessary (see *BIPRU 7.10.32G*).

- (5) A *firm* may use a look-through approach, under which the *VaR model* estimates are based on the underlying *positions*. If a *firm* uses a look through approach it should also ensure that all the relevant risk factors relating to the underlying *positions* are captured. *BIPRU 7.7* (Position risk requirements for collective investment undertakings) sets out *rules* relating to the look through approach when a *firm* is using the *VaR model approach*.

Model standards: Risk factors: Specific risk

- 7.10.46 R (1) If a *firm's VaR model* covers the calculation of *PRR* with respect to *specific risk* the *firm* must meet the *VaR specific risk minimum requirements* in addition to the other requirements of *BIPRU 7.10*.
- (2) The *VaR model* must explain the historical price variation in the portfolios concerned.
- (3) The *VaR model* must capture concentration in terms of magnitude and changes of composition of the portfolios concerned.
- (4) The *VaR model* must be robust to an adverse environment.
- (5) The *VaR model* must capture name-related basis risk. That is the *firm* must be able to demonstrate that the *VaR model* is sensitive to material idiosyncratic differences between similar but not identical *positions*.
- (6) The *VaR model* must capture event risk.
- (7) In addition to the other requirements in *BIPRU 7.10*, a *firm* must have an approach in place to capture, in the calculation of its capital requirements, the default risk of its *trading book positions* that is incremental to the default risk captured by the *VaR measures* as specified in this *rule*, *BIPRU 7.10.48R*, *BIPRU 7.10.49R* and *BIPRU 7.10.107R* (Backtesting: Specific risk backtesting).
- (8) A *firm* must be able to demonstrate that the approach referred to in (7) meets soundness standards comparable to the approach set out in *BIPRU 4* (The IRB approach), under the assumption of a constant level of risk, and adjusted where appropriate to reflect the impact of liquidity, concentrations, hedging and optionality.
- 7.10.47 G This paragraph provides *guidance* on *BIPRU 7.10.46R(3)*. Take as an example a *VaR model* based on a factor model or on a historical simulation model. The ability of the model to explain price variation could be demonstrated by a statistical comparison over the same period of time between actual price changes on the portfolio and the profit and loss impact of risk factors included within the model. A *firm* may wish to include an estimate of residual variation not explained by the model.

- 7.10.48 R (1) Where a *firm* is subject to event risk that is not reflected in its *VaR measure*, because it is beyond the 10-day holding period and 99 percent confidence interval (low probability and high severity events), the *firm* must ensure that the impact of such events is factored into its internal capital assessment.
- (2) A *firm's VaR model* must conservatively assess the risk arising from less liquid *positions* and *positions* with limited price transparency under realistic market scenarios. In addition, the *VaR model* must meet minimum data standards. Proxies must be appropriately conservative and may be used only where available data is insufficient or is not reflective of the true volatility of a *position* or portfolio.
- 7.10.49 R As techniques and best practices evolve, a *firm* must avail itself of these advances.
- 7.10.50 R To avoid double counting capital requirements under *BIPRU 7.10.46R(7)* a *firm* may, when calculating its incremental default charge, take into account the extent to which default risk has already been incorporated into the *VaR* calculation, especially for risk *positions* that could and would be closed within 10 *business days* in the event of adverse market conditions or other indications of deterioration in the credit environment. Where a *firm* captures its incremental default risk through a surcharge, it must have in place methodologies for validating the measure.
- 7.10.51 R A *firm* that does not capture the incremental default risk through an internally developed approach must calculate the surcharge through an approach consistent with either the *standardised approach* to credit risk or the *IRB approach*.
- 7.10.52 R With respect to *securitisation exposures* that would be subject to a deduction treatment in the calculation of its *capital resources* or *risk weighted* at 1250% as set out in *BIPRU 9*, these *positions* (cash or synthetic) are subject to a capital charge that is no less than set forth under that treatment. A *firm* that is a dealer in these *exposures* may apply a different treatment where it could demonstrate to the *FSA*, in addition to trading intent, that a liquid two-way market exists for the *securitisation exposures* or, in the case of *synthetic securitisations* that rely solely on credit derivatives, for the *securitisation exposures* themselves or all their constituent risk components. For the purposes of this *rule* a two-way market is deemed to exist where there are independent good faith offers to buy and sell so that a price reasonably related to the last sales price or current good faith competitive bid and offer quotations can be determined within one day and settled at such a price within a relatively short time conforming to trade custom. For a *firm* to apply a different treatment, it must have sufficient market data to ensure that it fully captures the concentrated default risk of these *exposures* in its internal approach for measuring the incremental default risk in accordance with the *VaR specific risk minimum requirements*.

Model standards: Materiality

- 7.10.53 R *A firm's VaR model must capture accurately all material price risks for positions within the scope of its VaR permission, including risks relating to options or option-like positions. The firm must ensure that, if its VaR model does not accurately capture any material risk, the firm has capital resources adequate to cover that risk. These capital resources must be additional to those required to meet its capital resources requirement.*
- 7.10.54 G *For example, BIPRU 7.10.53R might involve creating and documenting a prudent incremental PRR charge for the risk not captured in the VaR model and holding sufficient capital resources against this risk. In that case the firm should hold capital resources at least equal to its capital resources requirement as increased by adding this incremental charge to the model PRR. Alternatively the firm may make valuation adjustments through its profit and loss reserves to cover this material risk. These reserves should be transparent to senior management and auditable. The reserves should also be consistent with GENPRU 1.3 (Valuation) while not being excessive in relation to the principles of mark-to-market accounting. Therefore, a firm should be able to satisfy the FSA that all material risks are adequately addressed, whether this be through the VaR model, through taking an incremental PRR charge or through making an adjustment through profit and loss reserves.*
- 7.10.55 G *A firm is expected ultimately to move towards full revaluation of option positions. For portfolios containing path-dependent options, an instantaneous price shock applied to a static portfolio will be acceptable provided that the risks not captured by such an approach are not material. Where a risk is immaterial and does not justify further capital resources, that immaterial risk should still be documented.*

Risk management standards: Introduction

- 7.10.56 G *A firm with a complex portfolio is expected to demonstrate greater sophistication in its modelling and risk management than a firm with a simple portfolio. For example, a firm will be expected to consider, where necessary, varying degrees of liquidity for different risk factors, the complexity of risk modelling across time zones, product categories and risk factors. Some trade-off is permissible between the sophistication and accuracy of the model and the conservatism of underlying assumptions or simplifications.*
- 7.10.57 G *A firm should be able to demonstrate that it meets the risk management standards set out in the VaR model permission on a legal entity basis. This is particularly important for a subsidiary undertaking in a group subject to matrix management where the business lines cut across legal entity boundaries.*

Risk management standards: General requirement

- 7.10.58 R A *firm* must have a conceptually sound risk management system surrounding the use of its *VaR model* that is implemented with integrity and that in particular meet the qualitative standards set out in *BIPRU 7.10.59R - BIPRU 7.10.82R*.

Risk management standards: Use requirement

- 7.10.59 R A *firm* must base its *model PRR* calculation on the output of the *VaR model* which is used for its internal risk management rather than one developed specifically to calculate its *PRR*.
- 7.10.60 R The *VaR model* must be fully integrated into the daily risk management process of the *firm*, and serve as the basis for reporting risk exposures to *senior management* of the *firm*.
- 7.10.61 G A *firm's VaR model* output should be an integral part of the process of planning, monitoring and controlling a *firm's* market risk profile. The *VaR model* should be used in conjunction with internal trading and exposure limits. The links between these limits and the *VaR model* should be consistent over time and understood by *senior management*. The *firm* should regard risk control as an essential aspect of the business to which significant resources need to be devoted.

Risk management standards: Risk control unit

- 7.10.62 R A *firm* must have a risk control unit which is independent from business trading units and which reports directly to *senior management*. It:
- (1) must be responsible for designing and implementing the *firm's* risk management system;
 - (2) must produce and analyse daily reports on the output of the *VaR model* and on the appropriate measures to be taken in terms of the trading limits; and
 - (3) conduct the initial and on-going validation of the *VaR model*.

Risk management standards: Senior management

- 7.10.63 R A *firm's governing body* and *senior management* must be actively involved in the risk control process, and the daily reports produced by the risk control unit must be reviewed by a level of management with sufficient authority to enforce both reductions of *positions* taken by individual traders as well as in the *firm's* overall risk exposure.
- 7.10.64 G It is the responsibility of a *firm's* own management to ensure the accuracy and integrity of its *VaR model*. This responsibility includes obtaining appropriate independent validation of the *VaR model*.

Risk management standards: Skilled staff

- 7.10.65 R A *firm* must have sufficient numbers of staff skilled in the use of sophisticated models in the trading, risk control, audit and back office areas.

Risk management standards: Controls and compliance

- 7.10.66 R A *firm* must establish, document and maintain policies, controls and procedures to an auditable standard:
- (1) concerning the operation of its *VaR model approach*; and
 - (2) for monitoring and ensuring compliance with the policies, controls and procedures in (1).

Risk management standards: Documentation

- 7.10.67 R A *VaR model* must be adequately documented.
- 7.10.68 G (1) An example of documents required by *BIPRU 7.10.67R* may be a manual that describes the basic principles of the risk management framework, clearly setting out empirical techniques, principles and assumptions used within it.
- (2) This documentation should be of sufficient detail for the *FSA* to be able to develop a clear understanding of how the *VaR model* works from that documentation on its own.

Risk management standards: Track record

- 7.10.69 R A *firm's VaR model* must have a proven track record of acceptable accuracy in measuring risk.

Risk management standards: Development validation

- 7.10.70 R Adequate procedures must be in place to ensure that model changes are validated before being introduced.
- 7.10.71 G The procedures in *BIPRU 7.10.70R* need not necessarily rely on backtesting using a back-run of recreated data.

Risk management standards: Stress testing

- 7.10.72 R (1) A *firm* must frequently conduct a rigorous programme of stress testing. The results of these tests must be reviewed by *senior management* and reflected in the policies and limits the *firm* sets.
- (2) The programme must particularly address:
- (a) concentration risk;
 - (b) illiquidity of markets in stressed market conditions;

- (c) one way markets;
 - (d) event and jump to default risks;
 - (e) non linearity of products;
 - (f) deep out of the money *positions*;
 - (g) *positions* subject to the gapping of prices; and
 - (h) other risks that may not be captured appropriately in the *VaR model* (for example, recovery rate uncertainty, implied correlations and skew risk).
- (3) The shocks applied must reflect the nature of the portfolios and the time it could take to hedge out or manage risks under severe market conditions.

7.10.73 G The stress testing under *BIPRU 7.10.72R* should be taken into account under the *overall Pillar 2 rule*.

Risk management standards: Valuation

7.10.74 R A *firm* must have procedures to ensure that the valuation of assets and liabilities is appropriate, that valuation uncertainty is identified and appropriate reserving is undertaken where necessary.

Risk management standards: Risk review

7.10.75 R At least once a year, a *firm* must conduct, as part of its regular internal audit process, a review of its risk management process. This review must include both the activities of the business trading units and of the independent risk control unit, and must be undertaken by suitably qualified staff independent of the areas being reviewed. This review must consider, at a minimum:

- (1) the adequacy of the documentation of the risk management system and process;
- (2) the organisation of the risk control unit;
- (3) the integration of market risk measures into daily risk management;
- (4) the integrity of the management information system;
- (5) the process for approving risk pricing models and valuation systems used in front and back offices;
- (6) the validation of any significant changes in the risk management process;
- (7) the scope of risks and products captured by the *VaR model*;

- (8) the accuracy and completeness of *position* data;
- (9) the process used to ensure the consistency, timeliness, independence and reliability of data sources (including the independence of such data sources);
- (10) the accuracy and appropriateness of volatility and correlation assumptions;
- (11) reserving policies and the accuracy of the valuation procedures and risk sensitivity calculations;
- (12) the process employed to evaluate the *VaR model's* accuracy, including the programme of backtesting;
- (13) the controls surrounding the development of the *VaR model*; and
- (14) the process employed to produce the calculation of the *model PRR*.

Risk management standards: Validation and backtesting

- 7.10.76 G The *FSA* will require a period of initial monitoring or live testing before a *VaR model* can be recognised. This will be agreed on a *firm by firm* basis.
- 7.10.77 G In assessing the *firm's VaR model* and risk management, the *FSA* has regard to the results of internal model validation procedures used by the *firm* to assess the *VaR model*.
- 7.10.78 R A *firm* must have processes in place to ensure that its *VaR model* has been adequately validated by suitably qualified parties independent of the development process to ensure that it is conceptually sound and adequately captures all material risks. This validation must be conducted when the *VaR model* is initially developed and when any significant changes are made to the *VaR model*. The validation must also be conducted on a periodic basis but especially where there have been any significant structural changes in the market or changes to the composition of the portfolio which might lead to the *VaR model* no longer being adequate. As techniques and best practices evolve, a *firm* must avail itself of these advances. Model validation must not be limited to backtesting, but must, at a minimum, also include the following:
 - (1) tests to demonstrate that any assumptions made within the *VaR model* are appropriate and do not underestimate or overestimate the risk (including testing of the validity of the assumptions and approximations underlying the *VaR model*);
 - (2) in addition to the regulatory backtesting programmes, a *firm* must carry out its own model validation tests in relation to the risks and structures of its portfolios, such as statistical validation techniques and other methods of measuring performance and validity;

- (3) the use of hypothetical portfolios to ensure that the *VaR model* is able to account for particular structural features that may arise, for example material basis risks and concentration risk; and
 - (4) investigation of the limitations of the *VaR model* including testing of the accuracy of parts of the *VaR model* as well as of the whole.
- 7.10.79 G (1) In addition to regulatory backtesting programs, testing for model validation should be carried out using additional tests which may include for example:
- (a) testing carried out using hypothetical changes in portfolio value that would occur were end of day positions to remain unchanged;
 - (b) testing carried out for longer periods than required for the regular backtesting programme (for example, 3 years);
 - (c) testing carried out using confidence intervals other than the 99 percent interval required under the quantitative requirements in *BIPRU 7.10*; and
 - (d) testing of parts of portfolios.
- (2) A longer time period generally improves the power of backtesting. However a longer time period may not be desirable if the *VaR model* or market conditions have changed to the extent that historical data is no longer relevant.
- 7.10.80 G Further material on backtesting can be found in *BIPRU 7.10.91G - BIPRU 7.10.112G*.

Risk management standards: Information technology

- 7.10.81 G In assessing whether the *VaR model* is implemented with integrity as described in *BIPRU 7.10.58R* (Stress testing), the *FSA* will consider in particular the information technology systems used to run the model and associated calculations. The assessment may include:
- (1) feeder systems; risk aggregation systems; time series databases; the *VaR model* system; stress testing system; the backtesting system including profit and loss cleaning systems where appropriate; data quality; reconciliations and checks on completeness of capture;
 - (2) system development, change control and documentation; security and audit trails; system availability and contingency procedures; network adequacy; and
 - (3) operational statistics relating to the *VaR model* production process, including, for example, statistics relating to timeliness, number of re-runs required and the reliability of data feeds.

Risk management standards: Controls

- 7.10.82 R A *firm* must ensure that it has adequate controls relating to:
- (1) the derivation of the *model PRR*;
 - (2) the integrity of the backtesting programme, including the calculation of the profit and loss account;
 - (3) the integrity and appropriateness of the *VaR model*, including the *VaR model's* geographic coverage and the completeness of data sources;
 - (4) the *VaR model's* initial and ongoing development, including independent validation;
 - (5) the valuation models, including independent validation; and
 - (6) the adequacy, security and integrity of the information technology infrastructure.

Stress testing

- 7.10.83 R *BIPRU 7.10.84R-BIPRU 7.10.90G* relate to stress testing of a *VaR model* (see *BIPRU 7.10.72R* (Risk management standards: Stress testing)).
- 7.10.84 G Stress testing is a way of identifying the risk to a *firm* posed by a breakdown of model assumptions or by low-probability events. Where stress tests reveal unacceptable vulnerability to a given set of circumstances, a *firm* should take prompt steps to manage those risks appropriately, for example by hedging against the outcome or reducing the size of the *firm's exposures*.
- 7.10.85 R A *firm* must have the capacity to run daily stress tests.
- 7.10.86 R Stress testing must involve identifying market scenarios or other low probability events in all types of risks that generate the greatest losses on a *firm's* portfolio.
- 7.10.87 R A *firm* must periodically and actively identify all the worst case scenarios that are relevant to its portfolio. Scenarios used must be appropriate to test the effect of adverse movements in market volatilities and correlations and the effect of any change in the assumptions underlying the *VaR model*. Scenarios involving low probability market events must nevertheless be plausible.
- 7.10.88 R Stress testing must capture non-linear effects.
- 7.10.89 R A *firm* must have procedures to assess and respond to the results produced from stress testing. In particular, stress testing results must be:

- (1) used to evaluate its capacity to absorb such losses or identify steps to be taken to reduce risk; and
- (2) communicated routinely to *senior management* and periodically to the *governing body*.

7.10.90 G A *firm* may want to conduct the more complex stress tests at longer intervals or on an ad hoc basis.

Backtesting: Introduction

7.10.91 G Backtesting is the process of comparing value-at-risk risk measures to portfolio performance. It is intended to act as one of the mechanisms for the ongoing validation of a *firm's VaR model* and to provide incentives for *firms* to improve their *VaR measures*.

7.10.92 G It is a condition for granting a *VaR model permission* that a *firm* should have a backtesting programme in place and should provide three months of backtesting history.

7.10.93 G Backtesting conducted only at a whole portfolio level using a single measure of profit and loss has limited power to distinguish an accurate *VaR model* from an inaccurate one. Backtesting should therefore be regarded as an additional safeguard rather than a primary validation tool. Such testing does however form the basis of the *FSA's plus factor* system. The test has been chosen as the basis of the backtesting regime because of its simplicity. A *firm* will therefore be expected to complement this backtesting with more granular backtesting analysis and involving more than one measure of profit and loss (i.e. both a *clean profit and loss figure* and a *clean hypothetical profit and loss figure*).

7.10.94 R A *firm* must have the capacity to analyse and compare its *clean profit and loss figures* and *clean hypothetical profit and loss figures* to the *VaR measure*, both at the level of the whole portfolio covered by the *VaR model permission* and at the level of individual books that contain material amounts of risk.

7.10.95 G Clean profit and loss backtesting should be used for regulatory backtesting and used to calculate *plus factors*. Hypothetical profit and loss backtesting is used for model validation and for reporting to the *FSA*.

Backtesting: Basic testing requirements

7.10.96 R A *firm* must, on each *business day*, compare each of its 250 most recent *business days' clean profit and loss figures* (ending with the *business day* preceding the *business day* in question) with the corresponding *one-day VaR measures*.

7.10.97 G Generally the *positions* underlying the profit and loss account and *VaR measures* should not be materially different.

Backtesting: One day VaR measure

- 7.10.98 R The *one-day VaR measure* for a particular *business day* is the *VaR number* for that *business day* calibrated to a one *business day* holding period and a 99% one-tailed confidence level.

Backtesting: Calculating the clean profit and loss

- 7.10.99 G The ultimate purpose of backtesting is to assess whether capital is sufficient to absorb actual losses. Therefore backtesting should be performed using a measure of actual daily profit and loss. Actual daily profit and loss means the day's profit and loss arising from trading activities within the scope of the *VaR model permission*. This measure should, however, be 'cleaned' using *BIPRU 7.10.100R*. A clean profit and loss measure is used to backtest against in order to ensure that backtesting results are not biased by the inclusion in profit and loss of non-modelled factors.
- 7.10.100 R The *clean profit and loss figure* for a particular *business day* is the *firm's* actual profit or loss for that day in respect of the trading activities within the scope of the *firm's VaR model permission*, adjusted by stripping out:
- (1) fees and commissions;
 - (2) brokerage;
 - (3) additions to and releases from reserves which are not directly related to market risk (e.g. administration reserves); and
 - (4) any inception profit exceeding an amount specified for this purpose in the *firm's VaR model permission* (where inception profit is defined as any profit arising immediately on entering into a new transaction).
- 7.10.101 G The definition of *clean profit and loss figure* may be amended or replaced in an individual *VaR model permission* if the *firm* can demonstrate to the *FSA* that the alternative method meets the spirit and purpose of the provisions in *BIPRU 7.10* about the *clean profit and loss figure*.
- 7.10.102 G The *FSA* will review as part of a *firm's VaR model permission* application the processes and documentation relating to the derivation of profit and loss used for backtesting. A *firm's* documentation should clearly set out the basis for cleaning profit and loss. To the extent that certain profit and loss elements are not updated every day (for example certain reserve calculations) the documentation should clearly set out how such elements are included in the clean profit and loss series.

Backtesting: Definition of backtesting exception

- 7.10.103 R A *backtesting exception* is deemed to have occurred for any *business day* if the *clean profit and loss figure* for that *business day* shows a loss, which in absolute magnitude, exceeds the *one-day VaR measure* for that *business day*. The only exception is if that *business day* is identified in the *firm's VaR model permission* as giving rise to an excluded *backtesting exception*.

Backtesting: Obligation to notify the FSA

- 7.10.104 R If a *backtesting exception* occurs, the *firm* must notify its usual supervisory contact at the *FSA* orally by close of business two *business days* after the *business day* for which the *backtesting exception* occurred. Within five *business days* following the end of each *Month*, the *firm* must submit to the *FSA* a written account of the previous *Month's backtesting exceptions* (if any). This explanation must include the causes of the *backtesting exceptions*, an analysis of whether the *backtesting exceptions* indicate a deficiency in the *firm's VaR model* and the *firm's* planned response (if any).

Backtesting: Summary of the backtesting cycle

- 7.10.105 G (1) This paragraph gives *guidance* on the backtesting calculation and reporting process in *BIPRU 7.10.96R - BIPRU 7.10.104R*.
- (2) Let the day on which the loss referred to in *BIPRU 7.10.100R* is made be day *n*. The value-at-risk measure for that day will be calculated on day *n-1*, or overnight between day *n-1* and day *n*. Profit and loss figures are produced on day *n+1*, and backtesting also takes place on day *n+1*. The *firm's* supervisor should be notified of any *backtesting exceptions* by close of business on day *n+2*.
- (3) Any *backtesting exception* initially counts for the purpose of the calculation of the *plus factor* even if subsequently the *FSA* agrees to exclude it under the process described in *BIPRU 7.10.106G*. Thus, where the *firm* experiences a *backtesting exception* and already has four or more *backtesting exceptions* for the previous 250 *business days*, changes to the *multiplication factor* arising from changes to the *plus factor* become effective at *n+3* (using the time-line terminology in (2)).

Backtesting: Process for disregarding backtesting exceptions

- 7.10.106 G (1) This paragraph gives *guidance* on the process for excluding *backtesting exceptions* as referred to in *BIPRU 7.10.103R*.

- (2) The *FSA* will respond flexibly to *backtesting exceptions*. However, the *FSA*'s starting assumption will be that a *backtesting exception* should be taken into account for the purpose of the calculation of *plus factors*. If the *firm* believes that a *backtesting exception* should not count for that purpose, then it should seek a variation of its *VaR model permission* in order to exclude that particular *backtesting exception*. The *FSA* will then decide whether to agree to such a variation.
- (3) One example of when a *firm's backtesting exception* might properly be disregarded is when it has arisen as a result of a risk that is not captured in its *VaR model* but against which *capital resources* are already held.

Backtesting: Specific risk backtesting

- 7.10.107 R If a *firm's VaR model permission* covers *specific risk*, the *firm* must validate its *VaR model* through backtesting aimed at assessing whether *specific risk* is being accurately captured. This backtesting must be carried out in accordance with the provisions of its *VaR model permission*. If the *VaR model permission* provides for this backtesting to be performed on the basis of relevant sub-portfolios, these must be chosen in a consistent manner.
- 7.10.108 G *Specific risk* backtesting involves the backtesting of a standalone *specific risk VaR* measure against a profit and loss series determined by reference to exposure risk factors categorised as *specific risk*. Alternatively *specific risk* backtesting may take the form of regular backtesting of trading books and portfolios that are predominantly exposed to risk factors categorised as *specific risk*. The precise requirements for *specific risk* backtesting will be specified in the *firm's VaR model permission* as will the definition of a *specific risk backtesting exception*.

Backtesting: Multiple exceptions

- 7.10.109 R If ten or more *backtesting exceptions* or ten or more *specific risk backtesting exceptions* are recorded in a 250 *business day* period, a *firm* must take immediate corrective action.
- 7.10.110 G Where backtesting reveals severe problems with the basic integrity of the *VaR model*, the *FSA* may withdraw model recognition. In particular, if ten or more *backtesting exceptions* are recorded in a 250 *business day* period, the *FSA* may apply a *plus factor* greater than one or the *FSA* may consider revoking a *firm's VaR model permission*. The *FSA* may also consider revoking a *firm's VaR model permission* if ten or more *specific risk backtesting exceptions* occur in such a period.

Backtesting: Hypothetical profit and loss

- 7.10.111 R A *firm* must also perform backtesting against a *clean hypothetical profit and loss figure* with respect to each *business day*. A *clean hypothetical profit and loss figure* for a *business day* means the *clean profit and loss figure* that would have occurred for that *business day* if the portfolio on which the *VaR number* for that *business day* is based remained unchanged.
- 7.10.112 G (1) A *clean hypothetical profit and loss figure* is based on the day's change in the value of the same portfolio that was used to generate the value-at-risk forecast.
- (2) Backtesting under *BIPRU 7.10.111R*, although carried out with respect to each *business day*, need not be carried out each day. A *firm* need only carry it out sufficiently frequently to comply with its reporting requirements under *BIPRU 7.10.129R*. An exception arising out of such backtesting need not be reported to the *FSA* under *BIPRU 7.10.104R*.
- (3) The *firm* may also need to calculate a *clean hypothetical profit and loss figure* in order to produce profit attribution reports and to analyse the cause of *backtesting exceptions*.

Capital calculations: General

- 7.10.113 R The *model PRR* is, for any *business day* (the "relevant" *business day*), calculated in accordance with the following formula:
- (1) the higher of:
- (a) the *VaR number* for the relevant *business day*; and
- (b) the average of its daily *VaR numbers* for each of the 60 *business days* ending with the relevant *business day*, multiplied by the *multiplication factor* for the relevant *business day*; and
- (2) (in the case of a *VaR model permission* that covers *specific risk*) the *incremental default risk charge* for the relevant *business day*.
- 7.10.114 R For any day that is not a *business day*, the *model PRR* is the amount for the prior *business day*.
- 7.10.115 R The *VaR number* for any *business day* means the *VaR measure*, in respect of the previous *business day's* close-of-business *positions* in products coming within the scope of the *VaR model permission*, calculated by the *VaR model* and in accordance with *BIPRU 7.10* and any methodology set out in the *VaR model permission*. The *VaR number* must not be calculated taking into account matters on the *business day* for which it is the *VaR number*.

7.10.116 R The *incremental default risk charge* for any *business day* means the incremental default risk charge required under the provisions in *BIPRU 7.10* about *specific risk*, in respect of the previous *business day's* close-of-business *positions* with respect to which those provisions apply.

7.10.117 G The following equation expresses *BIPRU 7.10.113R* mathematically:

$$PRR_{VaR} = \text{Max} \left\{ VaR_t, fx \frac{1}{60} \sum_{i=0}^{59} VaR_{t-i} \right\} + IDRC$$

where:

- (1) PRR_{VaR} is a *firm's model PRR*;
- (2) VaR_t represents the previous day's value-at-risk figure;
- (3) VaR_{t-i} represents the value-at-risk calculated for *i business days* earlier;
- (4) *f* is the *multiplication factor*; and
- (5) *IDRC* is the *incremental default risk charge* (if applicable).

Capital calculations: Multiplication factors

7.10.118 R The *multiplication factor* for any *business day* is the sum of the *minimum multiplication factor* and the *plus factor* for that day.

7.10.119 R The *minimum multiplication factor* is three or any higher amount the *VaR model permission* defines it as.

7.10.120 G The *minimum multiplication factor* will never be less than three. If the *FSA* does set the *minimum multiplication factor* above three the *VaR model permission* will have a table that sets out the reasons for that add on and specify how much of the add on is attributable to each reason (see *BIPRU 7.10.121R*). If there are weaknesses in the *VaR model* that may otherwise be considered a breach of the minimum standards referred to in *BIPRU 7.10.24R* the *FSA* may apply such an add on to act as a mitigant for those weaknesses.

7.10.121 R Something that would otherwise be a breach of the minimum standards to in *BIPRU 7.10.26R - BIPRU 7.10.53R* is not a breach to the extent that that thing is identified in the *firm's VaR permission* as a reason for an increase in the *minimum multiplication factor* above 3.

- 7.10.122 G Typically, any add on will be due to a specific weakness in systems and controls identified during the *FSA's* review that the *FSA* does not consider material enough to justify withholding overall model recognition. The *firm* will be expected to take action to address the reasons for any add on. The *FSA* will then review these periodically and, where satisfactory action has been taken, the add on will be removed through a variation of the *VaR model permission*.
- 7.10.123 G The *plus factor* system is designed so that the more often a *VaR model* has under-predicted losses in the past, the higher should be the capital requirement based on the *VaR model*. It is intended to provide a capital incentive for the *firm* to continue to improve the accuracy of its *VaR model*.
- 7.10.124 R The table in *BIPRU 7.10.125R* sets out the *plus factors* to be added to the *minimum multiplication factor* for any *business day*. It is based on the number of *backtesting exceptions* that occurred during the backtesting period as referred to in *BIPRU 7.10.96R* (Backtesting: Basic testing requirements) ending three *business days* preceding the *business day* for which the *model PRR* is being calculated.
- 7.10.125 R Table: Backtesting plus factors
This table belongs to *BIPRU 7.10.124R*

Zone	Number of recorded exceptions	Plus factor
Green	4 or less	0.00
Yellow	5	0.40
	6	0.50
	7	0.65
	8	0.75
	9	0.85
Red	10 or more	1.00

- 7.10.126 G A *VaR model* that correctly predicts a one-tailed 99% confidence level is expected to produce, on average, 2.5 *backtesting exceptions* every 250 days. Random events may cause the number of *backtesting exceptions* actually observed to vary. The *plus factor* system is designed to take this into account. Hence *plus factors* are only imposed on the *firm* if it has five or more recorded *backtesting exceptions*. Therefore, where a *backtesting exception* appears to be caused simply by chance, it will not be appropriate for a *VaR model permission* to be varied to exclude that *backtesting exception* as described in BIPRU 7.10.106G (Backtesting: Process for disregarding backtesting exceptions).

Capital calculations: Specific risk surcharge: transitional requirements

- 7.10.127 G *Firms* who gained model recognition before 1 January 2007 will be permitted to calculate *PRR* for *specific risk* in accordance with the methodology they were permitted to use immediately before that date instead of capturing event and default risk in their models (see BIPRU TP 14 (Market risk: VaR models)). This treatment will not be available to a *firm* that gains model recognition after that date.

Reporting procedures and requirements

- 7.10.128 G A *VaR model permission* will contain requirements for what the *firm* should report to the *FSA* and the procedures for reporting. The precise requirements will vary from *VaR model permission* to *VaR model permission*. BIPRU 7.10.129R-BIPRU 7.10.130R set out what the *FSA* regards as the standard requirements.
- 7.10.129 R A *firm* must, no later than the number of *business days* after the end of each quarter specified in the *VaR model permission* for this purpose, submit, in respect of that quarter, a report to the *FSA* about the operation of the *VaR model*, the systems and controls relating to it and any changes to the *VaR model* and those systems and controls. Each report must outline as a minimum the following information in respect of that quarter:
- (1) methodological changes and developments to the *VaR model*;
 - (2) the introduction of all new pricing models used in connection with the *VaR model* and any changes to any pricing models used in connection with the *VaR model*, including details of any material associated valuation or risk management issues;
 - (3) a summary of backtesting performance against *clean profit and loss figures* and *clean hypothetical profit and loss figures*, which must be provided in electronic format as stipulated by the *VaR model permission*;
 - (4) (if the *VaR model permission* covers *specific risk*) the results of the *specific risk* backtesting including *specific risk backtesting exceptions*;

- (5) any change to any feeder or pre-processing systems in connection with the *VaR model*, including changes to any of the systems set out in the list described in *BIPRU 7.10.131G(1)* (as it exists at the date of the *VaR model permission*), and any introduction of a new such system;
- (6) any changes to the products coming within the scope of the *VaR model*;
- (7) any material changes or additions to any of the matters referred to in the *firm's* internal documentation in relation to the *VaR model* (as it exists at the date of the *VaR model permission*) or to any matters subsequently notified under (7);
- (8) any changes in *senior management*;
- (9) an up-to-date list of products covered by the *VaR model permission* showing all changes made since the *VaR model permission* was granted; and
- (10) where applicable (nil returns are not required), details of:
 - (a) any use of a changed historical observation period in accordance with *BIPRU 7.10.30R* or any change in the use of any weighting scheme as described in *BIPRU 7.10.33R*;
 - (b) any data series becoming unreliable as described in *BIPRU 7.10.31R* and any subsequent use of alternative value-at-risk measurement techniques;
 - (c) the frequency of updating data sets being increased in accordance with *BIPRU 7.10.34R*;
 - (d) any change in the method employed to derive 10-day *VaR measures* (see *BIPRU 7.10.28R*);
 - (e) to the extent that the use of correlations is permitted by a *firm's VaR model permission*, a summary of any notifications that are required under *BIPRU 7.10.37R*; and
 - (f) the *VaR model* not accurately capturing risks (as referred to in *BIPRU 7.10.53R*) and any steps taken under *BIPRU 7.10.53R*.

7.10.130 R A *firm* must provide to, and discuss with, the *FSA* details of any significant planned changes to the *VaR model* before those changes are implemented. These details must include information about the nature of the change and an estimate of the impact on *VaR numbers* and the *incremental default risk charge*.

Updating the VaR model permission

- 7.10.131 G The *VaR model permission* will generally contain a list of the following:
- (1) feeder systems and pre-processing systems;
 - (2) products covered by the *VaR model permission*; and
 - (3) the *firm's* internal documentation in relation to the *VaR model*.
- 7.10.132 G The information in *BIPRU 7.10.131G* will vary over time. It is therefore not included in a *VaR model permission* as a *rule* but for information only. The *FSA* will update that information regularly in accordance with information supplied under *BIPRU 7.10.129R*. That updating will not amount to a variation of the *VaR model permission*.

Link to standard *PRR* rules: Incorporation of the model output into the capital calculation

- 7.10.133 G A *VaR model permission* will modify *GENPRU 2.1.52R* (Calculation of the market risk capital requirement) to provide that a *firm* should calculate its *market risk capital requirement* in accordance with *BIPRU 7.10* to the extent set out in the *VaR model permission*.
- 7.10.134 G By modifying *GENPRU 2.1.52R* (Calculation of the market risk capital requirement) to allow the *firm* to use the *VaR model* to calculate all or part of its *PRR* for certain positions, the *FSA* is treating it like an application *rule*. The modification means that the *PRR* calculation set out in *BIPRU 7.10* supersedes the *standard market risk PRR rules* for products and risks coming within the scope of the *VaR model permission*.
- 7.10.135 R To the extent that a *position* does not fall within the scope of a *firm's VaR model permission* the *firm* must calculate the *PRR* under the *standard PRR rules* or, as applicable, those provisions as modified by the *firm's CAD 1 waiver*.
- 7.10.136 R
- (1) This *rule* applies to a *position* of a type that comes within the scope of a *firm's VaR model permission*.
 - (2) If, where the *standard market risk PRR rules* apply, a *position* is subject to a *PRR charge* and the *firm's VaR model permission* says that it covers the risks to which that *PRR charge* relates, the *firm* must, for those risks, calculate the *PRR* for that *position* under the *VaR model approach* rather than under the *standard market risk PRR rules*.
 - (3) If, where the *standard market risk PRR rules* apply, a *position* is subject to one or more *PRR charges* and the *firm's VaR model permission* does not cover all the risks to which those *PRR charges* relate, the *firm* must calculate the *PRR* for that *position* under the *VaR model approach* (for those risks that are covered) and under the *standard market risk PRR rules* (for those other risks).

- (4) Where the *standard market risk PRR rules* distinguish between *specific risk* and *general market risk* a *firm's VaR model permission* covers *specific risk* to the extent that it says it does. If the *firm's VaR model permission* does not cover *specific risk*, *BIPRU 7.10.143R* and *BIPRU 7.10.144R* apply.
- (5) If a *firm's VaR model permission* covers *positions* in *CIUs* it covers *specific risk* with respect to those *positions*.
- 7.10.137 R A *firm* may exclude from the *VaR model approach* immaterial risks within the scope of its *VaR model permission*. If a *firm* does so it must instead apply the *standard market risk PRR rules* to those risks.
- 7.10.138 R (1) If a *firm* calculates its *market risk capital requirement* using a combination of the *standard market risk PRR rules* and either the *VaR model approach* or the *VaR model approach* with the *CAD 1 model approach* the *PRR* from each method must be added together.
- (2) A *firm* must take appropriate steps to ensure that all of the approaches are applied in a consistent manner.
- 7.10.139 G An example of the effect of *BIPRU 7.10.138R* is that where a *firm* normally calculates the *PRR* for a particular portfolio using a *VaR model*, a *firm* should not switch to the *standard market risk PRR rules* purely to achieve a more attractive *PRR*.
- 7.10.140 R If:
- (1) the *standard market risk PRR rules* provide for a choice of which of the *PRR charges* to use or specify that one type must be used in some circumstances and that another type must be used in other circumstances;
- (2) one of those types is disapplied under *BIPRU 7.10.136R*; and
- (3) the other type is not disapplied;
- the *firm*:
- (4) must use the *VaR model approach* if under the *standard market risk PRR rules* the *firm* must use the *standard market risk PRR rules* in (2); and
- (5) may use the *VaR model approach* if under the *standard market risk PRR rules* the *firm* may use the *standard market risk PRR rules* in (2).

7.10.141 G The treatment of a *convertible* is an example of a situation in which *BIPRU 7.10.140R* applies. The table in *BIPRU 7.3.3G* (Table: Instruments which result in notional positions) shows that there are circumstances in which under the *standard market risk PRR rules* a *firm* should calculate an *equity PRR* and that there are circumstances in which a *firm* may choose between calculating an *equity PRR* and an *interest rate PRR*. *BIPRU 7.10.140R* would be relevant if a *firm's VaR model permission* only covers one of *equity risk* and *interest rate risk*.

7.10.142 R The *standard market risk PRR rules* for the *option PRR* are only disappplied to the extent that the derived positions arising under *BIPRU 7.6.13R* (Table: Derived positions) come within the scope of the *VaR model permission*.

Link to standard *PRR rules*: General market risk only

7.10.143 R If a *firm's VaR model permission* covers *interest rate general market risk* but not *interest rate specific risk*, the *firm* must calculate the *interest rate PRR* so far as it relates to *interest rate specific risk* in accordance with the *standard market risk PRR rules* except that the *firm* must not use the basic *interest rate PRR* calculation in *BIPRU 7.3.45R* (Basic interest rate calculation for equity instruments).

Link to standard *PRR rules*: General market risk only

7.10.144 R If a *firm's VaR model permission* covers *equity general market risk* but not *equity specific risk*, the *firm* must calculate the *equity PRR* so far as it relates to *equity specific risk* in accordance with the *standard market risk PRR rules* except that the *PRR* for *equity specific risk* must be calculated under the *standard equity method*.

Link to standard *PRR rules*: Miscellaneous

7.10.145 R (1) To the extent that a *firm's VaR model permission* does not allow it to use an approach set out in *BIPRU 7.10* the relevant provisions in *BIPRU 7.10* do not apply to that *firm*.

(2) If a provision of the *Handbook* refers to *BIPRU 7.10*, that reference must, in the case of a particular *firm* with a *VaR model permission*, be treated as excluding provisions of *BIPRU 7.10* that do not apply under the *VaR model permission* and as taking into account any modifications to *BIPRU 7.10* made by the *VaR model permission*. Such references also include requirements and conditions contained in the *VaR model permission* but not *BIPRU 7.10* and to the *rules* modified by the *VaR model permission*.

Requirement to use value at risk methodology

7.10.146 R A *VaR model* must be a value-at-risk model. It must provide an estimate of the worst expected loss on a portfolio resulting from market movements over a period of time with the specified confidence level.

Ceasing to meet the requirements of BIPRU 7.10

- 7.10.147 G If a *firm* ceases to meet any of the requirements set out in *BIPRU 7.10*, the *FSA*'s policy is that the *VaR model permission* should cease to have effect. In part this will be achieved by making it a condition of a *firm's VaR model permission* that it complies at all times with the minimum standards referred to in *BIPRU 7.10.26R - BIPRU 7.10.53R*. Even if they are not formally included as conditions, the *FSA* is likely to consider revoking the *VaR model permission* if the requirements are not met.
- 7.10.148 R If a *firm* ceases to meet the conditions or requirements in its *VaR model permission* or *BIPRU 7.10* it must notify the *FSA* at once.

Changes to a VaR model

- 7.10.149 R A *firm* may change its *VaR model* to such extent as it sees fit, except that it must not make a change that (either on its own or together with other changes since the date of *VaR model permission*) would:
- (1) be inconsistent with *VaR model permission* or *BIPRU 7.10*; or
 - (2) mean that backtesting in accordance with *BIPRU 7.10* and the *VaR model permission* would result in the use of data that is inappropriate for the purposes of measuring the performance of the *VaR model*.

7.11 Credit derivatives in the trading book

Scope

- 7.11.1 R This section applies to the treatment of credit derivatives in the *trading book*.
- Establishment of positions created by credit derivatives: Treatment of the protection seller
- 7.11.2 R *BIPRU 7.11.3R - BIPRU 7.11.11R* relate to the treatment of the *protection seller* for the purpose of calculating the *securities PRR*. *Positions* are determined in accordance with *BIPRU 7.11.4R - BIPRU 7.11.11R*.
- 7.11.3 R When calculating the *PRR* of the *protection seller*, unless specified differently by other *rules*, the notional amount of the credit derivative contract must be used. For the purpose of calculating the *specific risk PRR charge*, other than for total return swaps, the maturity of the credit derivative contract is applicable instead of the maturity of the obligation.
- 7.11.4 R A total return swap creates a long *position* in the *general market risk* of the reference obligation and a short *position* in the *general market risk* of a *zero-specific-risk security* with a maturity equivalent to the period until the next interest fixing and which is assigned a 0% *risk weight* under the *standardised approach* to credit risk. It also creates a long *position* in the *specific risk* of the reference obligation.
- 7.11.5 R A credit default swap does not create a *position* for *general market risk*. For the purposes of *specific risk*, a *firm* must record a synthetic long *position* in an obligation of the reference entity, unless the derivative is rated externally and meets the conditions for a *qualifying debt security*, in which case a long *position* in the derivative is recorded. If premium or interest payments are due under the product, these cash flows must be represented as notional *positions* in *zero-specific-risk securities*.
- 7.11.6 R A single name credit linked note creates a long *position* in the *general market risk* of the note itself, as an interest rate product. For the purpose of *specific risk*, a synthetic long *position* is created in an obligation of the reference entity. An additional long *position* is created in the issuer of the note. Where the credit linked note has an external rating and meets the conditions for a *qualifying debt security*, a single long *position* with the *specific risk* of the note need only be recorded.
- 7.11.7 R In addition to a long *position* in the *specific risk* of the issuer of the note, a multiple name credit linked note providing proportional protection creates a *position* in each reference entity, with the total notional amount of the contract assigned across the *positions* according to the proportion of the total notional amount that each exposure to a reference entity represents. Where more than one obligation of a reference entity can be selected, the obligation with the highest *risk weighting* determines the *specific risk*.

- 7.11.8 R Where a multiple name credit linked note has an external rating and meets the conditions for a *qualifying debt security*, a single long *position* with the *specific risk* of the note need only be recorded.
- 7.11.9 R A first-asset-to-default credit derivative creates a *position* for the notional amount in an obligation of each reference entity. If the size of the maximum credit event payment is lower than the *PRR* requirement under the method in the first sentence of this *rule*, the maximum payment amount may be taken as the *PRR* requirement for *specific risk*.
- 7.11.10 R A second-asset-to-default credit derivative creates a *position* for the notional amount in an obligation of each reference entity less one (that with the lowest *specific risk PRR* requirement). If the size of the maximum credit event payment is lower than the *PRR* requirement under the method in the first sentence of this *rule*, this amount may be taken as the *PRR* requirement for *specific risk*.
- 7.11.11 R If a first or second-asset to default derivative is externally rated and meets the conditions for a *qualifying debt security*, then the *protection seller* need only calculate one *specific risk* charge reflecting the rating of the derivative.

Establishment of positions created by credit derivatives: Treatment of the protection buyer

- 7.11.12 R For the *protection buyer*, the *positions* are determined as the mirror image of the *protection seller*, with the exception of a credit linked note (which entails no short *position* in the issuer). If at a given moment there is a call option in combination with a *step-up*, such moment is treated as the maturity of the protection. In the case of nth to default credit derivatives, a *firm* that is a *protection buyer* may off-set *specific risk* for n-1 of the underlyings (i.e., the n-1 assets with the lowest *specific risk PRR*).

Recognition of hedging provided by credit derivatives against cash positions

- 7.11.13 R (1) *BIPRU 7.11.14R - BIPRU 7.11.17R* relate to *specific risk PRR* for *trading book positions* hedged by credit derivatives for the purposes of the calculation of the *securities PRR*.
- (2) A *firm* may take an allowance for protection provided by credit derivatives for the purposes in (1) in accordance with the principles set out in the *rules* referred to in (1).
- (3) *BIPRU 7.11.13R - BIPRU 7.11.17R* are subject to the requirements of the *credit default swap PRR methods*.
- 7.11.14 R (1) A *firm* may take full allowance when the value of two legs always move in the opposite direction and broadly to the same extent.
- (2) This will be the case in the following situations:
- (a) the two legs consist of completely identical instruments; or

- (b) a long cash *position* is hedged by a total rate of return swap (or vice versa) and there is an exact match between the reference obligation and the underlying exposure (i.e., the cash *position*).
 - (3) The maturity of the swap itself may be different from that of the underlying exposure for the purposes of (2)(b).
 - (4) In these situations, a *firm* must not apply a *specific risk PRR* to either side of the *position*.
- 7.11.15 R An 80% offset may be applied when the value of two legs always move in the opposite direction and where there is an exact match in terms of the reference obligation, the maturity of both the reference obligation and the credit derivative, and the currency of the underlying exposure. In addition, key features of the credit derivative contract must not cause the price movement of the credit derivative materially to deviate from the price movements of the cash *position*. To the extent that the transaction transfers risk, an 80% *specific risk* offset may be applied to the side of the transaction with the higher *PRR*, while the *specific risk* requirements on the other side are zero.
- 7.11.16 R
- (1) A *firm* may take partial allowance when the value of two legs usually move in the opposite direction. This would be the case in the situations set out in (2) – (4).
 - (2) The first situation referred to in (1) is that the *position* falls under *BIPRU 7.11.14R(2)(b)* but there is an asset mismatch between the reference obligation and the underlying exposure. However, the *positions* meet the following requirements:
 - (a) the reference obligation ranks *pari passu* with or is junior to the underlying obligation; and
 - (b) the underlying obligation and reference obligation share the same obligor and have legally enforceable cross-default or cross-acceleration clauses.
 - (3) The second situation referred to in (1) is that the *position* falls under *BIPRU 7.11.14R(2)(a)* or *BIPRU 7.11.15* but there is a currency or maturity mismatch between the credit protection and the underlying asset (currency mismatches must be included in the normal reporting with respect to the *foreign exchange PRR*).
 - (4) The third situation referred to in (1) is that the *position* falls under *BIPRU 7.11.15* but there is an asset mismatch between the cash *position* and the credit derivative. However, the underlying asset is included in the (deliverable) obligations in the credit derivative documentation.

- (5) In each of those situations, rather than adding the *specific risk PRR* requirements for each side of the transaction, only the higher of the two *PRR* requirements applies.
- 7.11.17 R In all situations not falling under *BIPRU 7.11.14R - BIPRU 7.11.16R*, a *firm* must assess a *specific risk PRR charge* against both sides of the *positions*.
- Special treatment of credit default swaps: Provisions applicable to all methods
- 7.11.18 R *BIPRU 7.11.18R - BIPRU 7.11.58R* set out the calculation of the *specific risk* portion of the *interest rate PRR* for credit default swaps.
- 7.11.19 R The *specific risk* portion of the *interest rate PRR* is calculated separately for:
- (1) credit default swaps (other than those in (2));
 - (2) credit default swaps that are also *securitisation positions*; and
 - (3) other *positions*;
- that are subject to the *interest rate PRR*.
- 7.11.20 R The *specific risk* portion of the *interest rate PRR* for *positions* falling into *BIPRU 7.11.19R(1)* and (2) must be calculated in accordance with the *credit default swap PRR methods* rather than in accordance with *BIPRU 7.2* (Interest rate PRR) and the other provisions of *BIPRU 7.11*. However a *firm* may apply *BIPRU 7.11.13R- BIPRU 7.11.17R* before applying the *credit default swap PRR methods*. If it does so the *firm* must apply the *credit default swap PRR methods* to the remaining *positions* in credit default swaps.
- 7.11.21 R In accordance with the principle in *BIPRU 7.11.19R*, there is no netting for the purpose of calculating *specific risk PRR charges* (under *BIPRU 7.2.37R - BIPRU 7.2.40R* (Deriving the net position in each debt *security*: Netting positions in the same debt *security*) or otherwise) between:
- (1) a *position* falling into *BIPRU 7.11.19R(1)* or *BIPRU 7.11.19R(2)* and one falling into *BIPRU 7.11.19R(3)*; or
 - (2) a *position* falling into *BIPRU 7.11.19R(1)* and one falling into *BIPRU 7.11.19R(2)*.
- 7.11.22 R
- (1) A *firm* must calculate the *interest rate PRR* for *specific risk* for credit default swaps falling into *BIPRU 7.11.19R(1)* under the *ordinary credit default swap PRR method*.
 - (2) A *firm* must calculate the *interest rate PRR* for *specific risk* for credit default swaps falling into *BIPRU 7.11.19R(2)* under the *securitisation credit default swap PRR method*.

Ordinary credit default swap PRR method: Introduction

- 7.11.23 R *BIPRU 7.11.24R - BIPRU 7.11.37R* set out the *ordinary credit default swap PRR method*.

Ordinary credit default swap PRR method: Grouping of credit derivatives

- 7.11.24 R A *firm* must group together all credit default swaps being treated under the *ordinary credit default swap PRR method* that give rise to notional *positions* in the same *security* for *specific risk* purposes under the procedure in *BIPRU 7.11.2R - BIPRU 7.11.12R* and that may be netted under *BIPRU 7.11.56R*.

- 7.11.25 R The provisions in *BIPRU 7.11.2R - BIPRU 7.11.12R* about the creation of a *specific risk* charge for credit default swaps reflecting the rating of the derivative (see *BIPRU 7.11.11R* and part of *BIPRU 7.11.5R*) do not apply for the purposes of calculating the *ordinary credit default swap PRR method*.

Ordinary credit default swap PRR method: Main rule for calculating the specific risk PRR

- 7.11.26 R The *specific risk* portion of the *interest rate PRR* for credit default swaps treated under the *ordinary credit default swap PRR method* is the higher of:
- (1) an amount equal to what would have been the *specific risk* portion of the *interest rate PRR* for such credit default swaps if it had been calculated under of *BIPRU 7.2.43R* to *BIPRU 7.2.50R* (Specific risk calculation for interest rate risk), taking into account *BIPRU 7.11.19R* and *BIPRU 7.11.21R*; and
 - (2) the sum of the valuation change capital charge (see *BIPRU 7.11.28R*) and the default capital charge (see *BIPRU 7.11.36R*) for all such credit derivatives.

Ordinary credit default swap PRR method: The valuation change capital charge

- 7.11.27 R A *firm* must allocate each credit default swap grouped together under *BIPRU 7.11.24R* to the time bands set out in *BIPRU 7.11.33R* for the purposes of calculating the valuation change capital charge.
- 7.11.28 R The valuation change capital charge for a group of credit default swaps created under *BIPRU 7.11.24R* is equal to six multiplied by the larger of the potential loss produced under *BIPRU 7.11.29R* and the potential loss produced under *BIPRU 7.11.30R*. The total valuation change capital charge for credit default swaps treated under the *ordinary credit default swap PRR method* is equal to the sum of such amounts for all such groups.
- 7.11.29 (1) The amount of the potential loss calculated under this *rule* is calculated as follows.

- (2) Within each time band the *firm* must calculate the net valuation change in the credit default swaps that would occur if spreads (as defined in *BIPRU 7.11.55R*) were to increase by the amount shown in *BIPRU 7.11.34R*. The amount of the change in spread is the same for each time band.
- (3) The potential loss calculated under this *rule* is the sum of all bands that create a net loss. Bands which produce a profit must be ignored.
- (4) The time bands referred to in this *rule* are those established under *BIPRU 7.11.27R*

- 7.11.30 R The amount of the potential loss calculated under this *rule* is calculated in the same way as it is under *BIPRU 7.11.29R* except that the net valuation change is the one that would occur if spreads were to decrease by the amount shown in *BIPRU 7.11.34R*.
- 7.11.31 R The valuation change in *BIPRU 7.11.29R - BIPRU 7.11.30R* is applied to the current value of the credit default swap.
- 7.11.32 R The *credit quality step* applicable under the table in *BIPRU 7.11.34R* is that which would be attributable to the *security* in question under the *standardised approach* to credit risk. If a rating from an *eligible ECAI* is not available to the *firm* it must treat that *position* as having *credit quality step 6*. The *security* in question is the one by reference to which the grouping under *BIPRU 7.11.24R* is carried out (the reference entity).
- 7.11.33 R Time bands
This table belongs to *BIPRU 7.11.27R*

Time band	Residual contract maturity
1	Less than three months
2	Three months to one year
3	Over one year to two and half years
4	Over two and a half years to five years
5	Greater than five years

- 7.11.34 R Stress factors based on rating of reference entity
This table belongs to *BIPRU 7.11.29R* and *BIPRU 7.11.30R*

<i>Credit quality step 1</i>	<i>Credit quality step 2</i>	<i>Credit quality step 3</i>	<i>Credit quality step 4</i>	<i>Credit quality step 5</i>	<i>Credit quality step 6</i>
0.4 x spread	0.35 x spread	0.3 x spread	0.4 x spread	0.45 x spread	0.45 x spread
Spread is defined in <i>BIPRU 7.11.55R</i> .					

Valuation changes for credit default swaps resulting in positions in multiple *securities*

- 7.11.35 (1) This *rule* applies if *BIPRU 7.11.24R* results in a credit default swap being split into *positions* in more than one *security*.
- (2) The *firm* must, for each notional *security* produced as described in (1), apply to the whole of the credit default swap in question the stresses in the table in *BIPRU 7.11.34R* using the *credit quality step* in the table in *BIPRU 7.11.34R* for that *security*.
- (3) The *firm* must then allocate the different changes in the value of the credit default swap under (2) between the calculations for each *security* produced as described in (1) on a proportional basis in accordance with the principles in *BIPRU 7.11.2R - BIPRU 7.11.12R*. The *firm* must do this by multiplying the amount of the change in (2) calculated with respect to the *security* in question by a fraction based on the proportion of the credit default swap attributable to the *security* under those principles.

Ordinary credit default swap PRR method: The default capital charge

- 7.11.36 R The default capital charge for each group of credit default swaps created under *BIPRU 7.11.24R* is equal to four multiplied by the amount in *BIPRU 7.11.37R*. The total default capital charge for credit default swaps treated under the *ordinary credit default swap PRR method* is equal to the sum of such amounts for each such group.
- 7.11.37 R (1) The amount calculated under this *rule* is the amount resulting from the calculation in (5).

- (2) A *firm* must fully net all notional *positions* along a timeline by calculating, for all credit default swaps in the group in question created under *BIPRU 7.11.24R*, the net *position* in the *security* in question for all times in the future until those *positions* expire or otherwise cease to exist.
- (3) The *firm* must calculate the net *positions* under (2) in accordance with *BIPRU 7.2.37R - BIPRU 7.2.40R* (Deriving the net position in each debt *security*: Netting positions in the same debt *security*).
- (4) The *firm* must identify the largest long *position* to which it is exposed over the next year.
- (5) The *firm* must then multiply the amount established under (4) by the *appropriate PRA* that would have applied for the purpose of calculating the *specific risk* portion of the *interest rate PRR* under *BIPRU 7.2* (Interest rate PRR).
- (6) The *security* in question is the one by reference to which the grouping under *BIPRU 7.11.24R* is carried out (the reference entity).

Securitisation credit default swap PRR method: Introduction

7.11.38 R *BIPRU 7.11.39R - BIPRU 7.11.53R* set out the *securitisation credit default swap PRR method*.

Securitisation credit default swap PRR method: Main rule for calculating the specific risk PRR

7.11.39 R The *specific risk* portion of the *interest rate PRR* for credit default swaps treated under the *securitisation credit default swap PRR method* is the higher of:

- (1) an amount equal to what would have been the *specific risk* portion of the *interest rate PRR* for such credit default swaps if it had been calculated under of *BIPRU 7.2.43R to BIPRU 7.2.50R* (Specific risk calculation for interest rate risk), taking into account *BIPRU 7.11.19R* and *BIPRU 7.11.21R*; and
- (2) the sum of the valuation change capital charge (see *BIPRU 7.11.40R*) and the default capital charge (see *BIPRU 7.11.48R*) for all such credit derivatives.

Securitisation credit default swap PRR method: Valuation change capital charge: General

- 7.11.40 R In order to calculate the valuation change capital charge a *firm* must group together each credit default swap that relates to the same *securitisation*. The valuation change capital charge for each such group is equal to six multiplied by the potential loss amount in *BIPRU 7.11.41R*. The total valuation change capital charge for credit default swaps treated under the *securitisation credit default swap PRR method* is equal to the sum of such amounts for each such group.
- 7.11.41 R (1) The potential loss amount as referred to in *BIPRU 7.11.40R* for a group of credit default swaps relating to the same *securitisation* is equal to the greatest loss the *firm* would suffer in the scenarios set out in the matrix in *BIPRU 7.11.43R*. Each scenario consists of the combination of one of the nine scenarios on the vertical axis with one of the three scenarios on the horizontal axis.
- (2) T as referred to in that matrix is the amount set out in the table in *BIPRU 7.11.44R*.
- (3) Stresses (1) – (4) as referred to in that matrix are further defined in *BIPRU 7.11.45R - BIPRU 7.11.46R*.
- (4) The underlying reference entities referred to in that matrix refer to the obligor under the *securities* that are the subject of the *securitisation* in question. In the case of a *resecuritisation* the reference entities are the ultimate underlying obligors (the obligors under the *securitised securitisation*).
- (5) The valuation change under this *rule* is applied to the current value of the credit default swap.
- 7.11.42 R References in the table in *BIPRU 7.11.43R* to *credit quality steps* are to the *credit quality steps* that would apply under the *standardised approach* to credit risk to the *securities* referred to in *BIPRU 7.11.41R(4)*. If a rating from an *eligible ECAI* is not available to the *firm* it must treat that *security* as having the lowest *credit quality step*.
- 7.11.43 R Calculation of the valuation change capital charge: Scenarios
This table belongs to *BIPRU 7.11.41R*

	Change in credit spread of the underlying reference entities		
	$-T \sqrt{\text{spread}}$	No change	$+T \sqrt{\text{spread}}$

		Change in credit spread of the underlying reference entities		
		$-T \sqrt{\text{spread}}$	No change	$+T \sqrt{\text{spread}}$
(1)	Base correlation steepening (see row (1) of the table in <i>BIPRU</i> 7.11.46R)			
(2)	Base correlation flattening (see row (2) of the table in <i>BIPRU</i> 7.11.46R)			
(3)	Base correlation parallel up (see row (3) of the table in <i>BIPRU</i> 7.11.46R)			
(4)	Base correlation down (see row (4) of the table in <i>BIPRU</i> 7.11.46R)			
(5)	No correlation change			
(6)	Combination of (1) and (3)			
(7)	Combination of (1) and (4)			
(8)	Combination of (2) and (3)			
(9)	Combination of (2) and (4)			
Spread is defined in <i>BIPRU</i> 7.11.55R.				

- 7.11.44 R Calculation of the valuation change capital charge: Definition of T
This table belongs to *BIPRU 7.11.41R*

<i>Credit quality step under the standardised approach to credit risk</i>	T
1	0.4
2	0.35
3	0.3
4	0.4
5	0.45
6	0.45

Securitisation credit default swap PRR method: Valuation change capital charge: Base correlation

- 7.11.45 R
- (1) This *rule* explains how the correlation calculations in the vertical axis of the matrix in *BIPRU 7.11.43R* are to be carried out.
 - (2) The *firm* must calculate the base correlation relating to each of the deemed *tranches* set out in the table in *BIPRU 7.11.46R*. Base correlation refers, in relation to a *securitisation position*, to the correlation in credit risk between the *securities* that are the subject of that *securitisation*.
 - (3) The *firm* must then multiply the base correlation for each deemed *tranche* under (2) by the relevant figure in the table in *BIPRU 7.11.46R*. It must calculate each such base correlation in the way that a *person* would use to calculate the fair market value of a credit default swap on the following basis:
 - (a) the *tranche* is the most junior *tranche*; and
 - (b) the thickness of the *tranche* (as referred to in *BIPRU 9 (Securitisation)*) is equal to the percentage figure at the head of the relevant column in the table in *BIPRU 7.11.46R*.
 - (4) The *firm* must then produce a stressed base correlation curve through the use of interpolation based on the calculations under this *rule*.

- (5) Notwithstanding (3), the curve in (4) must not show a correlation above 100%.
- (6) The *firm* must then use the curve for the purpose of the revaluation of the credit default swap under *BIPRU 7.11.41R* using an appropriate and prudent technique.

7.11.46 R Correlation moves
This table belongs to *BIPRU 7.11.45R*

	Thickness of <i>tranche</i>					
		3%	7%	10%	15%	30%
Scenario from <i>BIPRU 7.11.43R</i>	(1) Base correlation steepening	0.7	0.9	1	1.1	1.3
	(2) Base correlation flattening	1.3	1.1	1	0.9	0.7
	(3) Base correlation parallel up	1.2	1.2	1.2	1.2	1.2
	(4) Base correlation parallel down	0.8	0.8	0.8	0.8	0.8

7.11.47 G The fact that the *FSA* has used the base correlation methodology in this section does not mean that it endorses the use of that technique to value credit default swaps for other purposes. The *FSA* has used it in this section as it is well-known and publicly available. If a *firm* uses another technique to value its credit default swaps it should discuss this with the *FSA*.

Securitisation credit default swap PRR method: Default charge

7.11.48 R The default charge for a *firm's position* in a *securitisation* treated under the *securitisation credit default swap PRR method* is equal to the default charge for that *position* calculated under *BIPRU 7.11.50R* and *BIPRU 7.11.51R*. The total default charge for *positions* treated under the *securitisation credit default swap PRR method* is equal to the sum of those figures.

- 7.11.49 R To the extent that a *firm* has a matching long and short *position* in the same *tranche* of the same *securitisation* with the same maturity it may net the short and long *positions*.
- 7.11.50 R If a *position* is short, the default charge for that *position* is zero.
- 7.11.51 R If a *position* is long, the default charge for that *position* must be calculated in accordance with the following formula:

$$V \times RW \times AP \times 2$$

where:

- (1) V means the notional amount of the *position*;
 - (2) RW means the *risk weight* that the *position* would attract under *BIPRU 9* (Securitisation); and
 - (3) AP means the appropriate percentage from the table *BIPRU 7.11.52R*.
- 7.11.52 R Calculation of the default requirement
This table belongs to *BIPRU 7.11.51R*

		Type of <i>position</i>		
		<i>Resecuritisation position</i>	Trades based on an index	Other
<i>Risk weight</i>	Less than 400%	4.8%	1.6%	3.2%
	400% to less than 800%	6.4%	3.2%	4.8%
	800% to less than 1250%	8%	4.8%	6.4%
	1250% and over	8%	8%	8%

- 7.11.53 R (1) The column of the table in *BIPRU 7.11.52R* headed "Trades based on an index" applies if:
- (a) the *position* is not a *resecuritisation position*;

- (b) the underlying reference entities (as defined in *BIPRU* 7.11.41R(4)) are identical to those that make up an index of entities widely used by those who deal in credit default swaps;
 - (c) that index contains the price for entering into a credit default swap whose reference entities constitute all the entities in the index; and
 - (d) the credit default swap is constructed in such a way that the *firm* is able to price the credit derivative using the index.
- (2) The column of the table in *BIPRU* 7.11.52R headed "Other" applies to any case not covered by the other two categories in the table.

Special treatment of credit default swaps: Supplementary material

- 7.11.54 R *BIPRU* 7.11.55R - *BIPRU* 7.11.58R apply to each of the *credit default swap PRR methods*.
- 7.11.55 R The spread referred to in the tables in *BIPRU* 7.11.34R and *BIPRU* 7.11.43R refers to the premia and other cash flows referred to in *BIPRU* 7.11.5R (expressed as a percentage). The spread must be calculated every *business day*. It is the spread that would apply if the credit default swap in question were entered into on that day on arm's length commercial terms.
- 7.11.56 R Where a *credit default swap PRR method* requires netting between *positions*, a *firm* may only net *positions* arising out of credit default swaps that have comparable deliverable obligations, identical credit events and documentation that will act identically on the occurrence of a credit event.
- 7.11.57 R A notional *position* in a *zero-specific-risk security* created under *BIPRU* 7.11.5R must not be treated under either *credit default swap PRR method*. The *firm* must instead treat it in accordance with the other *rules* for the calculation of the *interest rate PRR*.
- 7.11.58 R (1) If the size of the maximum credit event payment under a credit default swap is lower than the *PRR* requirement that would otherwise apply, that credit default swap must be excluded from the *credit default swap PRR methods*. However *BIPRU* 7.11.19R and *BIPRU* 7.11.21R still apply.
- (2) A *firm* must work out whether (1) applies to a credit default swap by calculating the *PRR* for that credit default swap in accordance with this section (including the applicable *credit default swap PRR method*) on the assumption that it is the only item for which an *interest rate PRR* is being calculated.

Valuation

- 7.11.59 G *GENPRU 1.3.29R – GENPRU 1.3.35G* (General requirements: Valuation adjustments or reserves) are particularly relevant for a *firm* trading credit derivatives, especially for credit default swaps that are also *securitisation positions*.
- Other risks relating to credit derivatives
- 7.11.60 R A *firm* must be able to describe, demonstrate and explain to the *FSA* its trading strategies in relation to credit derivatives both in theory and in practice.
- 7.11.61 G *BIPRU 7.11.62G - BIPRU 7.11.64G* cover risks relating to credit derivatives that may not be captured in this section. This *guidance* is of particular relevance to the *overall financial adequacy rule*, the *overall Pillar 2 rule* and the *general stress and scenario testing rule*.
- 7.11.62 G *BIPRU 7.11.5* requires a *firm* to recognise any premiums payable or receivable under the contract as notional *zero-specific-risk securities*. These *positions* are then entered into the *general market risk* framework. As premium payments paid under such contracts are contingent on no credit event occurring, a credit event could significantly change the *general market risk* capital requirement. A *firm* should consider, under the *overall Pillar 2 rule*, whether this risk means that the capital requirements under this section materially understate the *firm's general market risk* position.
- 7.11.63 G If a *firm* recognises profits on a non-accrual basis it should consider whether the capital requirements for its credit derivatives business adequately cover the risk that any recognised profit may not be achieved due to a credit event occurring. This includes *positions* for which the *firm* may have a perfect hedge in place.
- 7.11.64 G If a *firm* uses models in its valuation process, it should consider whether the default capital requirements under the *credit default swap PRR methods* adequately cover the default losses that the *firm's* model estimates it will be exposed to.

8 Group risk – consolidation

Application

8.1.1 R This chapter applies to:

- (1) a *BIPRU firm* that is a member of a *UK consolidation group*;
- (2) a *BIPRU firm* that is a member of a *non-EEA sub-group*;
- (3) an *ELMI* that is a member of a *UK consolidation group* or *non-EEA sub-group* if that group includes a *BIPRU firm*; and
- (4) a *firm* that is not a *BIPRU firm* and is a *parent financial holding company in a Member State* in a *UK consolidation group*.

8.1.2 R This chapter does not apply to a *firm* in *BIPRU* 8.1.1R(1) to (3) which is a member of the *UK consolidation group* or *non-EEA sub-group* if the interest of the relevant *UK consolidation group* or *non-EEA sub-group* in that *firm* is no more than a *participation*.

Purpose

8.1.3 G This chapter implements articles 71, 73(1) and (2), 125, 126, 127(1), 133 and 134 of the *Banking Consolidation Directive* and articles 2 (in part), 22-27 and 37(1) (in part) of the *Capital Adequacy Directive*.

How this chapter is organised

8.1.4 G *BIPRU* 8.2 sets out the definition of *UK consolidation group* and the basic requirement to apply financial resources and concentration risk requirements to that group on a consolidated basis.

8.1.5 G *BIPRU* 8.3 sets out the definition of a *non-EEA sub-group* and the basic requirement to apply financial resources and concentration risk requirements to that group on a consolidated basis.

8.1.6 G *BIPRU* 8.4 sets out how a group of *CAD investment firms* can apply for a *waiver* from consolidated capital requirements although remaining subject to consolidated supervision (including reporting requirements).

8.1.7 G *BIPRU* 8.5 sets out the basis for including and excluding *undertakings* within the group for the purposes of consolidation.

8.1.8 G *BIPRU* 8.6 sets out the calculation of the *consolidated capital resources* of a group and the limits that apply.

- 8.1.9 G *BIPRU 8.7* sets out the calculation of the *consolidated capital resources requirement* of a group.
- 8.1.10 G *BIPRU 8.8* deals with the application of *advanced prudential calculation approaches* on a consolidated basis.
- 8.1.11 G *BIPRU 8.9* sets out consolidated concentration risk requirements.

Consolidation requirements for BIPRU firms elsewhere in the Handbook

- 8.1.12 G *SYSC 12* (Group risk systems and controls requirement) deals with systems and controls requirements for groups.
- 8.1.13 G *GENPRU 1.2* (Adequacy of financial resources) deals with the detail about how *GENPRU 1.2* applies on a consolidated basis although the underlying requirement to apply it on a consolidated basis is in *BIPRU 8.2* and *BIPRU 8.3*.
- 8.1.14 G *BIPRU 11* (Disclosure) itself deals with how that chapter is applied on a consolidated basis.
- 8.1.15 G *GENPRU 3.1* (Cross sector groups) deals with *financial conglomerates*.
- 8.1.16 G *GENPRU 3.2* (Prudential rules for third country groups) deals, amongst other things, with banking and investment services groups headed by a *parent undertaking* outside the *EEA*.

8.2 Scope and basic consolidation requirements for UK consolidation groups

Main consolidation rule for UK consolidation groups

8.2.1 R A *firm* that is a member of a *UK consolidation group* must comply, to the extent and in the manner prescribed in *BIPRU* 8.5, with the obligations laid down in *GENPRU* 1.2 (Adequacy of financial resources), the *main BIPRU firm Pillar 1 rules* (but not the *base capital resources requirement*) and *BIPRU* 10 (Concentration risk requirements) on the basis of the consolidated financial position of:

- (1) where either Test 1A or Test 1B in *BIPRU* 8 Ann 1R (Decision tree identifying a UK consolidation group) apply, the *parent institution in a Member State* in the *UK consolidation group*; or
- (2) where either Test 1C or Test 1D in *BIPRU* 8 Ann 1R apply, the *parent financial holding company in a Member State*.

8.2.2 R Further to *BIPRU* 8.2.1R, a *firm* that is a member of a *UK consolidation group* must at all times ensure that the *consolidated capital resources* of the *UK consolidation group* are equal to or exceed its *consolidated capital resources requirement*.

8.2.3 G The *base capital resources requirement* does not apply on a consolidated basis.

Definition of UK consolidation group

8.2.4 R A *firm's UK consolidation group* means the group that is identified as a *UK consolidation group* in accordance with the decision tree in *BIPRU* 8 Annex 1R (Decision tree identifying a UK consolidation group).

8.2.5 R For the purposes of this chapter, what would otherwise be a *UK consolidation group* is not a *UK consolidation group* if all the members of that *UK consolidation group* wholly form part of another *UK consolidation group*.

8.2.6 G *BIPRU* 8 Annex 2G (Examples of how to identify a UK consolidation group) sets out examples of how to identify a *UK consolidation group*.

8.2.7 G *BIPRU* 8 Annex 1R (Decision tree identifying a UK consolidation group) shows that Articles 125 and 126 of the *Banking Consolidation Directive* are important in deciding whether the *FSA* is obliged to supervise a group or part of a group and hence whether that group or part of a group is a *UK consolidation group*. *BIPRU* 8 Annex 4G (Text of Articles 125 and 126 of the *Banking Consolidation Directive*) sets out these articles together with an explanation of how those articles should be read in the case of a group which also contains *CAD investment firms*.

8.3 Scope and basic consolidation requirements for non-EEA sub-groups

Main consolidation rule for non-EEA sub-groups

- 8.3.1 R (1) A *BIPRU firm* that is a *subsidiary undertaking* of a *BIPRU firm* or of a *financial holding company* must apply the requirements laid down in *GENPRU 1.2* (Adequacy of financial resources), the *main BIPRU firm Pillar 1 rules* (but not the *base capital resources requirement*) and *BIPRU 10* (Concentration risk requirements) on a sub-consolidated basis if the *BIPRU firm*, or the *parent undertaking* where it is a *financial holding company*, have a *third country banking or investment services undertaking* as a *subsidiary undertaking* or hold a *participation* in such an *undertaking*.
- (2) (1) only applies if the *FSA* is required by the *Banking Consolidation Directive* or the *Capital Adequacy Directive* to supervise the group established under (1) under Article 73(2) of the *Banking Consolidation Directive (Non-EEA sub-groups)*.

- 8.3.2 R Further to *BIPRU 8.3.1R*, a *firm* that is a member of a *non-EEA sub-group* must at all times ensure that the *consolidated capital resources* of that *non-EEA sub-group* are equal to or exceed its *consolidated capital resources requirement*.

- 8.3.3 G The *base capital resources requirement* does not apply on a consolidated basis.

- 8.3.4 G The sub-group identified in *BIPRU 8.3.1R* is called a *non-EEA sub-group*.

How to identify a non-EEA sub-group

- 8.3.5 G *BIPRU 8 Annex 3G* (Examples of how to identify a non-EEA sub-group) sets out examples of how to identify a *non-EEA sub-group*.

- 8.3.6 G The remainder of this section sets out a process for identifying a *non-EEA sub-group* in straightforward cases.

- 8.3.7 G A *firm* will not be a member of a *non-EEA sub-group* unless it also a member of a *UK consolidation group*. So the first step is to identify each *undertaking* in the *firm's UK consolidation group* that satisfies the following conditions:

- (1) it is an *institution, financial institution* or *asset management company* whose head office is outside the *EEA* (a *third country banking or investment services undertaking*);
- (2) one of the following applies:

- (a) it is a *subsidiary undertaking* of a *BIPRU firm* in that *UK consolidation group*; or
 - (b) a *BIPRU firm* in that *UK consolidation group* holds a *participation* in it; and
- (3) that *BIPRU firm* is not a *parent institution in a Member State*.
- 8.3.8 G The *sub-group* of the *BIPRU firm* identified in *BIPRU 8.3.7G(2)(a)* or *BIPRU 8.3.7G(2)(b)* is a potential *non-EEA sub-group*.
- 8.3.9 G If more than one *BIPRU firm* is a direct or indirect *parent undertaking* in accordance with *BIPRU 8.3.7G(2)(a)* then the *sub-groups* of each them are all potential *non-EEA sub-groups*. This is illustrated in example three in *BIPRU 8 Annex 3G (Examples of how to identify a non-EEA sub-group)*, where the *sub-group* of UK bank 1 and the *sub-group* of UK bank 2 are potential *non-EEA sub-groups*.
- 8.3.10 G Similarly if there is more than one *BIPRU firm* that holds a *participation* in the *third country banking or investment services undertaking* in accordance with *BIPRU 8.3.7G(2)(b)* then the *sub-group* of each such *BIPRU firm* is a potential *non-EEA sub-group*.
- 8.3.11 G The effect of *BIPRU 8.3.7G(3)* is that a *non-EEA sub-group* cannot be headed by a *parent institution in a Member State*. This is illustrated in example one of *BIPRU 8 Annex 3G (Examples of how to identify a non-EEA sub-group)*.
- 8.3.12 G The *firm* should then identify each *undertaking* in the *firm's UK consolidation group* that satisfies the following conditions:
- (1) it is an *institution, financial institution* or *asset management company* whose head office is outside the *EEA* (a *third country banking or investment services undertaking*);
 - (2) one of the following applies:
 - (a) it is a *subsidiary undertaking* of a *financial holding company* in that *UK consolidation group*; or
 - (b) a *financial holding company* in that *UK consolidation group* holds a *participation* in it;
 - (3) the head office of that *financial holding company* is in the *United Kingdom*; and
 - (4) that *financial holding company* has a *subsidiary undertaking* that is a *BIPRU firm*.
- 8.3.13 G The *sub-group* of the *financial holding company* identified in *BIPRU 8.3.12G(2)(a)* or *BIPRU 8.3.12G(2)(b)* is a potential *non-EEA sub-group*.

- 8.3.14 G The *financial holding company* identified in BIPRU 8.3.12G may be a *parent financial holding company in a Member State*. This is illustrated by example 2 of BIPRU 8 Annex 3G (Examples of how to identify a non-EEA sub-group).
- 8.3.15 G If more than one *financial holding company* is a direct or indirect *parent undertaking* in accordance with BIPRU 8.3.12G(2)(a) then the *sub-groups* of each them are all potential *non-EEA sub-groups*.
- 8.3.16 G Similarly if there is more than one *financial holding company* that holds a *participation* in the *third country banking or investment services undertaking* in accordance with BIPRU 8.3.12G(2)(b) then the *sub-group* of each such *financial holding company* is a potential *non-EEA sub-group*.
- 8.3.17 G The *firm* should apply the process in BIPRU 8.3.12G to a *third country banking or investment services undertaking* even though it may be also be part of a potential *non-EEA sub-group* under BIPRU 8.3.7G.
- 8.3.18 G Having identified potential *non-EEA sub-groups* for each *third country banking or investment services undertaking* in its *UK consolidation group* the *firm* should then eliminate overlapping potential *non-EEA sub-groups* in the following way. If:
- (1) one potential *non-EEA sub-group* is contained within a wider potential *non-EEA sub-group*; and
 - (2) the *third country banking or investment services undertakings* in the two potential *non-EEA sub-groups* are the same;
- then the smaller potential *non-EEA sub-group* is eliminated.
- 8.3.19 G If there is a chain of three or more potential *non-EEA sub-groups*, each with the same *third country banking or investment services undertakings*, the elimination process may remove all but the highest. This is illustrated in example three in BIPRU 8 Annex 3G (Examples of how to identify a non-EEA sub-group). In this example there are four potential *non-EEA sub-groups* and the elimination process results in just one remaining (the one headed by the *UK parent financial holding company in a Member State*).
- 8.3.20 G Each remaining potential *non-EEA sub-group* is a *non-EEA sub-group*, even though it may be part of a wider *non-EEA sub-group*.
- 8.3.21 G Examples four and five in BIPRU 8 Annex 3G (Examples of how to identify a non-EEA sub-group) show how the same group may contain two *non-EEA sub-groups* even though the smaller potential *non-EEA sub-group* is part of a bigger one. The reason for there being two *non-EEA sub-groups* in these examples is that one of the *third country banking or investment services undertakings* is not a member of both potential *non-EEA sub-groups*.

- 8.3.22 G If a *UK consolidation group* is headed by a *parent financial holding company in a Member State* the result of the elimination process may be that a *firm's UK consolidation group* contains only one *non-EEA sub-group* and that the *non-EEA sub-group* is the same as the *UK consolidation group*. In theory that means that there are two sets of consolidation requirements, one in relation to the *UK consolidation group* and one in relation to the *non-EEA sub-group*. However as the *UK consolidation group* and the *non-EEA sub-group* are the same, in practice this means that the additional *non-EEA sub-group* consolidation disappears. This is illustrated in example three in *BIPRU 8 Annex 3G (Examples of how to identify a non-EEA sub-group)*. The effect of *BIPRU 8.3.7G(3)* is that this is not the case if the *UK consolidation group* is headed by a *parent institution in a Member State*, as illustrated in example 1 in *BIPRU 8 Annex 3G*.
- 8.3.23 G Even where the requirements for a *non-EEA sub-group* are absorbed into those for the *UK consolidation group* a *firm* should still make clear in its regulatory reporting that the consolidation figures relate to a *UK consolidation group* and a *non-EEA sub-group* and that they both contain the same members.
- 8.3.24 G The examples in this section have so far assumed that the only *EEA State* involved is the *United Kingdom*. If a potential *non-EEA sub-group* that would otherwise be regulated by the *FSA* contains a potential *non-EEA sub-group* in another *EEA State* then the *United Kingdom* one is eliminated if the *third country banking or investment services undertakings* in the *UK* potential *non-EEA sub-group* and the potential *non-EEA sub-group* in the other *EEA State* are the same. The intention here is that the *EEA competent authority* closest to the *third country banking or investment services undertakings* should be responsible for the *non-EEA sub-group* subconsolidation. Example 6 in *BIPRU 8 Annex 3G (Examples of how to identify a non-EEA sub-group)* illustrates this situation.

8.4 CAD Article 22 groups and investment firm consolidation waiver

Application

- 8.4.1 R This section applies to a *BIPRU investment firm* with an *investment firm consolidation waiver*.

The effect of an investment firm consolidation waiver and the conditions for getting one

- 8.4.2 G A *BIPRU investment firm* may apply for a *waiver* of the requirement in this chapter to apply capital requirements on a consolidated basis. Such a *waiver* is called an *investment firm consolidation waiver*.

- 8.4.3 G An *investment firm consolidation waiver* will waive the application of *BIPRU 8.2.1R* and *BIPRU 8.2.2R* (if it applies with respect to a *UK consolidation group*) or *BIPRU 8.3.1R* and *BIPRU 8.3.2R* (if it applies with respect to a *non-EEA sub-group*). The effect will be to switch off this chapter with respect to the group in question apart from this section.

- 8.4.4 G The *FSA* will not grant an *investment firm consolidation waiver* unless:

- (1) the *UK consolidation group* or *non-EEA sub-group* meets the conditions for being a *CAD Article 22 group*;
- (2) the *FSA* is satisfied that each *BIPRU firm* in the *UK consolidation group* or *non-EEA sub-group* will be able to meet its capital requirements using the calculation of *capital resources* in *GENPRU 2 Annex 6R* (Capital resources table for a *BIPRU investment firm* with a waiver from consolidated supervision); and
- (3) the *firm* demonstrates that the requirements in *BIPRU 8.4.11R* to *BIPRU 8.4.18R* will be met.

- 8.4.5 G The standards in *BIPRU 8.4.4G* are minimum standards. Satisfaction of these conditions does not automatically mean the *FSA* will give an *investment firm consolidation waiver*. The *FSA* will in addition also apply the tests in section 148 of the *Act* (Modification or waiver of rules).

- 8.4.6 G *SUP 8* (Waiver and modification of rules) and *BIPRU 1.3* (Application for advanced approaches) are also relevant to applications for an *investment firm consolidation waiver*.

Meeting the terms of an investment firm consolidation waiver

- 8.4.7 R If a *firm* has an *investment firm consolidation waiver* with respect to its *UK consolidation group* or *non-EEA sub-group* but that *UK consolidation group* or *non-EEA sub-group* ceases to meet the definition of a *CAD Article 22 group* the *firm* must comply with the rest of this chapter rather than this section notwithstanding the *investment firm consolidation waiver*.
- 8.4.8 G Compliance with the capital requirements set out in *BIPRU 8.4.11R* is a condition under the *Capital Adequacy Directive* for the exemption from capital requirements. Thus if they are breached the *FSA* is likely to revoke the *investment firm consolidation waiver*.

Definition of a CAD Article 22 group

- 8.4.9 R
- (1) A *CAD Article 22 group* means a *UK consolidation group* or *non-EEA sub-group* that meets the conditions in this rule.
 - (2) There must be no *bank*, *building society* or *credit institution* in the *UK consolidation group* or *non-EEA sub-group*.
 - (3) Each *CAD investment firm* in the *UK consolidation group* or *non-EEA sub-group* which is an *EEA firm* must use the definition of own funds given in the *CRD implementation measure* of its *EEA State* for Article 16 of the *Capital Adequacy Directive*.
 - (4) Each *CAD investment firm* in the *UK consolidation group* or *non-EEA sub-group* must be a:
 - (a) *limited activity firm*; or
 - (b) *limited licence firm*.
 - (5) Each *CAD investment firm* in the *UK consolidation group* or *non-EEA sub-group* which is an *EEA firm* must:
 - (a) meet the requirements imposed by the *CRD implementation measures* of its *EEA State* for Articles 18 and Article 20 of the *Capital Adequacy Directive* on an individual basis; and
 - (b) deduct from its own funds any contingent liability in favour of other members of the *UK consolidation group* or *non-EEA sub-group*.
 - (6) Each *BIPRU investment firm* in the *UK consolidation group* or *non-EEA sub-group* must comply with the *main BIPRU firm Pillar 1 rules* on an individual basis.

- 8.4.10 G *GENPRU 2.2 (Capital resources)* says that a *BIPRU investment firm* with an *investment firm consolidation waiver* should calculate its *capital resources* on a solo basis using *GENPRU 2 Annex 6R (Capital resources table for a BIPRU investment firm with a waiver from consolidated supervision)*. *GENPRU 2 Annex 6R* requires a *BIPRU investment firm* to deduct contingent liabilities in favour of other members of the *UK consolidation group* or *non-EEA sub-group*. Therefore *BIPRU 8.4.9R(5)(b)* only imposes the requirement to deduct them on *EEA firms*.

Capital adequacy obligations relating to a CAD Article 22 group: General rule

- 8.4.11 R If a *firm* has an *investment firm consolidation waiver*, it must ensure that any *financial holding company* in the *UK consolidation group* or the *non-EEA sub-group* that is the *UK parent financial holding company in a Member State* of a *CAD investment firm* in the *UK consolidation group* or *non-EEA sub-group* has capital resources, calculated under *BIPRU 8.4.12R*, in excess of the sum of the following (or any higher amount specified in the *investment firm consolidation waiver*):
- (1) the sum of the solo notional capital resources requirements for each *CAD investment firm, financial institution, asset management company* and *ancillary services undertaking* in the *UK consolidation group* or the *non-EEA sub-group*, as calculated in accordance with *BIPRU 8.4.13R*; and
 - (2) the total amount of any contingent liability in favour of *CAD investment firms, financial institutions, asset management companies* and *ancillary services undertakings* in the *UK consolidation group* or *non-EEA sub-group*.

Capital adequacy obligations relating to a CAD Article 22 group: Capital resources

- 8.4.12 R A *firm* must calculate the capital resources of the *parent financial holding company in a Member State* for the purpose of *BIPRU 8.4.11R* as follows:
- (1) the capital resources are the sum of *capital resources* calculated at stages D (Total tier one capital before deductions) and I (Total tier two capital) of the version of the *capital resources table* in *GENPRU 2 Annex 4R (Capital resources table for a BIPRU investment firm deducting material holdings)* as adjusted in accordance with this rule;
 - (2) *capital resources* at stage D must not include *innovative tier one capital resources*, but they may be included at stage I if (5) allows this;
 - (3) the amount of the items which may be included at stage I must not exceed the amount calculated at stage D of the *capital resources table*;

- (4) the amount of the items which may be included in *lower tier two capital* in stage I must not exceed 50% of the amount calculated at stage D of the *capital resources table*; and
- (5) *GENPRU 2.2.25R* (Limits on the use of different forms of capital: Use of higher tier capital in lower tiers) and *GENPRU 2.2.27R* (Use of *innovative tier one capital* in lower stages of capital) apply.

Capital adequacy obligations relating to a CAD Article 22 group: Capital resources requirement

- 8.4.13 R The solo notional capital resources requirement as referred to in *BIPRU 8.4.11R(1)* is calculated in the same way as:
- (1) (if each *CAD investment firm* in the *UK consolidation group* or *non-EEA sub-group* is a *limited licence firm*) the *capital resources requirement* for a *BIPRU limited licence firm*; or
 - (2) (in any other case) the *capital resources requirement* for a *BIPRU limited activity firm*.
- 8.4.14 R A *firm* must exclude *material holdings* in the notional calculation of the *credit risk capital requirement* for the purposes of *BIPRU 8.4.13R*. A *firm* must identify whether it has any *material holdings* and the amount of them in accordance with *GENPRU 2.2* (Capital resources) and *GENPRU 2 Annex 4R* (Capital resources table for a *BIPRU investment firm* deducting material holdings).
- 8.4.15 G The notional capital resources requirement calculated under *BIPRU 8.4.13R* need not include a credit charge for *material holdings*. However it should include one for *illiquid assets*.
- 8.4.16 R Intra-group *exposures* must not be netted for the purpose of *BIPRU 8.4.11R*.

Capital adequacy obligations relating to a CAD Article 22 group: Advanced prudential calculation approaches

- 8.4.17 R A *firm* may not use an *advanced prudential calculation approach* for the purpose of *BIPRU 8.4.11R*.

Additional rules that apply to a firm with an investment firm consolidation waiver

- 8.4.18 R If a *firm* has an *investment firm consolidation waiver*, it must:
- (1) ensure that each *CAD investment firm* in the *UK consolidation group* or *non-EEA sub-group* which is a *firm* or an *EEA firm* has in place systems to monitor and control the sources of capital and funding of all the members in the *UK consolidation group* or *non-EEA sub-group*;

- (2) notify the *FSA* of any serious risk that could undermine the financial stability of the *UK consolidation group* or *non-EEA sub-group*, as soon as the *firm* becomes aware of that risk, including those associated with the composition and sources of the capital and funding of members of the *UK consolidation group* or *non-EEA sub-group*;
- (3) report the amount of the *consolidated capital resources* and *consolidated capital resources requirement* of the *UK consolidation group* or *non-EEA sub-group* on a periodic basis as set out in the *investment firm consolidation waiver*;
- (4) report any *large exposures* risks of members of the *UK consolidation group* or *non-EEA sub-group* including any *undertakings* not located in an *EEA State* on a periodic basis set out in the *investment firm consolidation waiver*;
- (5) notify the *FSA* immediately it becomes aware that the *UK consolidation group* or *non-EEA sub-group* has ceased to meet the conditions for being a *CAD Article 22 group*; and
- (6) notify the *FSA* immediately it becomes aware of any breach of *BIPRU 8.4.11R*.

8.4.19 G Although an *investment firm consolidation waiver* switches off most of this chapter, a *firm* should still carry out the capital adequacy calculations in *BIPRU 8.3* to *BIPRU 8.8* as if those parts of this chapter still applied to the *UK consolidation group* or *non-EEA sub-group* and report these to the *FSA*. It should also still monitor *large exposure* risk on a consolidated basis.

8.5 Basis of consolidation

Undertakings to be included in consolidation

8.5.1 R A *firm* must include only the following types of *undertaking* in a *UK consolidation group* or *non-EEA sub-group* for the purposes of this chapter:

- (1) a *BIPRU firm*;
- (2) an *institution*;
- (3) a *financial institution*;
- (4) an *asset management company*;
- (5) a *financial holding company*; and
- (6) an *ancillary services undertaking*.

8.5.2 G Although an *undertaking* falling outside *BIPRU* 8.5.1R will not be included in a *UK consolidation group* or *non-EEA sub-group* it may be relevant in deciding whether one *undertaking* in the *banking sector* or the *investment services sector* is a *subsidiary undertaking* of another with the result that they should be included in the same *UK consolidation group* or *non-EEA sub-group*.

8.5.3 G An example of *BIPRU* 8.5.2G is as follows. Say that the *undertaking* at the head of a *bank's UK group* is a *parent financial holding company in a Member State*. One of its *subsidiary undertakings* is the *bank*. The *parent financial holding company in a Member State* also has an *insurer* as a *subsidiary undertaking*. That *insurer* has several *investment firms* as *subsidiary undertakings*. Say that the *UK group* is not a *financial conglomerate*. The *UK consolidation group* will include the *parent financial holding company in a Member State* and the *bank*. It will also include the *investment firms* that are *subsidiary undertakings* of the *insurer*. This is because the *investment firms* are *subsidiary undertakings* of the *parent financial holding company in a Member State* through the *parent financial holding company in a Member State's* holding in the *insurer*. However it will not include the *insurer* itself.

Basis of inclusion of undertakings in consolidation

8.5.4 R A *firm* must include any *subsidiary undertaking* in the *UK consolidation group* or *non-EEA sub-group* in full in the calculations in this chapter.

8.5.5 R In carrying out the calculations for the purposes of this chapter a *firm* must only include the relevant proportion of an *undertaking* that is a member of the *UK consolidation group* or *non-EEA sub-group*:

- (1) by virtue of a *consolidation Article 12(1) relationship*;

- (2) by virtue of an *Article 134 relationship*; or
- (3) because the group holds a *participation* in it.

8.5.6 R In *BIPRU* 8.5.5R, the relevant proportion is either:

- (1) (in the case of a *participation*) the proportion of *shares* issued by the *undertaking* held by the *UK consolidation group* or the *non-EEA sub-group*; or
- (2) (in the case of a *consolidation Article 12(1) relationship* or an *Article 134 relationship*), such proportion (if any) as stated in the *Part IV permission* of the *firm*.

Basis of inclusion of UCITS investment firms in consolidation

8.5.7 R *GENPRU* 2.1.46R (Adjustment of the variable capital requirement calculation for UCITS investment firms) and *BIPRU* 10.1.5R (Restricted application for UCITS investment firms) do not apply for the purpose of this chapter.

8.5.8 G In general a *UCITS investment firm* only calculates its capital and concentration risk requirements in relation to its *designated investment business* and does not calculate them with respect to *scheme management activity*. The effect of *BIPRU* 8.5.7R is that this does not apply on a consolidated basis. For the purpose of this chapter the calculations are carried with respect to the whole of the activities of a *UCITS investment firm*.

Exclusion of undertakings from consolidation: Balance sheet size

8.5.9 R A *firm* may, having first notified the *FSA* in writing in accordance with *SUP* 15.7 (Form and method of notification), exclude an *institution, asset management company, financial institution* or *ancillary services undertaking* that is a *subsidiary undertaking* in, or an *undertaking* in which a *participation* is held by, the *UK consolidation group* or *non-EEA sub-group* if the balance sheet total of that *undertaking* is less than the smaller of the following two amounts:

- (1) 10 million Euros;
- (2) 1% of the balance sheet total of the *parent undertaking* or the *undertaking* that holds the *participation*.

8.5.10 R A *firm* must include *undertakings*, to which *BIPRU* 8.5.9R would otherwise apply, if the balance sheet total of those *undertakings* taken together breaches the limit in *BIPRU* 8.5.9R.

Exclusion of undertakings from consolidation: Other reasons

8.5.11 G Article 73(1) of the *Banking Consolidation Directive* allows the *FSA* to decide to exclude an *institution*, *financial institution*, *asset management company* or *ancillary services undertaking* that is a *subsidiary undertaking* in, or an *undertaking* in which a *participation* is held by, the *UK consolidation group* or *non-EEA sub-group* for the purposes of this chapter in the following circumstances:

- (1) where the head office of the *undertaking* concerned is situated in a country outside the *EEA* where there are legal impediments to the transfer of the necessary information; or
- (2) where, in the opinion of the *FSA*, the *undertaking* concerned is of negligible interest only with respect to the objectives of monitoring *institutions*; or
- (3) where, in the opinion of the *FSA*, the consolidation of the financial situation of the *undertaking* concerned would be inappropriate or misleading as far as the objectives of the supervision of *institutions* are concerned.

8.5.12 G If a *firm* wishes to exclude an *undertaking* on the basis of any of the grounds set out in *BIPRU* 8.5.11G it should apply to the *FSA* for a *waiver*. The *FSA* will consider such applications in the light of the criteria in section 148 of the *Act*.

8.5.13 G If several *undertakings* meet the criteria in *BIPRU* 8.5.11G(2), the *FSA* will not agree to a *waiver* to exclude them all from consolidation where collectively they are of non-negligible interest with respect to the objectives of the supervision of *institutions*.

Information about excluded undertakings

8.5.14 G The *FSA* may require a *firm* to provide information about the *undertakings* excluded from consolidation of the *UK consolidation group* or *non-EEA sub-group* pursuant to this section.

8.6 Consolidated capital resources

General

- 8.6.1 R A *firm* must calculate the *consolidated capital resources* of its *UK consolidation group* or its *non-EEA sub-group* by applying *GENPRU 2.2 (Capital resources)* to its *UK consolidation group* or *non-EEA sub-group* on an accounting consolidation basis, treating the *UK consolidation group* or *non-EEA sub-group* as a single *undertaking*. The *firm* must adjust *GENPRU 2.2* in accordance with this section for this purpose.

Limits on the use of different forms of capital

- 8.6.2 R The *capital resources gearing rules* apply for the purposes of calculating *consolidated capital resources*. They apply to the *UK consolidation group* or *non-EEA sub-group* on an accounting consolidation basis, treating the *UK consolidation group* or *non-EEA sub-group* as a single *undertaking*.
- 8.6.3 G As the various components of capital differ in the degree of protection that they offer, the *capital resources gearing rules* as applied on a consolidated basis place restrictions on the extent to which certain types of capital are eligible for inclusion in a *UK consolidation group* or *non-EEA sub-group's consolidated capital resources*. *GENPRU 2.2.25R (Limits on the use of different forms of capital: Use of higher tier capital in lower tiers)* also applies.
- 8.6.4 G The prohibition in *GENPRU 2.2 (Capital resources)* on including *innovative tier one capital* in *tier one capital* for the purposes of meeting capital resources requirements applies under this section. However *GENPRU 2.2.27R (Innovative tier one capital may be included in lower stages of capital when excluded from tier one capital)* also applies. So, for example, a *firm* should not include *consolidated indirectly issued capital* in *tier one capital* but should generally include it as *upper tier two capital*.
- 8.6.5 G The *rules* in *GENPRU 2.2 (Capital resources)* on what *tier two capital* and *tier three capital* can be used for also apply under this section.

Calculation of consolidated capital resources if there is a building society in the group

- 8.6.6 R Where a *firm's UK consolidation group* or *non-EEA sub-group* includes a *building society*, the *firm* must calculate that group's *consolidated capital resources* using the calculation of *capital resources* for *building societies*.

Calculation of consolidated capital resources if there is a bank or credit institution in the group

- 8.6.7 R Where a *firm's UK consolidation group* or *non-EEA sub-group* includes a *bank* or *credit institution* but not a *building society*, the *firm* must calculate that group's *consolidated capital resources* using the calculation of *capital resources* for *banks*.

Calculation of consolidated capital resources for an investment firm group

- 8.6.8 R Where a *firm's UK consolidation group* or *non-EEA sub-group* does not include a *bank*, *building society* or *credit institution*, the *firm* must calculate that group's *consolidated capital resources* using the calculation of *capital resources* in *GENPRU 2 Annex 4R* (Capital resources table for a BIPRU investment firm deducting material holdings) or *GENPRU 2 Annex 5R* (Capital resources table for a BIPRU investment firm deducting illiquid assets).
- 8.6.9 R A *firm* must give one *Month's* prior notice to the *FSA* before starting to use or stopping using the method in *GENPRU 2 Annex 5R* (Capital resources table for a BIPRU investment firm deducting illiquid assets).

Treatment of minority interests

- 8.6.10 R (1) This *rule* sets out how to determine whether minority interests in an *undertaking* in a *UK consolidated group* or *non-EEA sub-group* may be included in *tier one capital*, *tier two capital* or *tier three capital* for the purpose of calculating *consolidated capital resources* (each referred to as a "tier" of capital in this *rule*).
- (2) A *firm* must identify the item of capital of the *undertaking* in question that gives rise to that minority interest.
- (3) A *firm* must include the minority interest in the tier of capital in which that *undertaking* would have to include the capital referred to in (2) if it were a *firm* calculating its *capital resources* on a solo basis under whichever method applies to the group under *BIPRU 8.6.6R* to *BIPRU 8.6.9R*.
- (4) This *rule* does not apply to a minority interest created by *consolidated indirectly issued capital*.

Indirectly issued capital and group capital resources

- 8.6.11 R For the purposes of this chapter, *GENPRU 2.2.123R* to *GENPRU 2.2.137R* (Indirectly issued tier one capital (BIPRU firm only)) do not apply. A *firm* may only include *consolidated indirectly issued capital* in *consolidated capital resources* (whether as a minority interest or otherwise) in accordance with this section.
- 8.6.12 R *Consolidated indirectly issued capital* means any *capital instrument* issued by a member of the *UK consolidation group* or *non-EEA sub-group* where:
- (1) some or all of the following conditions are satisfied:

- (a) that capital is issued to an *SPV*; or
 - (b) that capital is issued by an *SPV*; or
 - (c) the subscription for the capital issued by the member of the group in question is funded directly or indirectly by an *SPV*; and
- (2) any of the *SPVs* referred to in (1) is a member of the *UK consolidation group* or *non-EEA sub-group* or a *subsidiary undertaking* of any member of the *UK consolidation group* or *non-EEA sub-group*.
- 8.6.13 R A *firm* may only include *consolidated indirectly issued capital* in the *consolidated capital resources* of its *UK consolidation group* or *non-EEA sub-group* if:
- (1) it is issued by an *SPV* that is a member of the *UK consolidation group* or *non-EEA sub-group* to *persons* who are not members of the *UK consolidation group* or *non-EEA sub-group*; and
 - (2) the conditions in *BIPRU* 8.6.16R to 8.6.18R are satisfied.
- 8.6.14 R *Consolidated indirectly issued capital* that is eligible for inclusion in the *consolidated capital resources* of a *UK consolidation group* or *non-EEA sub-group* may only be included as a minority interest created by the *capital instrument* issued by the *SPV* referred to in *BIPRU* 8.6.13R. If it is eligible, it is *innovative tier one capital*.
- 8.6.15 R For the purposes of this section, an *undertaking* is an *SPV* if the main activity of the *SPV* is to raise funds for *undertakings* in:
- (1) (in the case of a *UK consolidation group*) that *UK consolidation group*; or
 - (2) (in the case of a *non-EEA sub-group*) that *non-EEA sub-group* or any *UK consolidation group* of which it forms part.
- 8.6.16 R The *SPV* referred to in *BIPRU* 8.6.13R must satisfy the conditions in *GENPRU* 2.2.127R (Conditions that an *SPV* has to satisfy if indirectly issued capital is to be included in *capital resources* on a solo basis) as modified by the following:
- (1) references in *GENPRU* 2.2.127R(1) to being controlled by the *firm* are to being controlled by a member of the *firm's UK consolidation group* or *non-EEA sub-group* as the case may be; and
 - (2) references to the *firm's group* are to the *firm's UK consolidation group* or *non-EEA sub-group* as the case may be.

- 8.6.17 R The capital issued by the *SPV* referred to in *BIPRU* 8.6.13R must satisfy the conditions in *GENPRU* 2.2.129R (Conditions that capital issued by an *SPV* has to satisfy if indirectly issued capital is to be included in *capital resources* on a solo basis) as modified by the following:
- (1) references to the *firm's group* are to the *firm's UK consolidation group* or *non-EEA sub-group* as the case may be;
 - (2) the substitution obligation in *GENPRU* 2.2.129R(2) need not be the *firm's* but may apply to any member of the *UK consolidation group* or *non-EEA sub-group* as the case may be; and
 - (3) that substitution obligation applies if the *consolidated capital resources* of the *UK consolidation group* or *non-EEA sub-group*, as the case may be, fall, or are likely to fall, below its *consolidated capital resources requirement*.
- 8.6.18 R The *SPV* referred to in *BIPRU* 8.6.13R must invest the funds raised from the issue of capital by the *SPV* by subscribing for capital resources issued by an *undertaking* that is a member of the *UK consolidation group* or *non-EEA sub-group*. Those capital resources must satisfy the following conditions:
- (1) those capital resources must at least comply with the requirements for *lower tier two capital*; and
 - (2) the first call date or fixed maturity date (if any) of those capital resources must not arise before the first call date on the instrument issued by the *SPV*.
- 8.6.19 R In relation to the obligation to substitute described in *BIPRU* 8.6.17R(2), a *firm* must take all reasonable steps to ensure that the *undertaking* in question has at all times sufficient authorised and unissued *tier one instruments* other than *innovative tier one instruments* (and authority to issue them) to enable it to discharge the obligation to substitute.
- 8.6.20 R A *firm* must comply with the requirements set out in *GENPRU* 2.2.135R (Notifying the *FSA* of unusual transactions in relation to indirectly issued capital) and *GENPRU* 2.2.137R (Contents of marketing documents in relation to indirectly issued capital) in relation to *consolidated indirectly issued capital* included in *consolidated capital resources*.

8.7 Consolidated capital resources requirements

General approach

- 8.7.1 G The calculation of the *consolidated capital resources requirement* of a firm's UK consolidation group or non-EEA sub-group involves taking the individual components that make up the *capital resources requirement* on a solo basis and applying them on a consolidated basis. Those components are the capital charge for credit risk (the *credit risk capital requirement*), the capital charge for market risk (the *market risk capital requirement*), the capital charge for *operational risk* (the *operational risk capital requirement*) and the *fixed overheads requirement*.
- 8.7.2 G Each of the capital charges in BIPRU 8.7.1G, as applied on a consolidated basis, is called a *consolidated requirement component*. The name of each *consolidated requirement component* reflects the solo capital charge on which it is based. Solo capital charges are called *risk capital requirements*. Thus for example the *consolidated requirement component* for market risk is called the *consolidated market risk requirement*. The calculation of the *consolidated market risk requirement* is based on the calculation of the capital charge for market risk that applies on a solo basis (the *market risk capital requirement*). So the *risk capital requirement* applicable to the *consolidated market risk requirement* is the *market risk capital requirement*.
- 8.7.3 G The first step is for a firm to identify what sort of group it belongs to as the calculation of the *consolidated capital resources requirement* differs between different types of groups. This is set out in BIPRU 8 Annex 5R (Decision tree for identifying the consolidated capital resources requirement of a UK consolidation group or a non-EEA sub-group). BIPRU 8 Annex 5R shows, for each type of group:
- (1) which of the *consolidated requirement components* apply and which do not; and
 - (2) how to add up the different *consolidated requirement components* to reach the overall *consolidated capital resources requirement*.
- 8.7.4 G BIPRU 8 Annex 5R (Decision tree for identifying the consolidated capital resources requirement of a UK consolidation group or a non-EEA sub-group) categorises groups by reference to what kind of *undertakings* they contain (*credit institutions, limited licence firms, limited activity firms* or *CAD full scope firms*).
- 8.7.5 G In general a firm should calculate each *consolidated requirement component* using the FSA's rules, even in the case of group members who are subject to the capital requirements of an overseas regulator. However this section sets out certain circumstances in which a firm may use the capital requirements of an overseas regulator.

- 8.7.6 G *BIPRU 8.8 (Advanced prudential calculation approaches) says that a firm should not apply an advanced prudential calculation approach on a consolidated basis unless the advanced prudential calculation approach permission allowing the firm to use the advanced prudential calculation approach specifically allows it to be used on consolidated basis.*
- 8.7.7 G *BIPRU 8.8 (Advanced prudential calculation approaches) has further details about how capital requirements are calculated on a consolidated basis if a firm uses an advanced prudential calculation approach.*
- 8.7.8 G *A firm has a choice about how it should apply a risk capital requirement to the group. It may do this by treating the whole of the group as a single entity and applying the risk capital requirement to the group (a line by line approach), calculating a separate risk capital requirement for each group member (an aggregation approach) or a mixture of the two.*
- 8.7.9 G *A firm may make the choice between an aggregation and a line by line approach differently for each consolidated requirement component. So for example a firm may decide to calculate the consolidated market risk requirement on an aggregation basis and the consolidated fixed overheads requirement on a line by line basis.*

Method of calculation to be used

- 8.7.10 R *A firm must calculate the consolidated capital resources requirement of its UK consolidation group or non-EEA sub-group in accordance with the method identified by the decision tree in BIPRU 8 Ann 5R (Decision tree for identifying the consolidated capital resources requirement of a UK consolidation group or a non-EEA sub-group).*

Calculation of the consolidated requirement components

- 8.7.11 R *A firm must calculate a consolidated requirement component by applying the risk capital requirement applicable to that consolidated requirement component to the UK consolidation group or non-EEA sub-group in accordance with BIPRU 8.7.13R. Except where BIPRU 8.7.34R to BIPRU 8.7.38R allow the requirements of another regulator to be used, the risk capital requirement must be calculated in accordance with the FSA's rules. The risk capital requirement applicable to a consolidated requirement component is the one specified in the second column of the table in BIPRU 8.7.12R.*

- 8.7.12 R Table: Capital charges relating to consolidated requirement components
This table belongs to *BIPRU 8.7.11R*

<i>Consolidated requirement component</i>	<i>Rules on which the consolidated requirement component are based (the applicable risk capital requirement)</i>
<i>Consolidated credit risk requirement</i>	<i>Credit risk capital requirement</i>
<i>Consolidated fixed overheads requirement</i>	<i>Fixed overheads requirement</i>
<i>Consolidated market risk requirement</i>	<i>Market risk capital requirement</i>
<i>Consolidated operational risk requirement</i>	<i>Operational risk capital requirement</i>

Choice of consolidation method

- 8.7.13 R (1) A *firm* must calculate a *consolidated requirement component* by using one of the methods in this *rule*.
- (2) Under the first method a *firm* must:
- (a) apply the *risk capital requirement* set out in *BIPRU 8.7.12R* to each *undertaking* in the *UK consolidation group* or *non-EEA sub-group*; and
 - (b) add the *risk capital requirements* together.
- (3) Under the second method a *firm* must:
- (a) treat the whole *UK consolidation group* or *non-EEA sub-group* as a single *undertaking*; and
 - (b) apply the *risk capital requirement* set out in *BIPRU 8.7.12R* to the group on an accounting consolidation basis.
- (4) The third method is a mixture of methods one and two. Under the third method a *firm* must:
- (a) treat one or more parts of the *UK consolidation group* or *non-EEA sub-group* as separate single *undertakings*;

- (b) apply the *risk capital requirement* set out in *BIPRU 8.7.12R* to each such part of the group on an accounting consolidation basis;
 - (c) apply the *risk capital requirement* set out in *BIPRU 8.7.12R* to each of the remaining *undertakings* in the *UK consolidation group* or *non-EEA sub-group* (if any); and
 - (d) add the *risk capital requirements* together.
- (5) A *firm* may use different methods for different *consolidated requirement components*.

8.7.14 G An accounting consolidation basis means applying the *rules* in *BIPRU 8.7.12R* on a line by line consolidation basis rather than an aggregation basis.

8.7.15 G The provisions of this section on credit risk and market risk restrict the choice given by *BIPRU 8.7.13R* in certain circumstances.

Notifying the FSA of the choice of consolidation technique

8.7.16 R A *firm* must notify the *FSA* which method under *BIPRU 8.7.13R* it applies for which *consolidated requirement component* and to which parts of the *UK consolidation group* or *non-EEA sub-group* it is applying an aggregation approach and to which parts it is applying an accounting consolidation approach.

Special rules for the consolidated credit risk requirement

8.7.17 R *BIPRU 8.7.18G* to *BIPRU 8.7.23R* relate to the calculation of the *consolidated credit risk requirement*.

8.7.18 G The *credit risk capital requirement* (on which the *consolidated credit risk requirement* is based) is split into three capital charges. One relates to credit risk in the *non-trading book* (the *credit risk capital component*). One relates to credit risk in the *trading book* (the *counterparty risk capital component*). The third is a capital charge for *exposures* in the *trading book* that exceed the limits in *BIPRU 10.5* (Limits on exposures and large exposures). This is called the *concentration risk capital component*. *BIPRU 8.9* (Consolidated concentration risk requirements) explains how to calculate the part of the *consolidated credit risk requirement* that corresponds to the *concentration risk capital component*.

8.7.19 G In particular *BIPRU 8.9* (Consolidated concentration risk requirements) says that a *firm* should calculate the part of the *consolidated credit risk requirement* that corresponds to the *concentration risk capital component* on an accounting consolidation basis. This means using method two in *BIPRU 8.7.13R*.

- 8.7.20 R A *firm* may use a combination of the *CCR standardised method*, the *CCR mark to market method* and the *CCR internal model method* on a permanent basis with respect to the *firm's UK consolidation group* or *non-EEA sub-group* for the purposes of calculating the *consolidated credit risk requirement*. In particular, where the *firm* is permitted to apply the *CCR internal model method* on a consolidated basis with respect to its *UK consolidation group* or *non-EEA sub-group*, it may combine the use of *CCR standardised method* and *CCR mark to market method* on a permanent basis for *financial derivative instruments* and *long settlement transactions* not covered by its *CCR internal model method permission*.
- 8.7.21 R *BIPRU 9.4.1R* (Minimum requirements for recognition of significant credit risk transfer) as applied on a consolidated basis requires the transfer to be to a *person* outside the *UK consolidation group* or *non-EEA sub-group*.
- 8.7.22 R A *firm* must not use both the *financial collateral simple method* and the *financial collateral comprehensive method* with respect to its *UK consolidation group* or *non-EEA sub-group*.
- 8.7.23 R (1) A *firm* may only treat an *exposure* as exempt under *BIPRU 3.2.25R* (Zero risk-weighting for intra-group exposures) as applied on a consolidated basis if the member of the *UK consolidation group* or *non-EEA sub-group* that has the *exposure*:
- (a) is a *BIPRU firm* and that *exposure* is exempt under *BIPRU 3.2.25R* as it applies to that *BIPRU firm* on a solo basis; or
 - (b) meets the conditions in *BIPRU 3.2.25R(1)(d)* (Condition relating to establishment in the *UK*) and that *exposure* would be exempt under (a) if that member was a *BIPRU firm*.
- (2) The notification obligation in *BIPRU 3.2.35R* applies.

Special rules for the consolidated market risk requirement

- 8.7.24 R For the purposes of calculating the *consolidated market risk requirement* of a *UK consolidation group* or *non-EEA sub-group*, a *firm* must apply *BIPRU 1.2.3R* (Definition of the *trading book*) and *BIPRU 1.2.17R* (Size thresholds for the purposes of the definition of the *trading book*) to the whole *UK consolidation group* or *non-EEA sub-group* as if the group were a single *undertaking*.

- 8.7.25 R A *firm* may not apply the second method in *BIPRU* 8.7.13R(3) (accounting consolidation for the whole group) or apply accounting consolidation to parts of its *UK consolidation group* or *non-EEA sub-group* under method three as described in *BIPRU* 8.7.13R(4)(a) for the purposes of the calculation of the *consolidated market risk requirement* unless the group or sub-group and the *undertakings* in that group or sub-group satisfy the conditions in this *rule*. Instead the *firm* must use the aggregation approach described in *BIPRU* 8.7.13R(2) (method one) or *BIPRU* 8.7.13R(4)(c). Those conditions are as follows:
- (1) each of the *undertakings* in that group or sub-group is an *institution* that is:
 - (a) a *BIPRU firm*;
 - (b) an *EEA firm*;
 - (c) a *recognised third country credit institution*; or
 - (d) a *recognised third country investment firm*;
 - (2) each of the *undertakings* referred to in (1) that is a *BIPRU firm* has *capital resources* that are equal to or in excess of its *capital resources requirement* and complies with *BIPRU* 10 (Concentration risk requirements);
 - (3) each of the *undertakings* referred to in (1) that is an *EEA firm* complies with the *CRD implementation measures* in its *EEA State* that correspond to the requirements in (2);
 - (4) each of the *undertakings* referred to in (1) that is a *recognised third country credit institution* or *recognised third country investment firm* complies with laws in the state or territory in which it has its head office that are equivalent to the requirements of the *Banking Consolidation Directive* or *Capital Adequacy Directive* relating to capital adequacy and concentration risk;
 - (5) there is no material legal, regulatory or contractual impediment to the transfer of funds between those *undertakings* in that group or sub-group;
 - (6) there is no material legal, regulatory or contractual impediment to mutual financial support between those *undertakings* in that group or sub-group;
 - (7) the *market risk positions* of the *undertakings* are monitored and managed on a co-ordinated basis; and
 - (8) there is satisfactory allocation of capital within the group or sub-group.

Special rules for the consolidated operational risk requirement

- 8.7.26 R For the purposes of calculating the *consolidated operational risk requirement*, a *firm* must apply *BIPRU 6.2.9R* to *BIPRU 6.2.12R* (Combination of different methodologies) to the whole *UK consolidation group* or *non-EEA sub-group* as if the group were a single *undertaking*.
- 8.7.27 R (1) This *rule* sets out how *BIPRU 6.3.2R(3)* (Negative figure arising in calculation of the relevant indicator under the *basic indicator approach*) applies on a consolidated basis.
- (2) If the calculation for any individual *undertaking* under method one in *BIPRU 8.7.13R(2)* (application of aggregation approach to the whole group) or method three as described in *BIPRU 8.7.13R(4)(c)* (mixture of aggregation and accounting consolidation) or for any sub-group created under method three as described in *BIPRU 8.7.13R(4)(a)* results in a figure of zero or a negative figure, that figure must be excluded.
- (3) If a *firm* is using method two in *BIPRU 8.7.13R* (accounting consolidation approach for the whole group), *BIPRU 6.3.2R(3)* applies to the *UK consolidation group* or *non-EEA sub-group* as if it were a single *undertaking*.
- (4) (3) also applies to a sub-group created under method 3 as described in *BIPRU 8.7.13R(4)(a)*.

Special rules for calculating specific consolidated requirement components

- 8.7.28 G *BIPRU 8.7.21R* to *BIPRU 8.7.26R* are generally examples of the application of the general principles in *BIPRU 8.2.1R* (Main consolidation *rule* for *UK consolidation groups*) and *BIPRU 8.3.1R* (Main consolidation *rule* for *non-EEA sub-groups*). *BIPRU 8.7.20R* and *BIPRU 8.7.25R* are exceptions to those principles.

Elimination of intra-group transactions

- 8.7.29 R In accordance with *BIPRU 8.2.1R* and *BIPRU 8.3.1R* (The basic consolidation *rules* for a *UK consolidation group* or *non-EEA sub-group*), a *firm* may exclude that part of the *risk capital requirement* that arises as a result of:
- (1) (in respect of the *consolidated credit risk requirement*) intra-group balances; or
- (2) (in respect of the *consolidated operational risk requirement* and *consolidated fixed overheads requirement*) intra-group transactions;
- with other *undertakings* in the *UK consolidation group* or *non-EEA sub-group*.

Other provisions about calculating risk capital requirements

- 8.7.30 R (1) This *rule* applies when the *rules* applicable under *BIPRU* 8.7.12R apply differently for different types of *firms*.
- (2) Where a *firm's UK consolidation group* or *non-EEA sub-group* is a group identified at Stage 1 in *BIPRU* 8 Annex 5R (Decision tree for identifying the consolidated capital resources requirement of a UK consolidation group or a non-EEA sub-group), the *rules* that apply are those that apply to a *bank* that is a *BIPRU firm*.
- (3) Where a *firm's UK consolidation group* or *non-EEA sub-group* is a group identified at Stage 2 in *BIPRU* 8 Annex 5R, the *rules* that apply are those that apply to a *full scope BIPRU investment firm*.
- (4) Where a *firm's UK consolidation group* or *non-EEA sub-group* is a group identified at Stage 3 in *BIPRU* 8 Annex 5R, the *rules* that apply are those that apply to a *BIPRU limited activity firm*.
- (5) Where a *firm's UK consolidation group* or *non-EEA sub-group* is a group identified at Stage 4 in *BIPRU* 8 Annex 5R, the *rules* that apply are those that apply to a *BIPRU limited license firm*.
- 8.7.31 G If a *firm* is calculating a *risk capital requirement* for an *undertaking* that is not a *BIPRU firm* it should calculate it as if the *undertaking* were a *BIPRU firm*.
- 8.7.32 G Similarly *BIPRU* 8.7.30R may have the effect that the *risk capital requirement* for a *BIPRU firm* is calculated differently from the way it is on a solo basis. Thus for example if the *risk capital requirement* is being calculated for a *BIPRU limited licence firm* that is a *subsidiary undertaking* of a *bank* the *risk capital requirement* should be calculated using the *rules* for a *bank*.
- 8.7.33 G A *firm* should not use an *advanced prudential calculation approach* for calculating a *risk capital requirement* unless this is permitted as explained in *BIPRU* 8.8 (Advanced prudential calculation approaches).

Use of the solo requirements of another EEA competent authority

- 8.7.34 R A *firm* may calculate the *risk capital requirement* for an *institution* in the *firm's UK consolidation group* or *non-EEA sub-group* that is an *EEA firm* in accordance with the *CRD implementation measures* in the *EEA firm's EEA State* that correspond to the *FSA's rules* that would otherwise apply under this section if the *institution* is subject to those *CRD implementation measures*.

Use of the solo requirements of a regulator outside the EEA

- 8.7.35 R (1) This *rule* applies where:

- (a) an *institution* in a *firm's UK consolidation group* or *non-EEA sub-group* is subject to any of the *sectoral rules* applicable to its *financial sector* for a state or territory outside the *EEA* that correspond to the *FSA's rules* that would otherwise apply under this section;
 - (b) those *sectoral rules* are shown in *BIPRU 8 Annex 6R* (Non – EEA regulators' requirements deemed CRD-equivalent for individual risks) as having been assessed as being equivalent to the *FSA rules* in relation to the *consolidated requirement component* in question; and
 - (c) that *institution* is incorporated in and has its head office in that state or territory.
- (2) If the conditions in this *rule* are satisfied, a *firm* may apply the *sectoral rules* referred to in (1) in order to calculate the *risk capital requirement* for the *institution* referred to in (1) provided that:
- (a) the *firm* has no reason to believe that the use of the *sectoral rules* referred to in (1) would produce a lower figure for the *consolidated requirement component* than would be produced by calculating the *risk capital requirement* under the *FSA's rules* in accordance with this section; or
 - (b) the *firm* increases the amount produced under the *sectoral rules* referred to in (1) and the *firm* has no reason to believe that the use of such figures would produce a lower figure for the *consolidated requirement component* than would be produced by calculating the *risk capital requirement* under the *FSA's rules* in accordance with this section.

8.7.36 G If a *firm* wants to include in its *consolidated capital resource requirement* a solo capital resource requirement for an individual risk calculated under the rules of a non-*EEA* regulator not assessed as equivalent in *BIPRU 8 Annex 6R* (Non –EEA regulators' requirements deemed CRD-equivalent for individual risks) it will need to apply for a *waiver*. A *firm* applying for such a *waiver* should demonstrate that the local requirements result in a capital charge that is at least as much as required under the corresponding *FSA rules*.

Use of the consolidated requirements of another EEA competent authority

8.7.37 R (1) This *rule* applies if:

- (a) a *firm* is applying an accounting consolidation approach to part of its *UK consolidation group* or *non-EEA sub-group* under method three as described in *BIPRU 8.7.13R(4)(a)*; and

- (b) the part of the group in (a) constitutes the whole of a group subject to the consolidated capital requirements of a *competent authority* under the *CRD implementation measures* relating to consolidation under the *Banking Consolidation Directive* or the *Capital Adequacy Directive*.
- (2) If the conditions in this *rule* are satisfied, a *firm* may apply the consolidated capital requirement in (1)(b) as the *risk capital requirement* for the group identified in (1)(a) so far as that consolidated capital requirement corresponds to the *FSA's rules* that would otherwise apply under this section.

Use of the consolidated requirements of a regulator outside the EEA

- 8.7.38 R (1) This *rule* applies if:
- (a) a *firm* is applying an accounting consolidation approach to part of its *UK consolidation group* or *non-EEA sub-group* under method three as described in *BIPRU* 8.7.13R(4)(a);
 - (b) the part of the group in (a) constitutes the whole of a group subject to the consolidated capital requirements of a *third country competent authority* under the *sectoral rules* for the *banking sector* or the *investment services sector*; and
 - (c) those *sectoral rules* are shown in *BIPRU* 8 Annex 6R (Non – EEA regulators' requirements deemed CRD-equivalent for individual risks) as having been assessed as being equivalent to the *FSA's rules* in relation to the *consolidated requirement component* in question.
- (2) If the conditions in this *rule* are satisfied, a *firm* may apply the consolidated capital requirement in (1)(b) as the *risk capital requirement* for the group identified in (1)(a) so far as that consolidated capital requirement corresponds to the *FSA's rules* that would otherwise apply under this section. However a *firm* may only do this if it also complies with *BIPRU* 8.7.35R(2).

Use of an advanced prudential calculation approach under the rules of an overseas regulator

- 8.7.39 G A *firm* should not use the requirements of an overseas regulator if that would involve the use of an *advanced prudential calculation approach* unless this is permitted under *BIPRU* 8.8 (Advanced prudential calculation approaches).

8.8 Advanced prudential calculation approaches

General

- 8.8.1 R A *firm* must not apply any *advanced prudential calculation approach* for the purposes of this chapter unless it has an *advanced prudential calculation approach permission* and that *advanced prudential calculation approach permission* requires the *firm* to use that *advanced prudential calculation approach* for those purposes.
- 8.8.2 G *BIPRU* 1.3 (Applications for advanced approaches) deals with how to apply for an *advanced prudential calculation approach permission*.

Prohibition on using the rules of an overseas regulator

- 8.8.3 R Even if a *firm* has an *advanced prudential calculation approach permission* that allows it to use an *advanced prudential calculation approach* for the purposes of this chapter, the *firm* may not use the requirements of another state or territory to the extent they provide for that *advanced prudential calculation approach*. Therefore a *firm* may not use *BIPRU* 8.7.34R to *BIPRU* 8.7.38R (Use of the capital requirements of an overseas regulator) if that would involve using an *advanced prudential calculation approach*.

Special provisions relating to the internal ratings based approach

- 8.8.4 R The conditions in *BIPRU* 4.2.26R (Combined use of methodologies under the *IRB approach*) apply to a *firm's UK consolidation group* or *non-EEA sub-group* as if that group were a single *undertaking*.

Special provisions relating to the advanced measurement approach

- 8.8.5 R *BIPRU* 6.5.27R(6) (Insurance should be provided by a third party entity for the purposes of the *advanced measurement approach*) is amended to provide that the insurance must be provided by an *undertaking* that is not in the same *group* as the *firm* or other members of the *UK consolidation group* or *non-EEA sub-group*. In the case of insurance through captives and affiliates, the exposure must be laid off to an independent *undertaking* that is not in the same *group* as the *firm* or other members of the *UK consolidation group* or *non-EEA sub-group*, for example through reinsurance that meets the eligibility criteria.
- 8.8.6 G In the case of insurance through captives and affiliates, the *exposure* should be laid off outside the *firm's group* to an independent third party.
- 8.8.7 G *BIPRU* 8.7.22R deals with the combination of the *advanced measurement approach* with other approaches to *operational risk* on a group level.

Special provisions relating to the CCR internal model method

- 8.8.8 G *BIPRU 8.7.17R* deals with the combination of the *CCR internal model method* with other approaches to calculating exposure values on a group level.

Corporate governance arrangement for the IRB approach and the AMA

- 8.8.9 G The governance arrangements that apply to the *governing body*, the senior management and any *designated committee* of a *firm* in relation to the *IRB approach* or the *AMA* also apply to the body or *persons* with equivalent powers with respect to the *UK consolidation group* or *non-EEA sub-group*. Where the *parent undertaking* and its *subsidiary undertakings* use rating systems on a unified basis, the approval and reporting process described in *BIPRU 4.3.12G* (Approval and reporting arrangements for the *IRB approach* where rating systems are used on a unified group basis) and *BIPRU 6.5.32G* (Approval and reporting arrangements for the *AMA* where rating systems are used on a unified group basis) apply for the purpose of this paragraph too.

8.9 Consolidated concentration risk requirements

Main rule

- 8.9.1 R *BIPRU 10 (Concentration risk requirements) applies to a firm's UK consolidation group or non-EEA sub-group as if it were a single undertaking, subject to the rest of this section.*

Definition of consolidated capital resources for concentration risk purposes

- 8.9.2 R *BIPRU 8.6 (Consolidated capital resources) applies for the purpose of this section subject to the adjustments required by BIPRU 8.9.1R. In particular BIPRU 10.5.2R to BIPRU 10.5.5R (Definition of capital resources for concentration risk purposes) apply on a consolidated basis.*

Calculation of the concentration risk capital component

- 8.9.3 R *A firm must calculate the consolidated credit risk requirement so far as it relates to the concentration risk capital component under BIPRU 8.9.1R. In particular a firm must not use the capital requirements of a regulator other than the FSA so far as they correspond to the concentration risk capital component.*

Treasury Concession

- 8.9.4 R *A firm may only treat an exposure as exempt under BIPRU 10.7.1R (Treasury Concession) as applied on a consolidated basis if the exposure is of a member of the UK consolidation group or non-EEA sub-group that is a BIPRU firm or that has its head office in the UK and that exposure is or (if that rule applied to the undertaking in question) would be exempt under BIPRU 10.7.1R on a solo basis. The following adjustments apply:*
- (1) *the exposure must be to a consolidation concentration risk group counterparty; and*
 - (2) *the limit in BIPRU 10.7.2R (Exemption limited to 50% of a firm's capital resources) is calculated on a consolidated basis.*

Intra-group securities financing transactions

- 8.9.5 R *A firm may only treat an exposure as exempt under BIPRU 10.7.4R (Intra-group securities financing transactions) as applied on a consolidated basis if the exposure is or (if that rule applied to the undertaking in question) would be exempt under BIPRU 10.7.4R on a solo basis. BIPRU 10.7.6R (Abuse of the exemption) continues to apply. The exemption is not available if the firm uses the CCR internal models method for securities financing transactions for the purpose of this chapter.*

UK integrated groups and wider integrated groups

8.9.6 G In many cases there is no need for the UK integrated groups and wider integrated groups regime in *BIPRU* 10.8 and *BIPRU* 10.9 to apply on a consolidated basis under this chapter as intra-group *exposures* within a *UK consolidation group* will be eliminated on consolidation. However it may be applicable to some group structures. For example a *UK consolidation group* may be part of a wider *EEA* or third country group. If the group has two or more *UK consolidation groups* in the *United Kingdom* because there is no common *parent undertaking* in the *United Kingdom* the regime may enable *exposures* between the two *UK consolidation groups* to be exempted. Likewise the regime may allow a *firm* to exempt *exposures* between its *UK group* and the wider worldwide group of which it forms part.

8.9.7 R *BIPRU* 10.8 (Concentration risk requirements: UK integrated groups) and *BIPRU* 10.9 (Concentration risk requirements: Wider integrated groups) do not apply on a consolidated basis under this chapter. *BIPRU* 8.9.8R to *BIPRU* 8.9.27R apply instead.

UK integrated groups: Introduction

8.9.8 R (1) *BIPRU* 8.9.9R to *BIPRU* 8.9.15R apply with respect to a *firm's UK consolidation group* or *non-EEA sub-group* (a "group") if:

- (a) the group is part of a *consolidation UK integrated group*; and
- (b) the *firm* gives notice in accordance with *BIPRU* 8.9.27R that it will apply those *rules* with respect to that group.

(2) If (1) applies with respect to a *firm's UK consolidation group* or *non-EEA sub-group*, the *firm* must apply *BIPRU* 8.9.9R to *BIPRU* 8.9.15R to all *exposures* to all *consolidation concentration risk group counterparties* and not just some of them.

UK integrated groups: Definition of consolidation UK integrated group

8.9.9 R An *undertaking* which is not itself a member of a *firm's UK consolidation group* or *non-EEA sub-group* (a "group") is a member of that group's *consolidation UK integrated group* if it satisfies the following conditions:

- (1) it is a *consolidation concentration risk group counterparty*;
- (2) it is an *institution, financial holding company, financial institution, asset management company* or *ancillary services undertaking*;
- (3) it is established in the *United Kingdom* and either it is incorporated in the *United Kingdom* or (if that *undertaking* is of a type that falls within the scope of that Regulation) the centre of its main interests is situated within the *United Kingdom* within the meaning of the Council Regulation of 29 May 2000 on insolvency proceedings (Regulation 1346/2000/EC);

- (4) the group and that *undertaking* are subject to the same risk evaluation, measurement and control procedures; and
- (5) there is no current or foreseen material practical or legal impediment to the prompt transfer of *capital resources* or repayment of liabilities from the *undertaking* to any member of the group that has an *exposure* to that *undertaking*.

8.9.10 G *Firms* are referred to the *guidance* in BIPRU 3.2.30G and BIPRU 3.2.31G (*Guidance* relating to 0% risk weights for intra-group *exposures* under the *standardised approach*) on the prompt transfer of *capital resources* and repayment of liabilities.

UK integrated groups: Definition of consolidation concentration risk group counterparty

8.9.11 R A *consolidation concentration risk group counterparty* means, in relation to a *firm's UK consolidation group* or *non-EEA sub-group* (a "relevant group"), an *undertaking* that satisfies the following conditions:

- (1) it is not a member of the relevant group;
- (2) it is:
 - (a) a *parent undertaking* of a member of the relevant group;
 - (b) a *subsidiary undertaking* of a member of the relevant group; or
 - (c) a *subsidiary undertaking* of a *parent undertaking* falling into (a); and
- (3) the *undertaking* and each member of the relevant group are:
 - (a) (if the relevant group is a *non-EEA sub-group*) included within the scope of consolidation on a full basis with respect to the same *UK consolidation group*;
 - (b) included within the scope of consolidation on a full basis with respect to the same group by a *competent authority* of an *EEA State* other than the *UK* under the *CRD implementation measures* about consolidated supervision in that *EEA State*; or
 - (c) (provided that this consolidation is carried out to standards equivalent to those in (a) and (b)) included within the scope of consolidation on a full basis with respect to the same *group* by a *third country competent authority* under prudential rules for the *banking sector* or *investment services sector* of or administered by that *third country competent authority*.

- 8.9.12 R For the purposes of *BIPRU* 8.9.11R(3)(c), a group is subject to consolidation to equivalent standards only if a member of that group has been notified in writing by the *FSA* or a *competent authority* of another *EEA State* pursuant to Article 143 of the *Banking Consolidation Directive* that that group is subject to equivalent supervision.
- 8.9.13 G An *undertaking* is included within the scope of consolidation of a group on a full basis if it is at the head of the group or if its assets and liabilities are taken into account in full as referred to in *BIPRU* 8.5.4R (Basis of inclusion of undertakings in consolidation).

UK integrated groups: Revised concentration risk limits

- 8.9.14 R A *firm* must treat *exposures* of members of the *firm's UK consolidation group* or *non-EEA sub-group* (the "relevant group") to *consolidation concentration risk group counterparties* as follows:
- (1) *exposures* of a member of the relevant group that has its head office in the *UK* to a member of the relevant group's *consolidation UK integrated group* are exempt; and
 - (2) all *exposures* falling into this *rule* not in (1) must be treated in accordance with *BIPRU* 8.9.15R.
- 8.9.15 R A *firm* must treat *exposures* falling into *BIPRU* 8.9.14R(2) as follows:
- (1) the *firm* must apply the *rules* set out in *BIPRU* 10.8.7R (List of concentration risk *rules* that apply to *UK integrated groups*) on a consolidated basis under *BIPRU* 8.9.1R with respect to its *UK consolidation group* or *non-EEA sub-group*;
 - (2) the other limits in *BIPRU* 10.5 (Concentration risk requirements: Limits on exposures and large exposures) do not apply, subject to *BIPRU* 8.9.26R; and
 - (3) all those *exposures* must be treated as being to a single *undertaking*.

Wider integrated groups: Introduction

- 8.9.16 R *BIPRU* 8.9.17R to *BIPRU* 8.9.24R apply with respect to a *firm's UK consolidation group* or *non-EEA sub-group* (a "group") if:
- (1) the *firm* has a *wider integrated group permission* that applies on a consolidated basis with respect to that group; and
 - (2) the group is part of a *consolidation UK integrated group* and of a *consolidation wider integrated group*.

8.9.17 R If *BIPRU* 8.9.16R applies with respect to a *firm's UK consolidation group* or *non-EEA sub-group*, the *firm* must apply *BIPRU* 8.9.18R to *BIPRU* 8.9.24R to all to *exposures* to all *consolidation concentration risk group counterparties* and not just some of them.

8.9.18 R If *BIPRU* 8.9.16R applies, *BIPRU* 8.9.8R to *BIPRU* 8.9.12R do not apply.

Wider integrated groups: Definition of wider integrated group

8.9.19 R An *undertaking* that is not itself a member of a *firm's UK consolidation group* or *non-EEA sub-group* (a "relevant group") is a member of the relevant group's *consolidation wider integrated group* if it satisfies all the conditions for membership of the *consolidation UK integrated group* except *BIPRU* 8.9.9R(3).

Wider integrated groups: Revised concentration risk limits

8.9.20 R A *firm* must treat *exposures* of members of the *firm's UK consolidation group* or *non-EEA sub-group* (the "relevant group") to *consolidation concentration risk group counterparties* as follows:

- (1) *exposures* of a member of the relevant group with its head office in the *UK* to a member of the relevant group's *consolidation UK integrated group* are exempt; and
- (2) all *exposures* falling into this *rule* not in (1) must be treated in accordance with *BIPRU* 8.9.21R.

8.9.21 R A *firm* must treat *exposures* falling into *BIPRU* 8.9.20R(2) as follows:

- (1) the *firm* must apply the *rules* set out in *BIPRU* 10.9.9R (List of concentration risk *rules* that apply to *wider integrated groups*) on a consolidated basis under *BIPRU* 8.9.1R with respect to its *UK consolidation group* or *non-EEA sub-group*;
- (2) the other limits in *BIPRU* 10.5 (Concentration risk requirements: Limits on exposures and large exposures) do not apply, subject to *BIPRU* 8.9.26R;
- (3) the *firm* must treat all *exposures* in a single *diverse block* as *exposures* to a single *undertaking*; and
- (4) the *firm* must treat all *exposures* in the *residual block* as *exposures* to a single *undertaking*.

Wider integrated groups: Definition of diverse block

8.9.22 R *Exposures* are treated as being in a single *diverse block* if:

- (1) they are eligible to be included in a *diverse block*; and

(2) they are to *undertakings* that are designated by the *wider integrated group permission* as being associated with the same *diverse block*.

- 8.9.23 R An *exposure* is only eligible for inclusion in a *diverse block* if one of the following conditions is satisfied:
- (1) it is an *exposure* of a member of the *firm's UK consolidation group* or *non-EEA sub-group* (the "group") with its head office in the *UK* to a member of the group's *consolidation wider integrated group*; or
 - (2) it is an *exposure* of a member of the group with its head office outside the *UK* to:
 - (a) a member of the *consolidation UK integrated group*; or
 - (b) a member of the *consolidation wider integrated group*.

Wider integrated groups: Definition of residual block

- 8.9.24 R The *residual block* consists of all *exposures to group concentration risk group counterparties* falling into *BIPRU 8.9.20R(2)* not included in a *diverse block*.

Capital base for a UK integrated groups or wider integrated group

- 8.9.25 G The capital base against which *exposure* limits are tested under the *consolidation UK integrated group* or *consolidation wider integrated group* regimes under this section remains that of the *firm's UK consolidation group* or *non-EEA sub-group*. It is not extended to cover the *consolidation UK integrated group*. This is in contrast with the integrated groups regime on a solo basis, where the capital base is extended from the *firm* to cover the *firm's UK integrated group*.

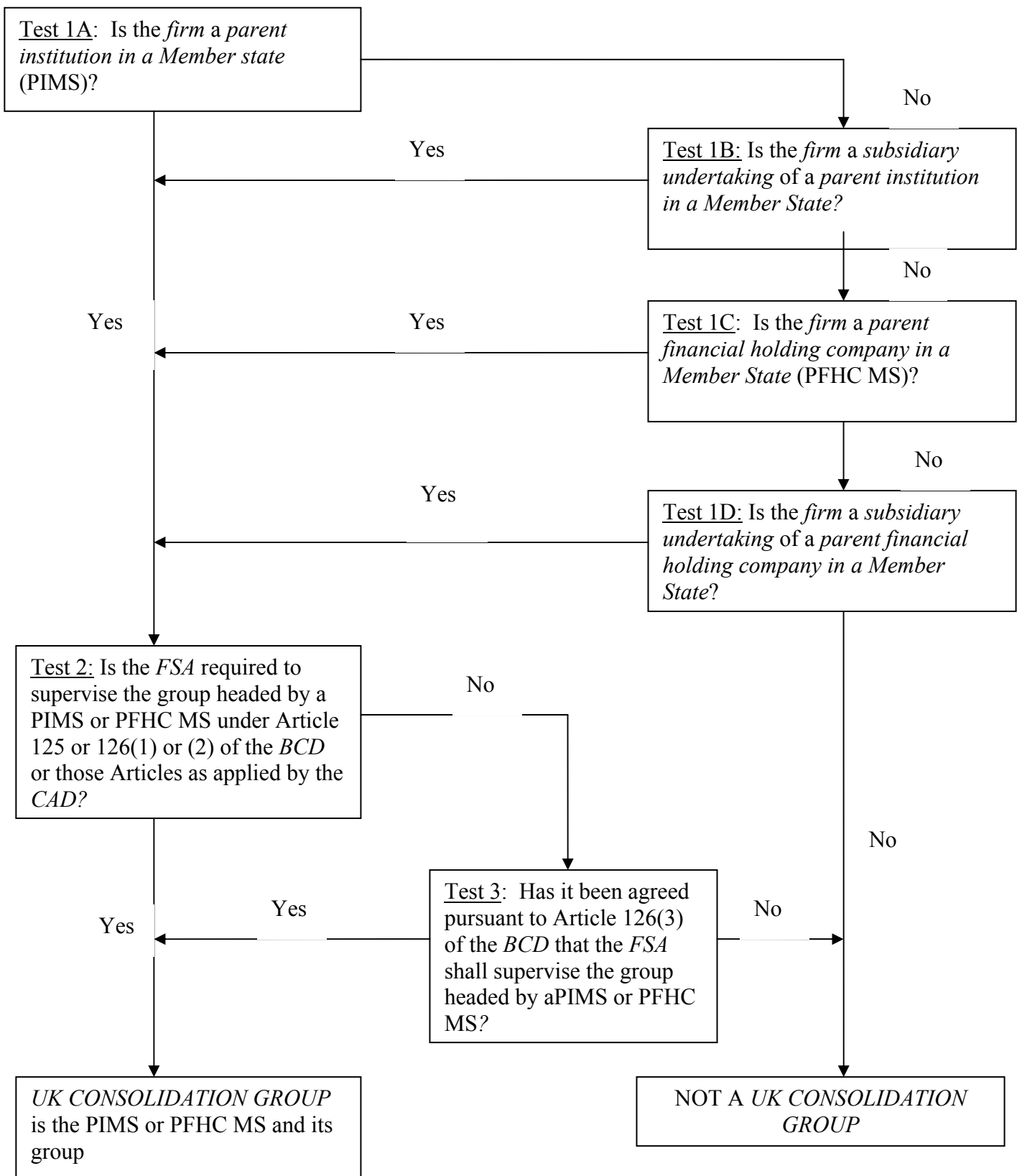
Trading book excesses for UK integrated groups and wider integrated groups

- 8.9.26 R *BIPRU 10.10* (Concentration risk requirements: Trading book excess) (as applied by *BIPRU 8.9.1R*) applies to a *firm* applying the treatments set out *BIPRU 8.9.8R* to *BIPRU 8.9.24R*.

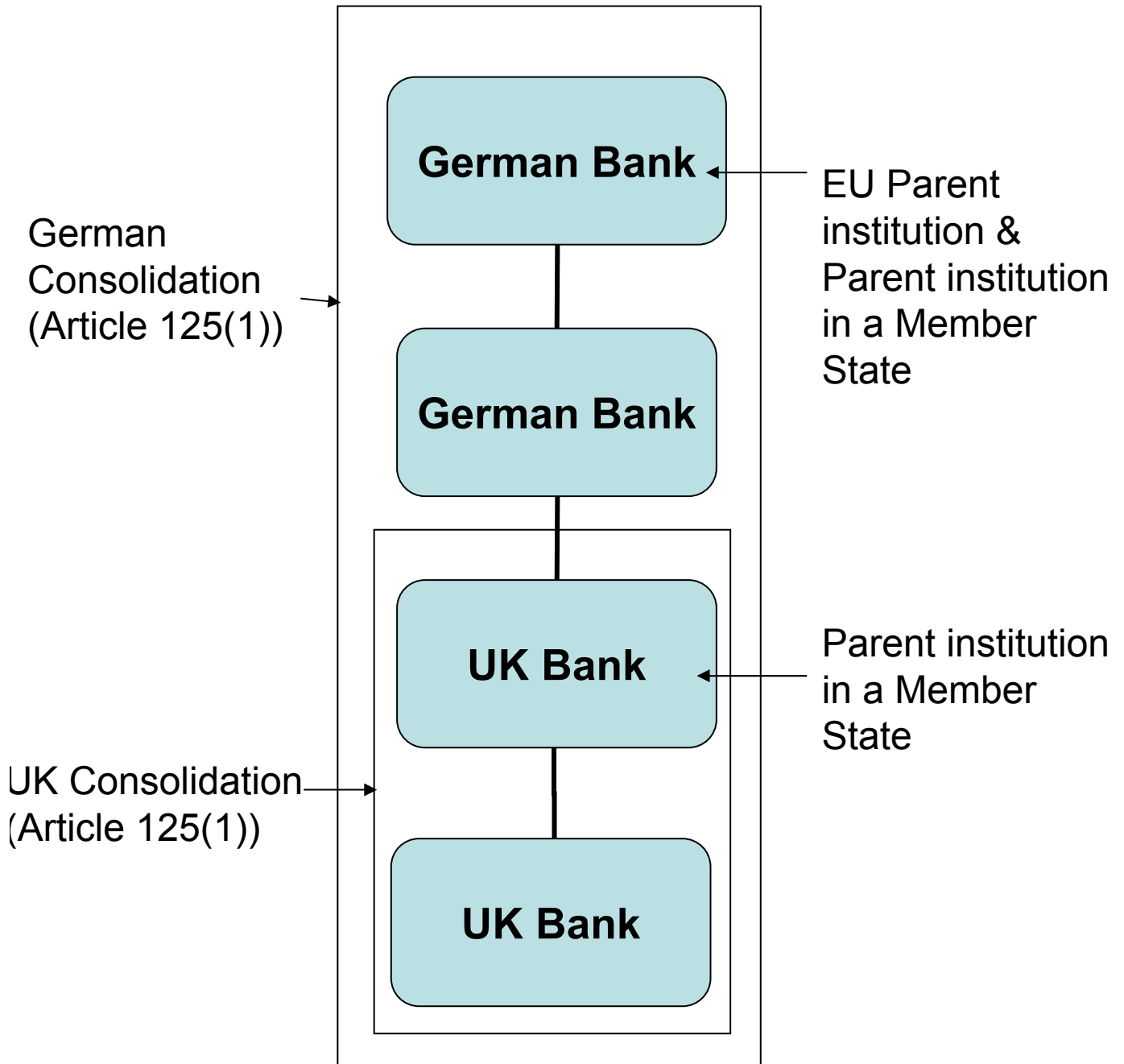
Notification procedures for UK integrated groups and wider integrated groups

- 8.9.27 R *BIPRU 10.11* (Concentration risk requirements: Notification procedures) (as applied by *BIPRU 8.9.1R*) applies to a *firm* applying the treatments set out in *BIPRU 8.9.8R* to *BIPRU 8.9.24R*.

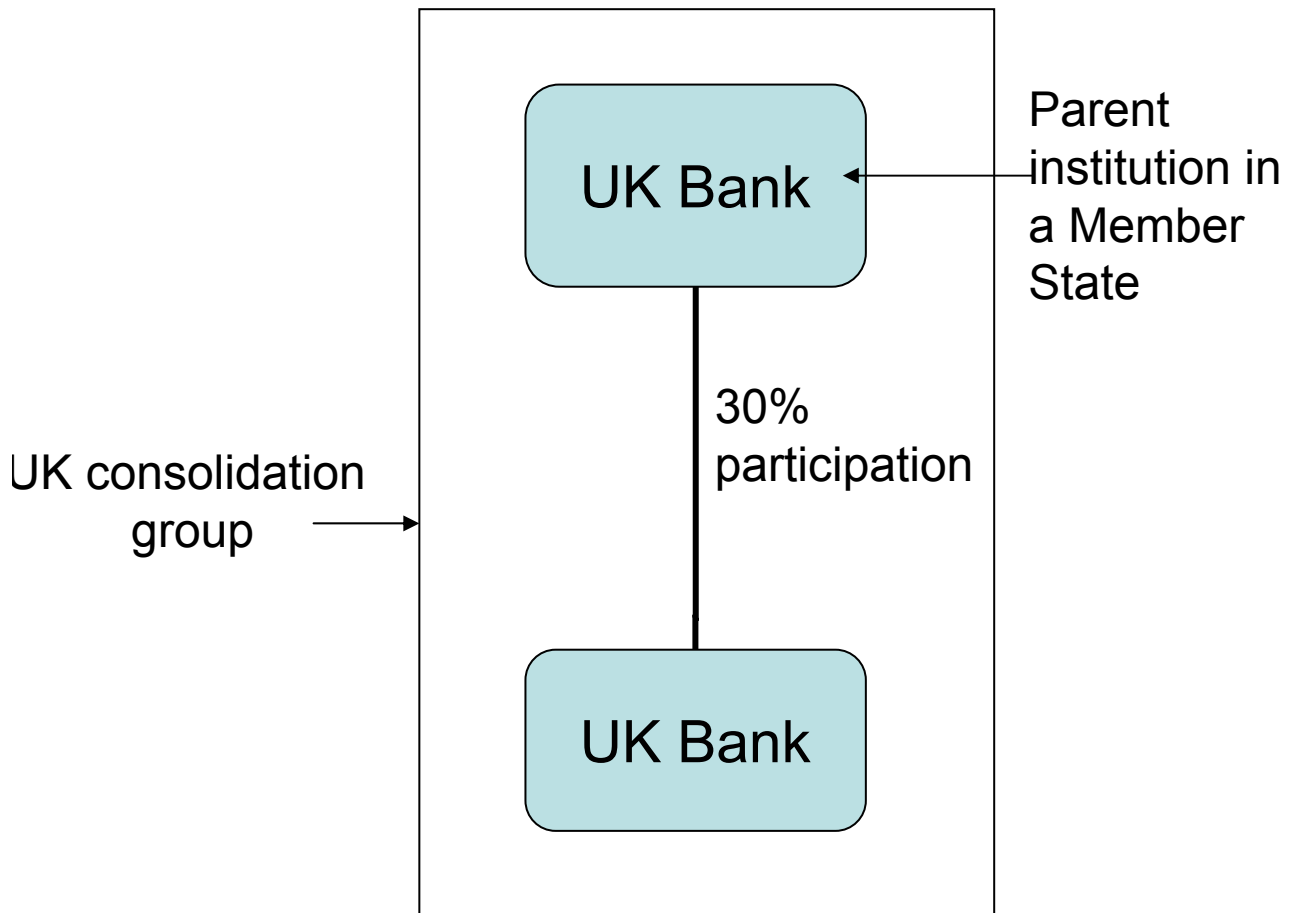
BIPRU 8 Ann 1R – Decision tree identifying a UK consolidation group



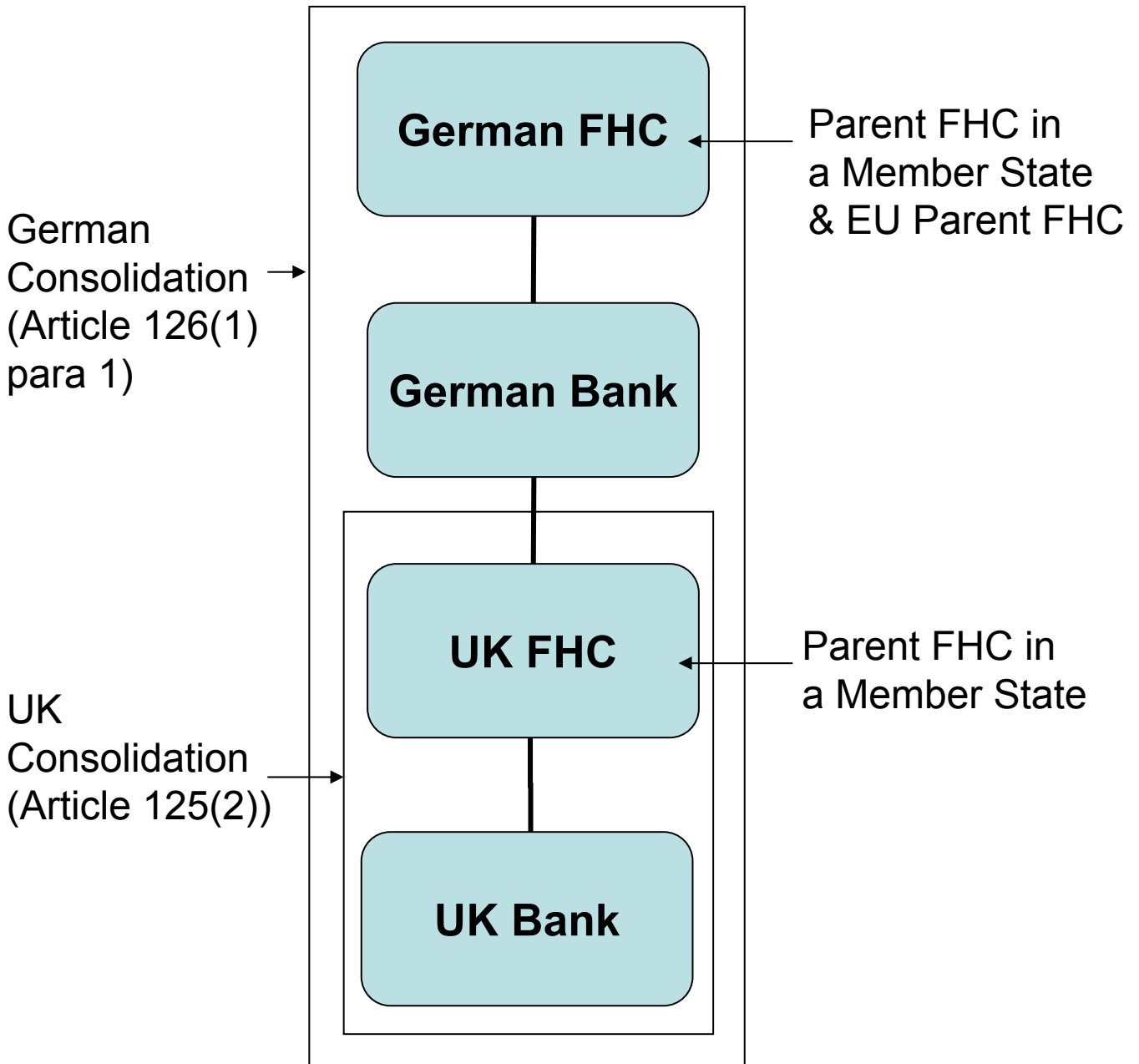
Example 1 (example of Article 125 (1))



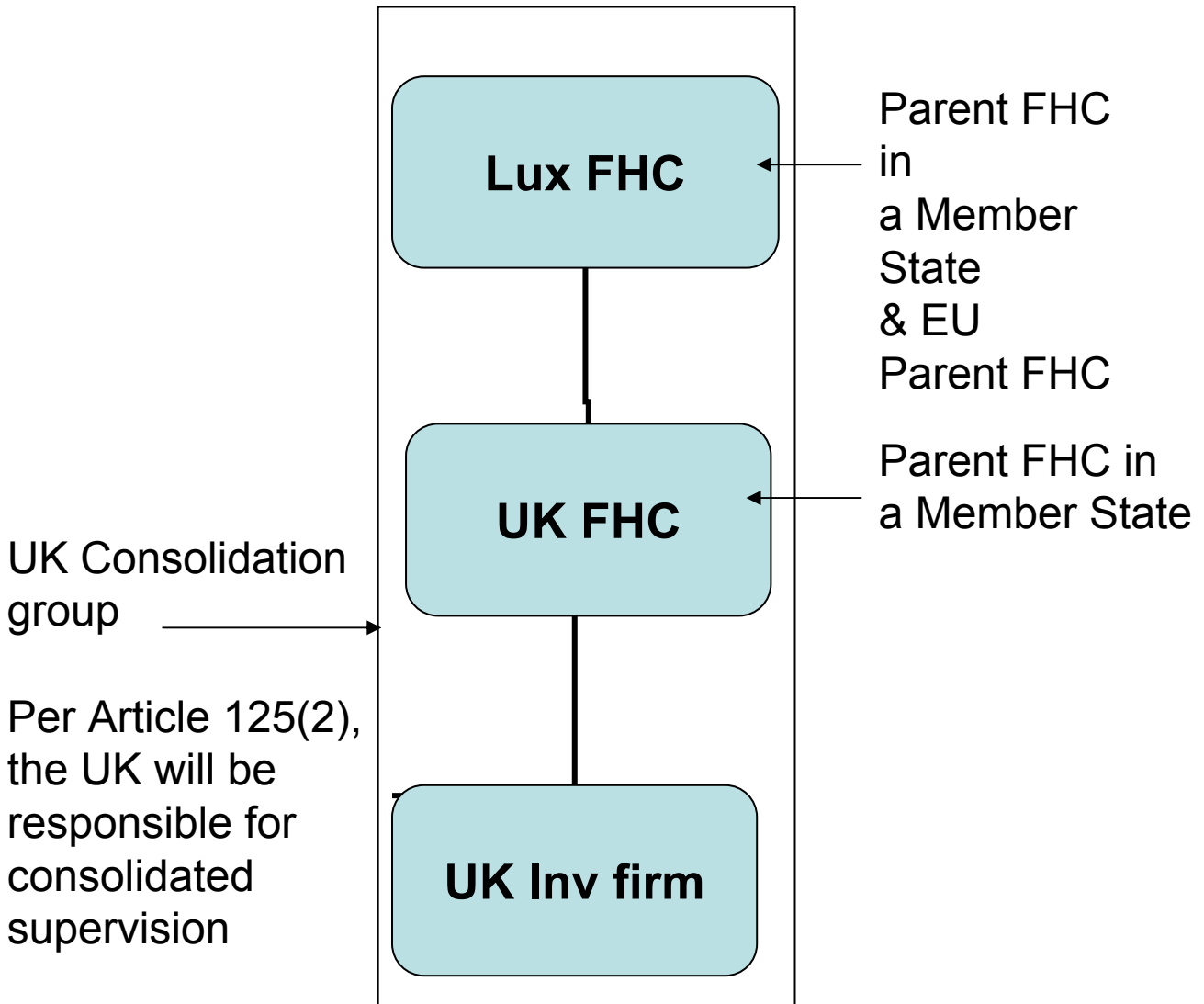
Example 2 (example of Article 125 (1))



Example 3 (example of Article 125 (2))

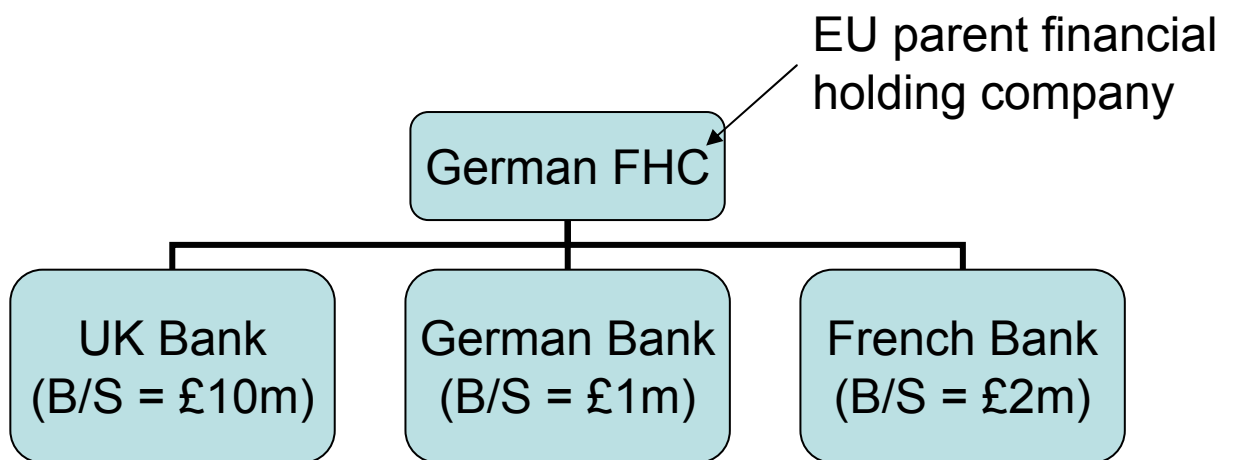


Example 4 (example of Article 125 (2))



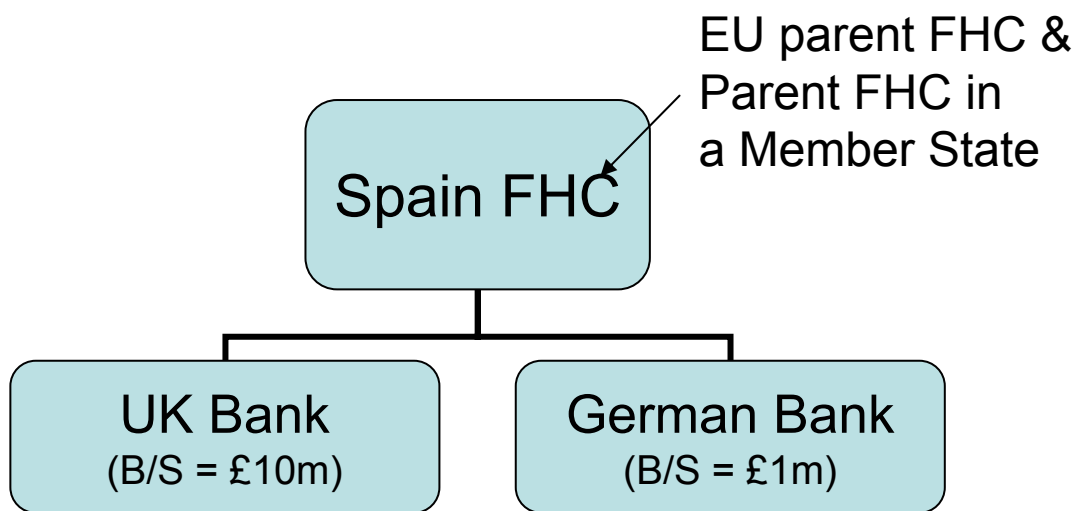
Example 5 (example of Article 126 (1) para 1)

Germany will be responsible for consolidated supervision

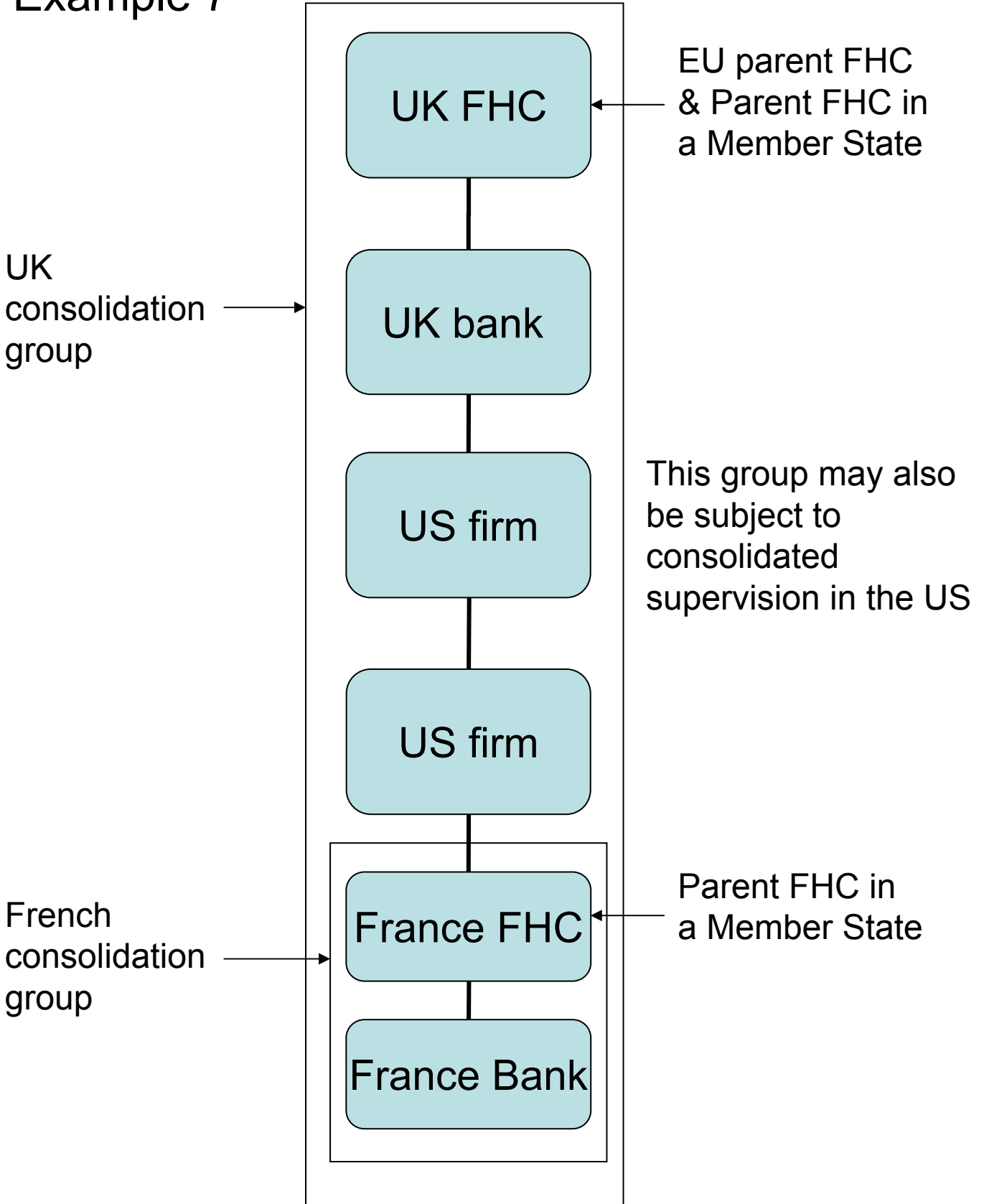


Example 6 (example of Article 126 (2))

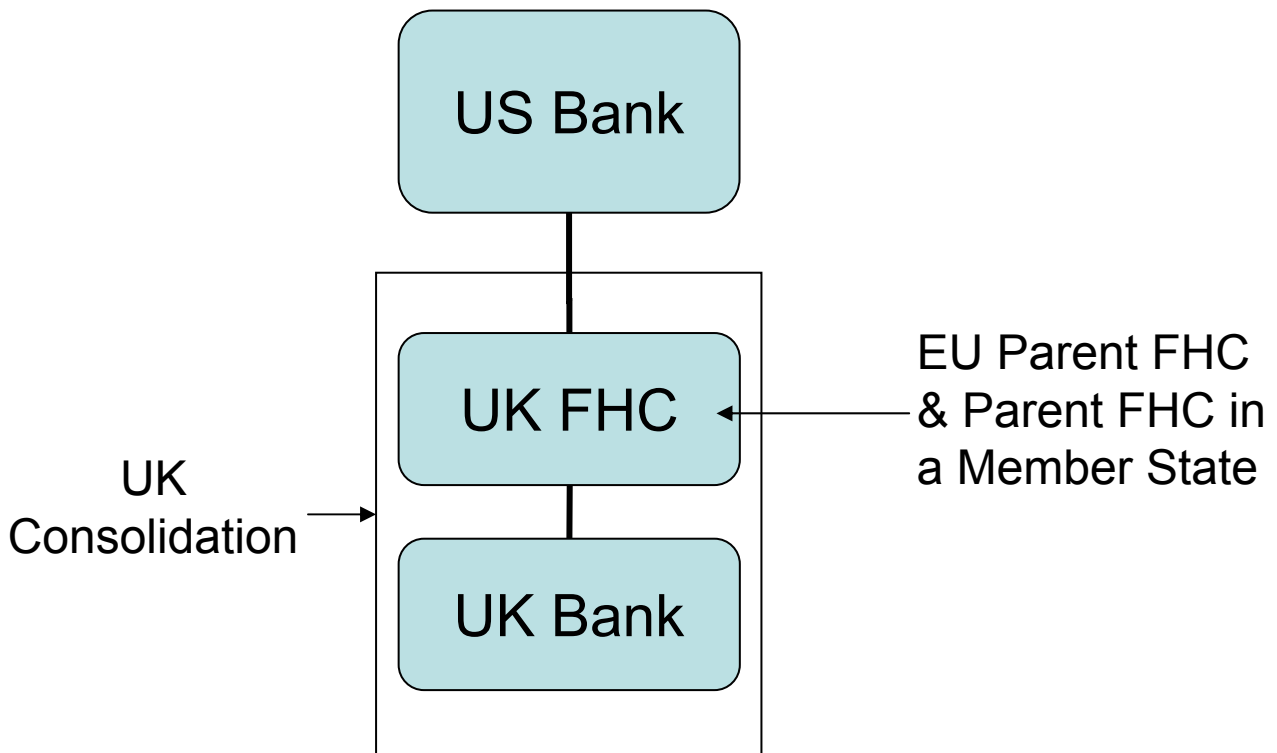
UK will be responsible for consolidated supervision



Example 7



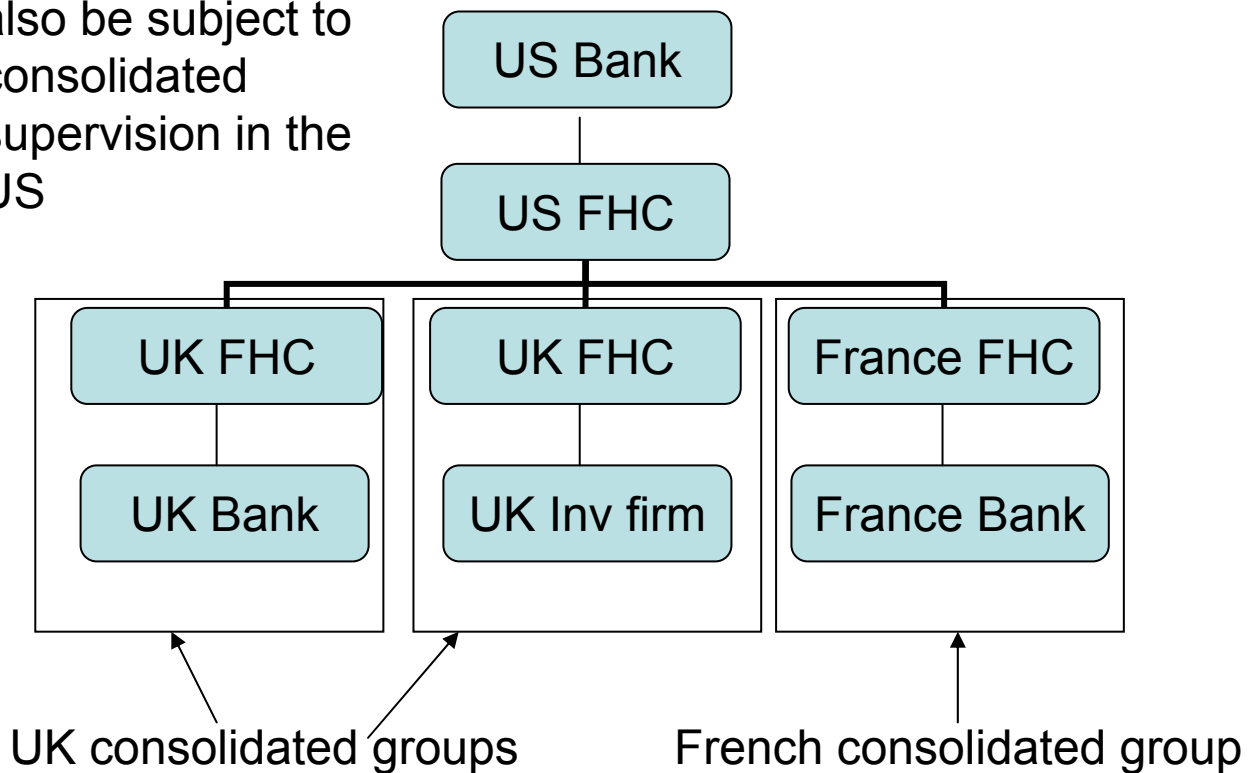
Example 8 (example of a group headed up by a non-EEA parent)



The UK firms, as well as being members of a UK consolidation group and subject to BIPRU 8, are members of a third country group and subject to GENPRU 3.2.

Example 9 (example of a group headed up by a non-EEA parent)

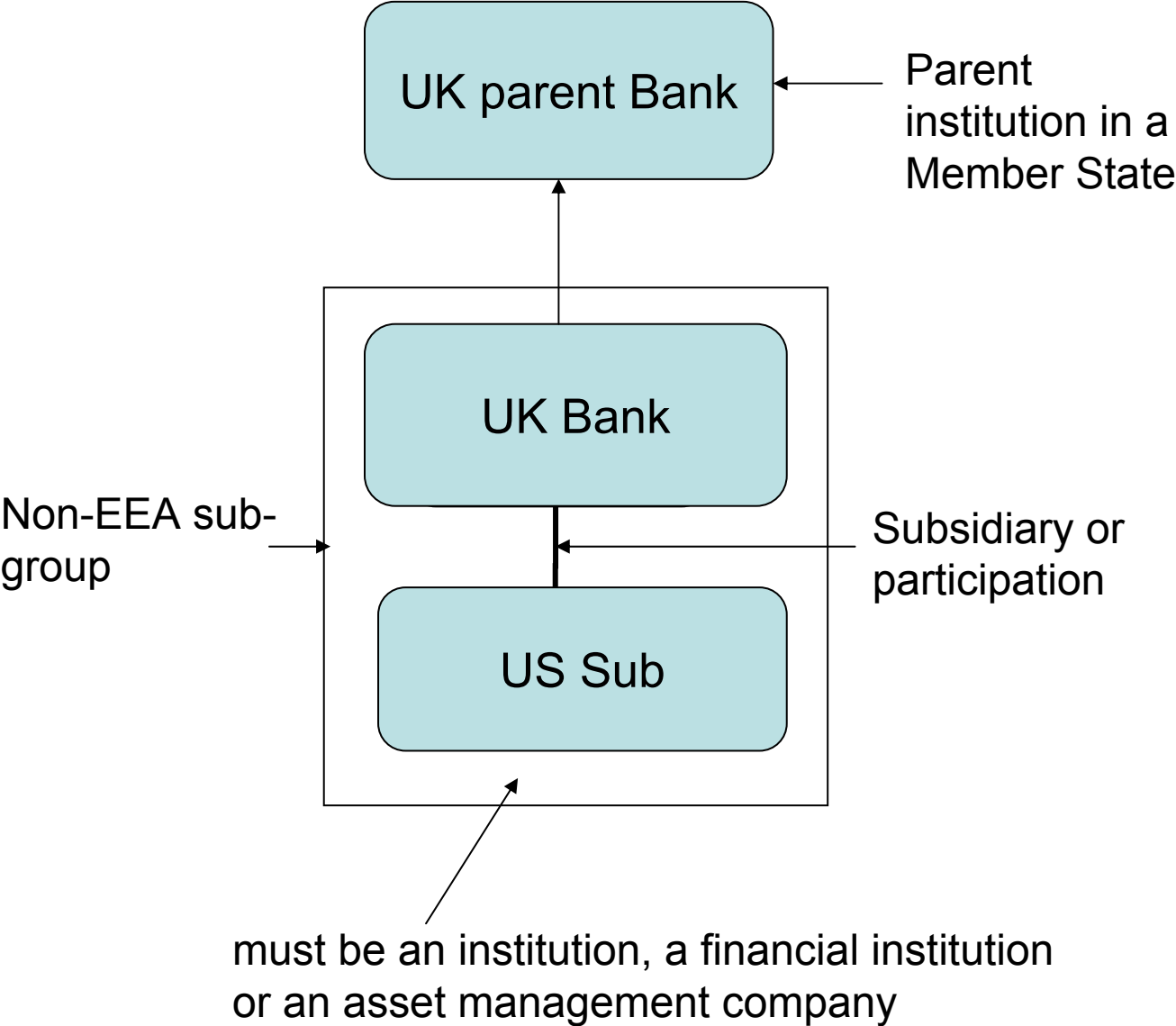
This group may
also be subject to
consolidated
supervision in the
US



The UK firms, as well as being members of a UK consolidation group and subject to BIPRU 8, are members of a third country group and subject to GENPRU 3.2.

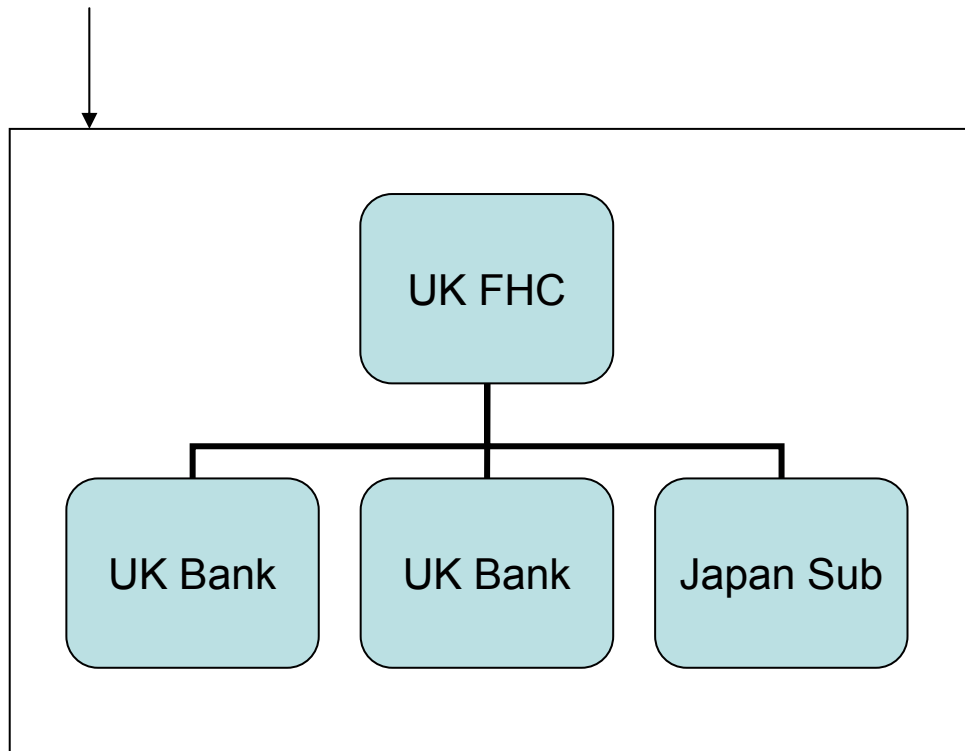
Example 1

(example refers to BIPRU 8.3.11)

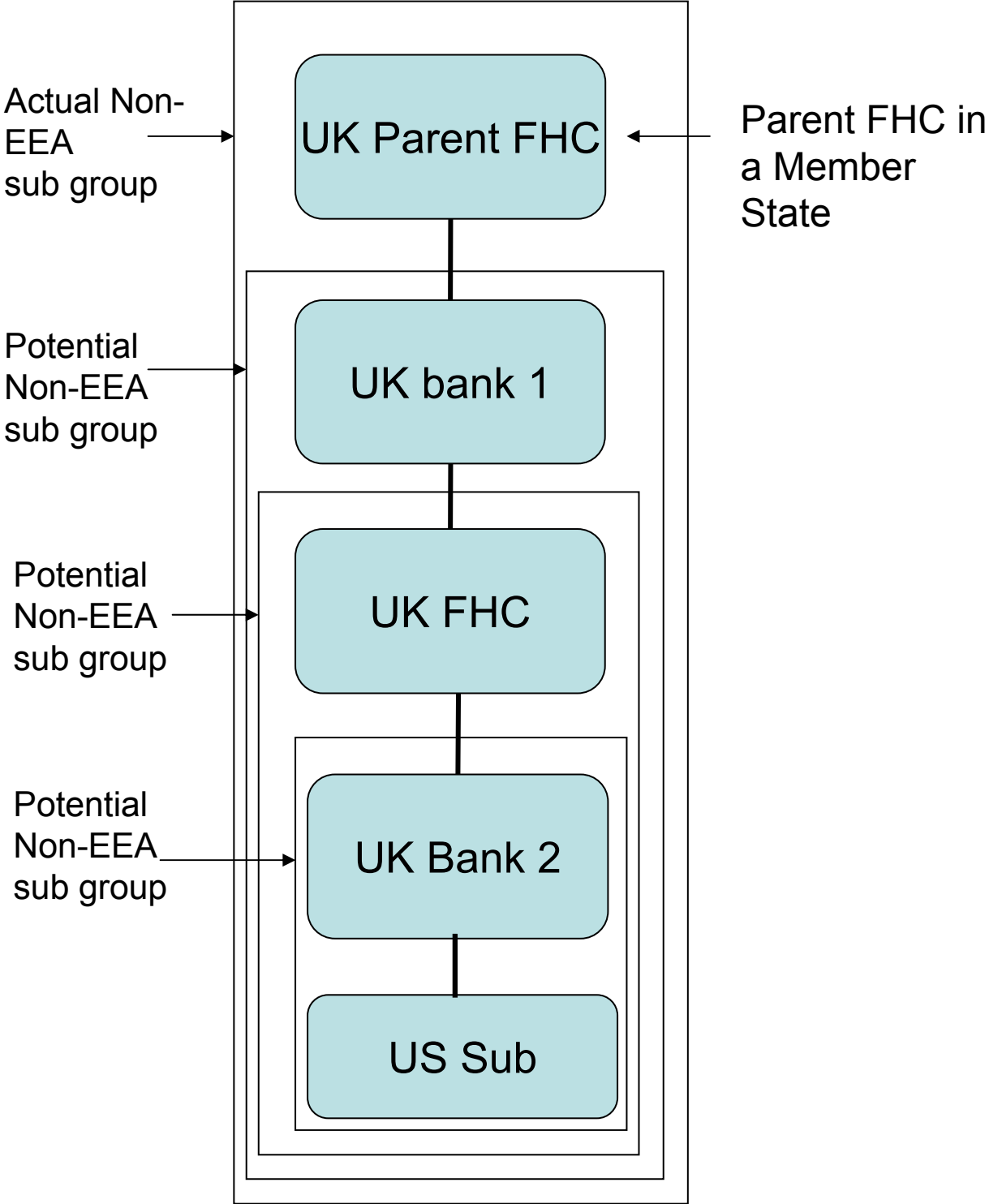


Example 2 (example refers to BIPRU 8.3.14)

Non-EEA sub-group & UK consolidation group

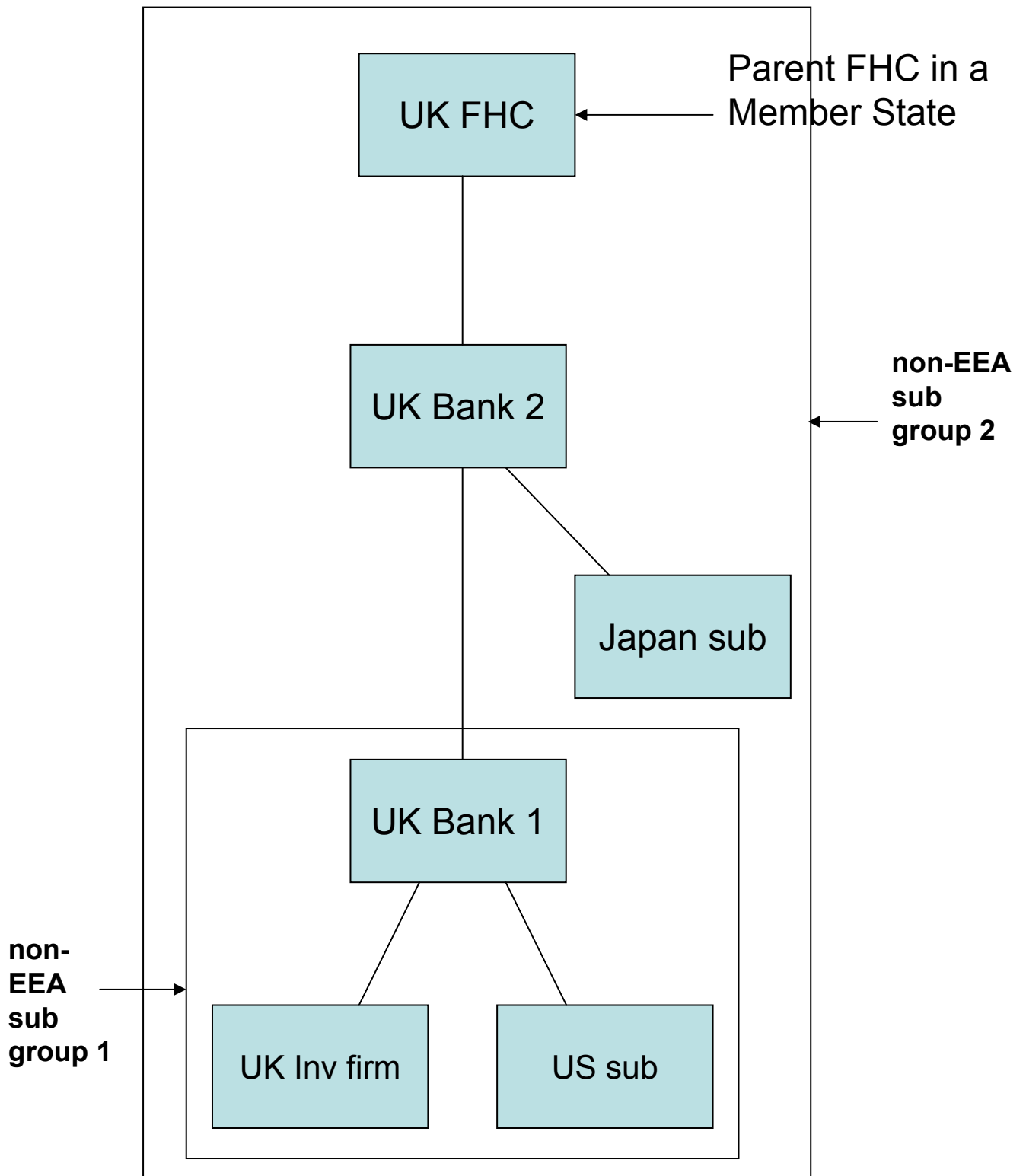


Example 3
(example refers to BIPRU 8.3.9, 8.3.19 & 8.3.22)



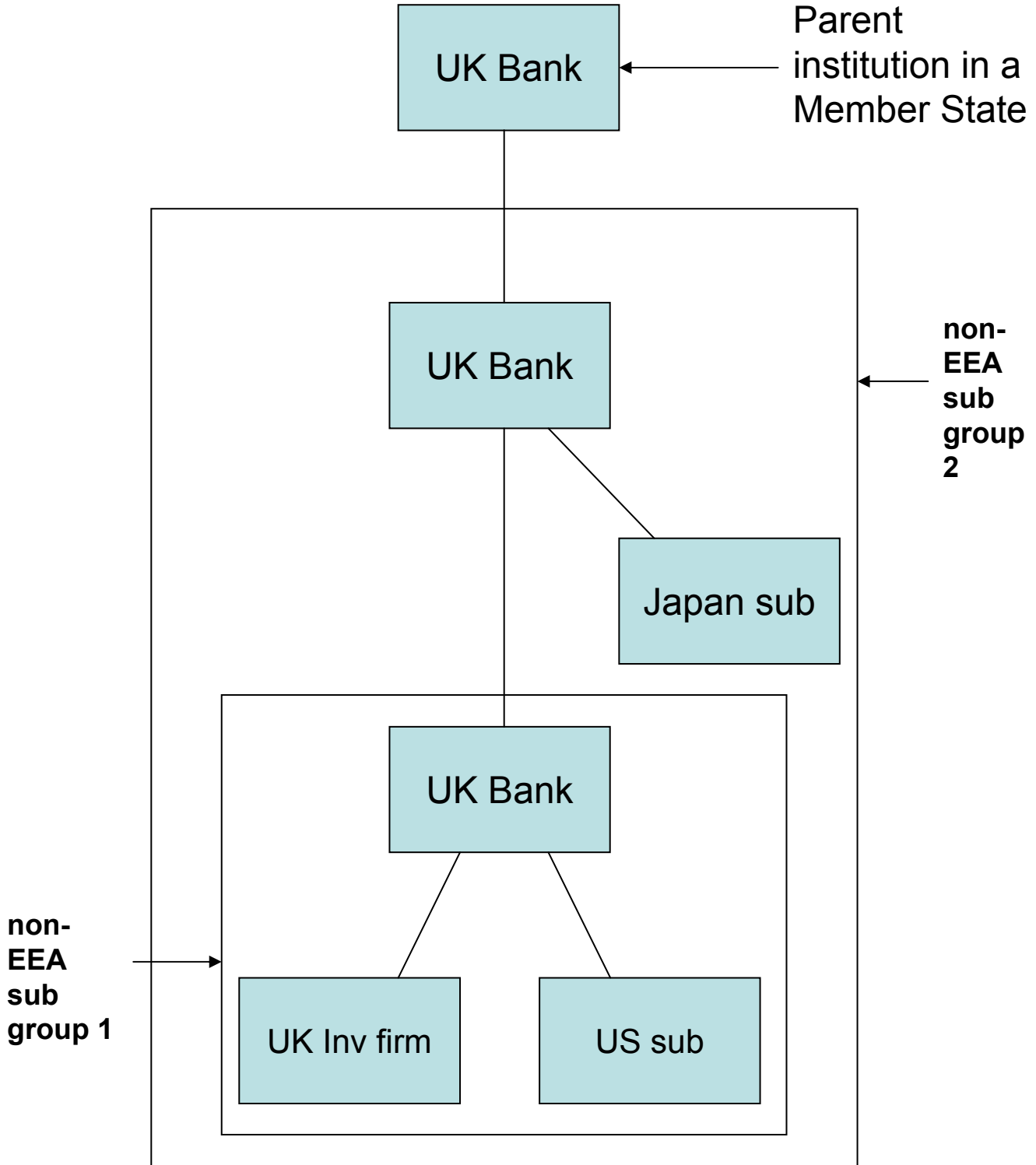
Example 4

(example refers to BIPRU 8.3.21)

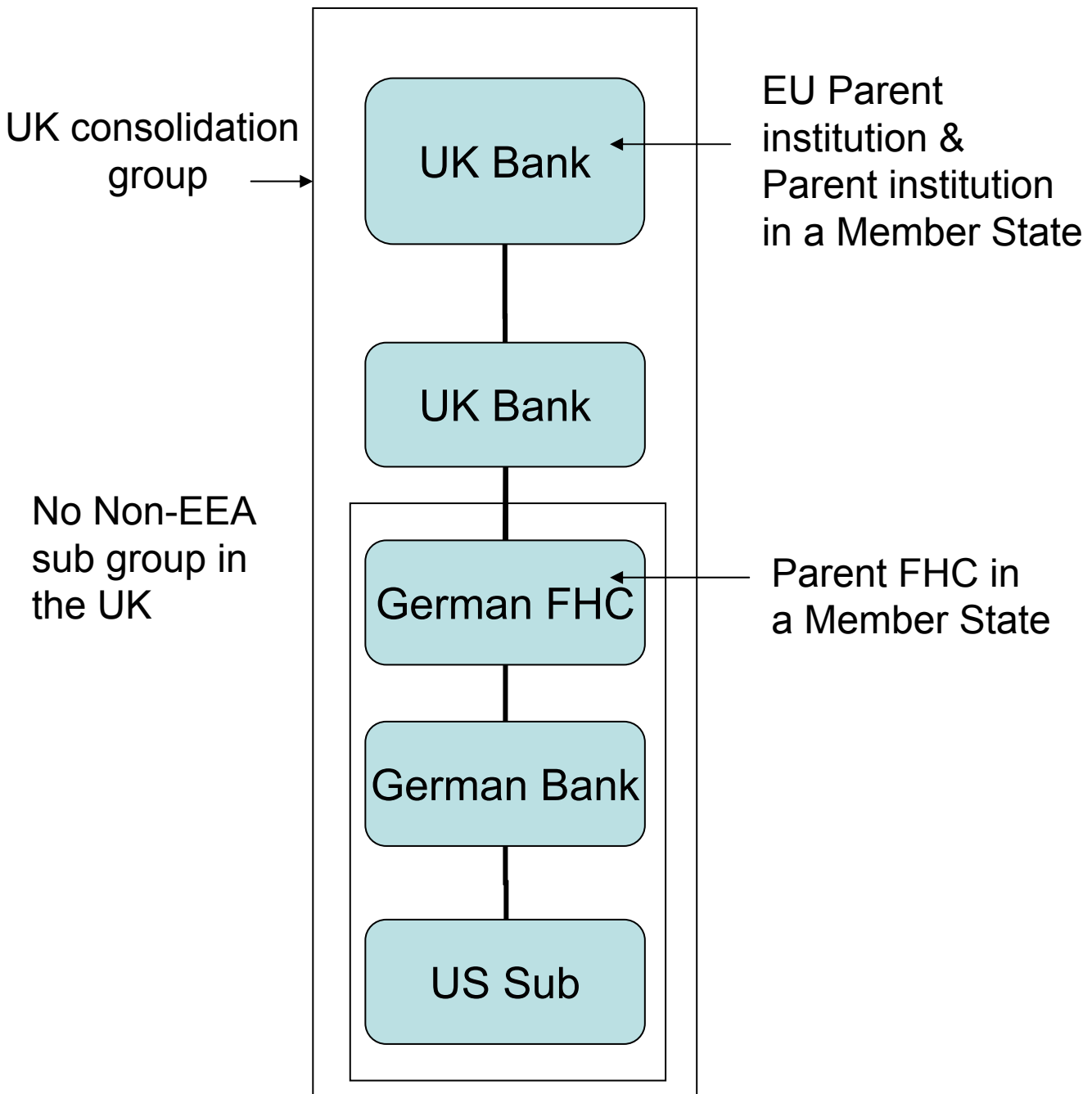


Example 5

(example refers to BIPRU 8.3.21)



Example 6 (example refers to BIPRU 8.3.24)



Text of Articles 125 and 126 of the Banking Consolidation Directive

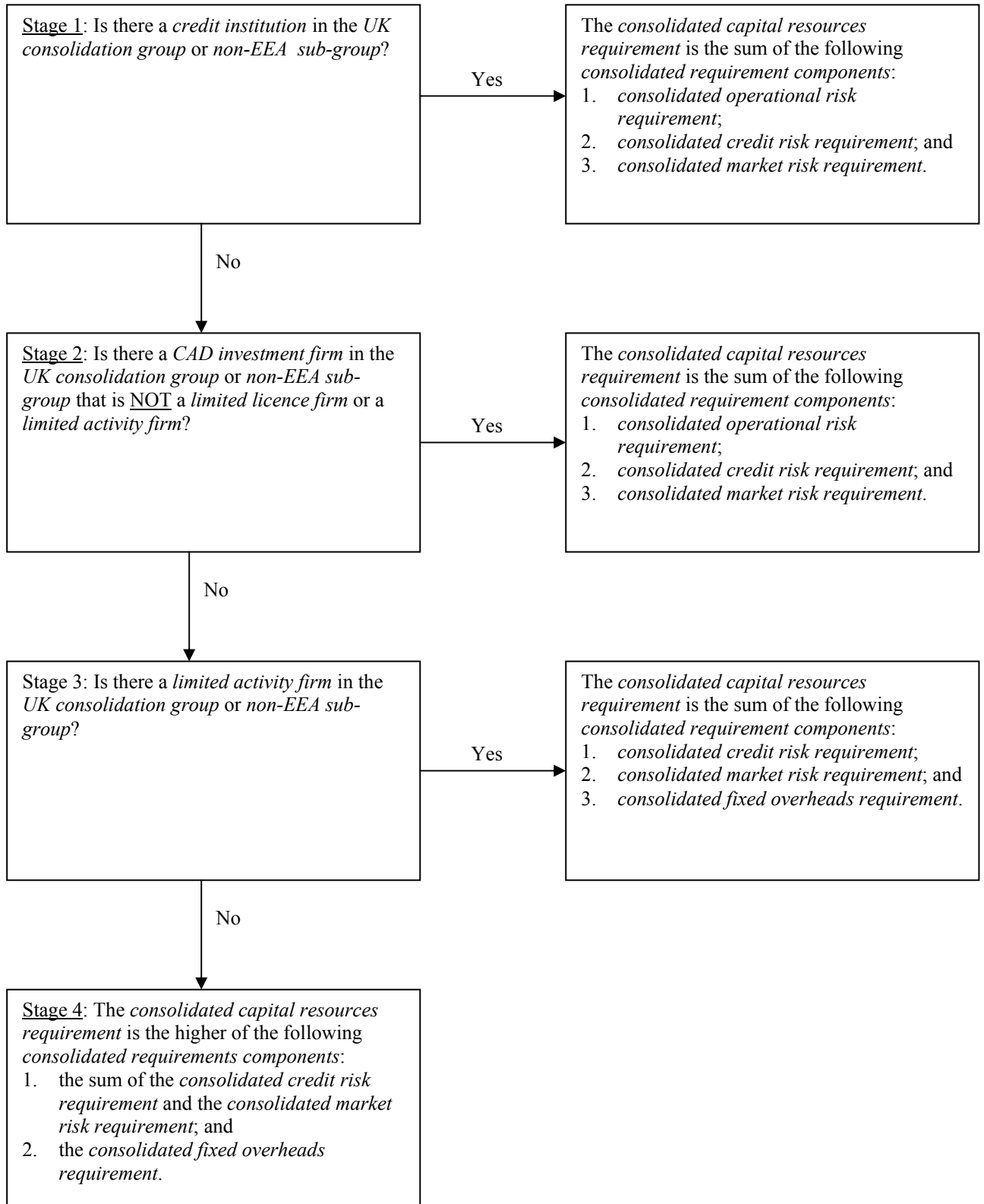
Article 125	
1.	Where a parent undertaking is a parent credit institution in a Member State or an EU parent credit institution, supervision on a consolidated basis shall be exercised by the competent authorities that authorised it under Article 6.
2.	Where the parent of a credit institution is a parent financial holding company in a Member State or an EU parent financial holding company, supervision on a consolidated basis shall be exercised by the competent authorities that authorised that credit institution under Article 6.
Article 126	
1.	Where credit institutions authorised in two or more Member States have as their parent the same parent financial holding company in a Member State or the same EU parent financial holding company, supervision on a consolidated basis shall be exercised by the competent authorities of the credit institution authorised in the Member State in which the financial holding company was set up.
	Where the parents of credit institutions authorised in two or more Member States comprise more than one financial holding company with head offices in different Member States and there is a credit institution in each of these States, supervision on a consolidated basis shall be exercised by the competent authority of the credit institution with the largest balance sheet total.
2.	Where more than one credit institution authorised in the Community has as its parent the same financial holding company and none of these credit institutions has been authorised in the Member State in which the financial holding company was set up, supervision on a consolidated basis shall be exercised by the competent authority that authorised the credit institution with the largest balance sheet total, which shall be considered, for the purposes of this Directive, as the credit institution controlled by an EU parent financial holding company.
3.	In particular cases, the competent authorities may by common agreement waive the criteria referred to in paragraphs 1 and 2 if their application would be inappropriate, taking into account the credit institutions and the relative importance of their activities in different countries, and appoint a different competent authority to exercise supervision on a consolidated basis. In these cases, before taking their decision, the competent authorities shall give the EU parent credit institution, or EU parent financial holding company, or credit institution with the largest balance sheet total, as appropriate, an opportunity to state its opinion on that decision.

4.	[Omitted]
Note	The <i>Capital Adequacy Directive</i> says that generally references in Articles 125 and 126 of the <i>Banking Consolidation Directive</i> to <i>credit institutions</i> should be read as including ones to <i>CAD investment firms</i> . Also, the <i>Banking Consolidation Directive</i> and the <i>Capital Adequacy Directive</i> apply to the <i>EEA</i> . Therefore for the purposes of <i>BIPRU 8</i> Articles 125 and 126 of the <i>Banking Consolidation Directive</i> should be read with the following adjustments:
	(1) a reference to a credit institution should be read as being one to a <i>credit institution</i> or <i>CAD investment firm</i> ;
	(2) a reference to a parent credit institution in a Member State should be read as being one to a <i>parent institution in a Member State</i> ;
	(3) a reference to a EU parent credit institution should be read as being one to an <i>EEA parent institution</i> ;
	(4) a reference to a EU parent financial holding company should be read as being one to an <i>EEA parent financial holding company</i> ;
	(5) a reference to a Member State should be read as being one to an <i>EEA State</i> ;
	(6) a reference to a credit institution authorised in the Community should be read as being to a <i>credit institution</i> or <i>CAD investment firm</i> authorised in an <i>EEA State</i> .
	Parent financial holding company in a Member State and financial holding company have the same meaning as they do in the <i>Glossary</i> .

BIPRU 8: Group risk - consolidation

BIPRU 8 Annex 5R

Decision tree for identifying the *consolidated capital resources requirement* of a *UK consolidation group* or a *non-EEA sub-group*.



BIPRU 8: Group risk - consolidation

ANNEX 6R

Non –EEA regulators' requirements deemed CRD -equivalent for individual risks

Part 1 (Non –EEA banking regulators' requirements deemed CRD -equivalent for individual risks)

Regime regulators	Market risk	Credit risk	Operational Risk
<p><u>USA</u> Office of the Comptroller of the Currency Board of Governors of the Federal Reserve System</p> <p>* a US banking subsidiary will be deemed equivalent for credit risk if:</p> <ul style="list-style-type: none"> • it is categorised as well capitalised: and • it scales up its US Basel 1 credit risk requirement by 25% 	<p>✓</p> <p>✓</p>	<p>x*</p> <p>x*</p>	<p>x</p> <p>x</p>
<p><u>Australia</u> Australian Prudential Regulation Authority [APRA]</p>	<p>✓</p>	<p>✓</p>	<p>x</p>
<p><u>Canada</u> Office of the Superintendent of Financial Institutions [OSFI]</p>	<p>✓</p>	<p>✓</p>	<p>✓</p>
<p><u>Switzerland</u> Swiss Federal Banking Commission [EBK]</p>	<p>✓</p>	<p>✓ See note2</p>	<p>✓</p>
<p><u>Japan</u> Financial Services Agency, Japan [JFSA]</p>	<p>✓</p>	<p>x</p>	<p>x</p>
<p><u>South Africa</u> South African Reserve Bank [SARB]</p>	<p>✓</p>	<p>✓</p>	<p>✓</p>
<p><u>Hong Kong</u> Hong Kong Monetary Authority [HKMA]</p>	<p>✓</p>	<p>✓</p>	<p>✓</p>
<p><u>Singapore</u> Monetary Authority of Singapore [MAS]</p>	<p>✓</p>	<p>✓</p>	<p>✓</p>
<p><u>India</u> Reserve Bank of India [RBI]</p>	<p>✓</p>	<p>✓</p>	<p>✓</p>

BIPRU 8: Group risk - consolidation

Regime regulators	Market risk	Credit risk	Operational Risk
<u>Korea</u> Financial Supervisory Service [FSS]	✓	✗	✗
Note 1: A ✓ denotes that the requirements have been assessed as equivalent to <i>EEA</i> standards. A ✗ denotes that the requirements have been assessed as not being equivalent to <i>EEA</i> standards.			
Note 2: ✓ International standardised approach only. The treatment of the Lombard loans is not equivalent and they must be treated under the <i>FSA's rules</i> .			

BIPRU 8: Group risk - consolidation

Part 2 (Non –EEA investment firm regulators' requirements deemed CRD- equivalent for individual risks)

Regime regulators	Market risk	Credit risk	Operational Risk
<u>Australia</u>			
Sydney Futures Exchange	✓	✗	✗
Australian Stock Exchange	✓	✗	✗
<u>Canada</u>			
Ontario Securities Commission	✓	✗	✗
Quebec Securities Commission	✓	✗	✗
British Columbia Securities Commission	✓	✗	✗
Alberta Securities Commission	✓	✗	✗
Investment dealers Association of Canada	✓	✗	✗
<u>Hong Kong</u>			
Hong Kong Monetary Authority [HKMA]	✓	✗	✗
Hong Kong Securities and Futures Commission	✓	✗	✗
<u>Japan</u>			
Financial Services Agency, Japan [JFSA]	✓	✗	✗
<u>Singapore</u>			
Monetary Authority of Singapore [MAS]	✓	✗	✗
Stock Exchange of Singapore	✓	✗	✗
<u>South Africa</u>			
South African Futures Exchange	✓	✗	✗
Johannesburg Stock Exchange	✓	✗	✗
Bond Exchange of South Africa	✓	✗	✗
<u>Switzerland</u>			
Swiss Federal Banking Commission [EBK]	✓	✓ Note 2	✓
<u>USA</u>			
Securities & Exchange Commission (SEC): Net Capital rule only	✓ Note 3	✗	✗
Commodities and Futures Trading Commission	✓	✗	✗
Note 1: A ✓ denotes that the requirements have been assessed as equivalent to <i>EEA</i> standards. A ✗ denotes that the requirements have been assessed as not being equivalent to <i>EEA</i> standards.			
Note 2: ✓ International standardised approach only. The treatment of Lombard loans is not equivalent and they must be treated under the <i>FSA's rules</i> .			
Note 3: ✓ Where entities are subject to a local regulatory capital requirement.			

- 9 Securitisation
- 9.1 Application and purpose
- Application
- 9.1.1 R *BIPRU 9* applies to a *BIPRU firm*.
- Purpose
- 9.1.2 G The purpose of *BIPRU 9* is to implement:
- (1) Articles 94 to 96, paragraphs (1) and (5) of Article 97 , Article 99, Article 100(1) and Article 101;
- (2) Points 8 and 9 of Annex V; and
- (3) Parts 2, 3 (in part) and 4 of Annex IX;
- of the *Banking Consolidation Directive*.
- General obligations: Risk-weighted exposures
- 9.1.3 R A *firm* must calculate the *risk weighted exposure amount* for *securitisation positions* in accordance with *BIPRU 9*.
- 9.1.4 G A *firm* should apply the *securitisation* framework set out in this chapter for determining regulatory capital requirements on *exposures* arising from *traditional securitisations* and from *synthetic securitisations* and from structures that contain features of both.
- 9.1.5 G Since transactions may be structured in many different ways, the capital treatment of a position should be determined on the basis of its economic substance rather than merely its legal form. A *firm* should look to the economic substance of a transaction to determine whether the *securitisation* framework is applicable for purposes of determining regulatory capital. A *firm* should consult the *FSA* when there is uncertainty about whether a given transaction should be considered a *securitisation*.
- General obligations: Systems
- 9.1.6 R The risks arising from *securitisation* transactions in relation to which a *firm* is *originator* or *sponsor* must be evaluated and addressed through appropriate policies and procedures, to ensure in particular that the economic substance of the transaction is fully reflected in the risk assessment and management decisions.

[**Note:** *BCD* Annex V point 8]

- 9.1.7 G A *firm* that is a party to a *securitisation* should fully understand the risks it has assumed or retained. In particular it should do so in order that it can correctly determine in accordance with *BIPRU 9* the capital effects of the *securitisation*.
- 9.1.8 G The *FSA* expects an *originator* to continue to monitor any risks that it may be subject to when it has excluded the *securitised exposures* from its calculation of *risk weighted exposure amounts*. The *originator* should consider capital planning implications where risks may return and the impact that *securitisation* has on the quality of the remaining *exposures* held by the *originator*.

Trading book and non-trading book

- 9.1.9 G *BIPRU 9* deals with:
- (1) requirements for *originators* and *sponsors* of *securitisations* of *non-trading book exposures*; and
 - (2) the calculation of *risk weighted exposure amounts* for *securitisation* positions for the purposes of calculating either the *credit risk capital component* or the *counterparty risk capital component*.
- 9.1.10 G *BIPRU 7* sets out the calculation of the *market risk capital requirement* for *securitisation* positions held in the *trading book*.

Approach to be used

- 9.2.1 R (1) Where a *firm* uses the *standardised approach* set out in *BIPRU 3* (Standardised approach to credit risk) for the calculation of *risk weighted exposure amounts* for the *standardised credit risk exposure class* to which the *securitised exposures* would otherwise be assigned under *BIPRU 3*, then it must calculate the *risk weighted exposure amount* for a *securitisation position* in accordance with the *standardised approach to securitisations* set out in *BIPRU 9.9, BIPRU 9.10, BIPRU 9.11 and BIPRU 9.13*.
- (2) In all other cases it must calculate a *risk weighted exposure amount* in accordance with the *IRB approach to securitisations* set out in *BIPRU 9.9, BIPRU 9.10, BIPRU 9.12, BIPRU 9.13 and BIPRU 9.14*.

[Note: *BCD Article 94*]

9.3 Requirements for originators

- 9.3.1 R (1) Where significant credit risk associated with *securitised exposures* has been transferred from the *originator* in accordance with the terms of *BIPRU 9.4* or *BIPRU 9.5*, that *originator* may:
- (a) in the case of a *traditional securitisation*, exclude from its calculation of *risk weighted exposure amounts* and, as relevant, *expected loss amounts*, the *exposures* which it has *securitised*; and
 - (b) in the case of a *synthetic securitisation*, calculate *risk weighted exposure amounts* and, as relevant, *expected loss amounts* in respect of such *exposures*, in accordance with the provisions of *BIPRU 9.5*.
- (2) Where (1) applies, the *originator* must calculate the *risk weighted exposure amounts* prescribed in this chapter for the positions it may hold in the *securitisation*.
- (3) Where the *originator* fails to transfer significant credit risk in accordance with (1), it need not calculate *risk weighted exposure amounts* for any positions it may hold in the *securitisation* in question.

[**Note:** *BCD Article 95*]

- 9.3.2 G Subject to *BIPRU 9.3.6G*, for the purposes of *BIPRU 9.4.1R* and *BIPRU 9.5.1R* the transfer of credit risk to third parties should only be considered significant if the proportion of risk transferred is broadly commensurate with, or exceeds, the proportion by which *risk weighted exposure amounts* are reduced.
- 9.3.3 G For measuring the reduction in risk and *risk weighted exposure amounts*, an *originator* should assess the *securitisation positions* it holds against the underlying *exposures* if they had never been *securitised*.
- 9.3.4 G An *originator* should use an appropriate method, consistent with its own internal processes, to assess whether the risk transferred is significant.
- 9.3.5 G If the result of,
- (1) applying a *risk weight* of 1250% to all positions that an *originator* holds in the *securitisation*; or
 - (2) deducting all those positions from *capital resources*;

is a reduction in the *originator's* capital requirement compared to the capital requirements that would apply had it not transferred the *securitised exposures*, then the *originator* may treat the risk transferred as significant for the purposes of *BIPRU 9.4.1R* and *BIPRU 9.5.1R*.

- 9.3.6 G An *originator* should not adjust its assessment of the transfer of risk in order to reflect uncertainties related to the effectiveness of a *securitisation* under *BIPRU* 9.4 or *BIPRU* 9.5. Instead the *originator* should treat the terms of *BIPRU* 9.4 or *BIPRU* 9.5 as not having been satisfied.

9.4 Traditional securitisation

Minimum requirements for recognition of significant credit risk transfer

- 9.4.1 R The *originator* of a *traditional securitisation* may exclude *securitised exposures* from the calculation of *risk weighted exposure amounts* and *expected loss amounts* if significant credit risk associated with the *securitised exposures* has been transferred to third parties and the transfer complies with the conditions in *BIPRU 9.4.2R-BIPRU 9.4.10R*.

[**Note:** *BCD Annex IX Part 2 point 1 (part)*]

- 9.4.2 R The *securitisation* documentation must reflect the economic substance of the transaction.

[**Note:** *BCD Annex IX Part 2 point 1 (part)*]

- 9.4.3 R The *securitised exposures* must be put beyond the reach of the *originator* and its creditors, including in bankruptcy and receivership. This must be supported by the opinion of qualified legal counsel.

[**Note:** *BCD Annex IX Part 2 point 1 (part)*]

- 9.4.4 G Legal counsel's opinions should be reviewed as necessary. For example, an opinion should be reviewed if a relevant statutory provision is amended or where a new decision or judgment of a court might have a bearing on the conclusions reached.

- 9.4.5 R The securities issued must not represent payment obligations of the *originator*.

[**Note:** *BCD Annex IX Part 2 point 1 (part)*]

- 9.4.6 R The transferee must be a *securitisation special-purpose entity*.

[**Note:** *BCD Annex IX Part 2 point 1 (part)*]

- 9.4.7 R The *originator* must not maintain effective or indirect control over the transferred *exposures*.

[**Note:** *BCD Annex IX Part 2 point 1 (part)*]

- 9.4.8 R Where there is a *clean-up call option*, the following conditions must be satisfied:

- (1) the *clean-up call option* is exercisable at the discretion of the *originator*;
- (2) the *clean-up call option* may only be exercised when 10% or less of the original value of the *exposures securitised* remains unamortised; and
- (3) the *clean-up call option* is not structured to avoid allocating losses to *credit enhancement* positions or other positions held by investors and is not otherwise structured to provide *credit enhancement*.

[**Note:** BCD Annex IX Part 2 point 1 (part)]

- 9.4.9 R The *securitisation* documentation must not contain clauses that:
- (1) other than in the case of *early amortisation provisions*, require positions in the *securitisation* to be improved by the *originator* including but not limited to altering the underlying credit exposures or increasing the yield payable to investors in response to a deterioration in the credit quality of the *securitised exposures*; or
 - (2) increase the yield payable to holders of positions in the *securitisation* in response to a deterioration in the credit quality of the underlying pool.

[**Note:** BCD Annex IX Part 2 point 1 (part)]

- 9.4.10 R For the purposes of BIPRU 9.4.7R, an *originator* will be considered to have maintained effective control over the transferred *exposures* if it has the right to repurchase from the transferee the previously transferred *exposures* in order to realise their benefits or if it is obligated to re-assume transferred risk. The *originator's* retention of servicing rights or obligations in respect of the *exposures* does not of itself constitute indirect control of the *exposures*.

[**Note:** BCD Annex IX Part 2 point 1 (part)]

9.5 Synthetic securitisation

Minimum requirements for recognition of significant credit risk transfer

- 9.5.1 R (1) An *originator* of a *synthetic securitisation* may calculate *risk weighted exposure amounts*, and, as relevant, *expected loss amounts*, for the *securitised exposures* in accordance with *BIPRU 9.5.3R* and *BIPRU 9.5.4R*, if significant credit risk has been transferred to third parties, either through funded or unfunded credit protection, and the transfer complies with the conditions in (2)-(5).
- (2) The *securitisation* documentation must reflect the economic substance of the transaction.
- (3) The credit protection by which the credit risk is transferred must comply with the eligibility and other requirements under *BIPRU 5* (Credit risk mitigation) and, so far as applicable, *BIPRU 4.10* (Credit risk mitigation under the IRB approach) for the recognition of such credit protection. For the purposes of this *rule*, *securitisation special purpose entities* must not be recognised as eligible unfunded protection providers.
- (4) The instruments used to transfer credit risk must not contain terms or conditions that:
- (a) impose significant materiality thresholds below which credit protection is deemed not to be triggered if a credit event occurs;
 - (b) allow for the termination of the protection due to deterioration of the credit quality of the underlying *exposures*;
 - (c) other than in the case of *early amortisation provisions*, require positions in the *securitisation* to be improved by the *originator*; or
 - (d) increase the *originator's* cost of credit protection or the yield payable to holders of positions in the *securitisation* in response to a deterioration in the credit quality of the underlying pool.
- (5) An opinion must be obtained from qualified legal counsel confirming the enforceability of the credit protection in all relevant jurisdictions.

[**Note:** *BCD* Annex IX Part 2 point 2]

Originators' calculation of risk-weighted exposure amounts for exposures securitised in a synthetic securitisation

- 9.5.2 R *BIPRU 9.5.3R-BIPRU 9.5.8R* apply to the calculation by an *originator* of *risk weighted exposure amounts* for *exposures securitised* in a *synthetic securitisation*.

- 9.5.3 R (1) In calculating *risk weighted exposure amounts* for the *securitised exposures*, where the conditions in *BIPRU 9.5.1R* are met, the *originator* of a *synthetic securitisation* must, subject to the treatment of maturity mismatches set out in *BIPRU 9.5.6R-BIPRU 9.5.8R*, use the relevant calculation methodologies set out in *BIPRU 9.9-BIPRU 9.14* and not those set out in *BIPRU 3* (Standardised credit risk) or *BIPRU 4* (IRB approach).
- (2) For *firms* calculating *risk weighted exposure amounts* and *expected loss* amounts under the *IRB approach*, the *expected loss* amount in respect of such *exposures* must be zero.
- (3) For clarity, this paragraph refers to the entire pool of *exposures* included in the *securitisation*.

[**Note:** *BCD* Annex IX Part 2 point 3 and point 4 (part)]

- 9.5.4 R Subject to the treatment of maturity mismatches set out in *BIPRU 9.5.6R-BIPRU 9.5.8R*, the *originator* must calculate *risk weighted exposure amounts* in respect of all *tranches* in the *securitisation* in accordance with the provisions of *BIPRU 9.9-BIPRU 9.14*. For example, where a *tranche* is transferred by means of unfunded credit protection to a third party, the *risk weight* of that third party must be applied to the *tranche* in the calculation of the *originator's risk weighted exposure amounts*.

[**Note:** *BCD* Annex IX Part 2 point 4 (part)]

Treatment of maturity mismatches in synthetic securitisations

- 9.5.5 R *BIPRU 9.5.6R-BIPRU 9.5.8R* apply to the treatment of maturity mismatches in a *synthetic securitisation*.
- 9.5.6 R For the purposes of calculating *risk weighted exposure amounts* in accordance with *BIPRU 9.5.3R*, any maturity mismatch between the credit protection by which the *tranching* is achieved and the *securitised exposures* must be taken into consideration in accordance with *BIPRU 9.5.7R-BIPRU 9.5.8R*.

[**Note:** *BCD* Annex IX Part 2 point 5]

- 9.5.7 R The maturity of the *securitised exposures* must be taken to be the longest maturity of any of those *exposures* subject to a maximum of five years. The maturity of the credit protection must be determined in accordance with *BIPRU 5* (Credit risk mitigation) and, so far as relevant, *BIPRU 4.10* (Credit risk mitigation under the IRB approach).

[**Note:** *BCD* Annex IX Part 2 point 6]

- 9.5.8 R (1) An *originator* must ignore any maturity mismatch in calculating *risk weighted exposure amounts* for *tranches* appearing pursuant to *BIPRU 9.9 - BIPRU 9.14* with a *risk weight* of 1250%. For all other *tranches* the maturity mismatch treatment prescribed in *BIPRU 5.8* (Maturity mismatches) must be applied in accordance with the following formula:

RW^* is $[RW(SP) \times (t-t^*)/(T-t^*)] + [RW(Ass) \times (T-t)/(T-t^*)]$

- (2) The following apply for the purposes of the formula in (1):
- (a) RW^* is *risk weighted exposure amounts*;
 - (b) $RW(Ass)$ is *risk weighted exposure amounts* for *exposures* if they had not been *securitised* calculated on a pro-rata basis;
 - (c) $RW(SP)$ is *risk weighted exposure amounts* calculated under *BIPRU 9.6.3R* as if there was no maturity mismatch;
 - (d) T is maturity of the underlying *exposures* expressed in years;
 - (e) t is maturity of credit protection. expressed in years; and
 - (f) t^* is 0.25.

[**Note:** *BCD Annex IX Part 2 point 7*]

9.6 Implicit support

9.6.1 R An *originator* which, in respect of a securitisation, has made use of *BIPRU 9.3.1R* in the calculation of *risk weighted exposure amounts*, or a *sponsor*, must not, with a view to reducing potential or actual losses to investors, provide support to the *securitisation* beyond its contractual obligations.

[Note: *BCD Article 101(1)*]

9.6.2 R If an *originator* or *sponsor* fails to comply with *BIPRU 9.6.1R* in respect of a *securitisation*, it must :

- (1) hold capital against all of the *securitised exposures* associated with the *securitisation* transaction as if they had not been *securitised*; and
- (2) disclose publicly:
 - (a) that it has provided non-contractual support, and
 - (b) the regulatory capital impact of doing so.

[Note: *BCD Article 101(2)*]

9.6.3 G (1) *Securitisation* documentation should make clear, where applicable, that any repurchase of *securitised exposures* or *securitisation positions* by the *originator* or *sponsor* beyond its contractual obligations is not mandatory and may only be made at fair market value. In general, any such repurchase should be subject to a *firm's* credit review and approval process, which should be adequate to ensure that the repurchase complies with *BIPRU 9.6.1R*.

(2) If an *originator* or *sponsor* repurchases *securitised exposures* or *securitisation positions*, it should be able to satisfy the *FSA* that it has adequately considered the following:

- (a) the price of the repurchase;
- (b) the *firm's* capital and liquidity position before and after repurchase;
- (c) the performance of the *securitised exposures*; and
- (d) the performance of the issued securities;

and has concluded that, taking into account those factors and any other relevant factors, the repurchase is not structured to provide support.

(3) A *firm* should keep adequate records of the matters in (1) and (2).

- 9.6.4 G If a *firm* is found to have provided implicit support to a *securitisation*, that fact increases the expectation that the *firm* will provide future support to its *securitisations* thus failing to achieve a significant transfer of risk. The *FSA* will consider taking appropriate measures to reflect this increased expectation after an instance of implicit support is found.
- 9.6.5 G A *firm* may need to consider three main situations to determine whether there is a breach of the prohibition against implicit support in *BIPRU* 9.6.1R:
- (1) support given under a contractual obligation;
 - (2) support given under the contractual documentation for the *securitisation* which the *firm* is entitled, but not obliged, to give; and
 - (3) support which is not provided for under the contractual documentation for the *securitisation*.
- 9.6.6 G
- (1) The support described in *BIPRU* 9.6.5G(1) is permitted by *BIPRU* 9.6.1R.
 - (2) The support described in *BIPRU* 9.6.5G(3) is not permitted by *BIPRU* 9.6.1R.
 - (3) The support described in *BIPRU* 9.6.5G(2) may be permitted by *BIPRU* 9.6.1R under the following conditions:
 - (a) the fact that the *firm* may give it is expressly set out in the contractual and marketing documents for the *securitisation*;
 - (b) the nature of the support that the *firm* may give is precisely described in the documentation;
 - (c) the maximum degree of support that can be given can be ascertained at the time of the *securitisation* both by the *firm* and by a *person* whose only information comes from the marketing documents for the *securitisation*;
 - (d) the assessment of whether there has been significant risk transfer and the amount of that transfer is made on the basis that the *firm* will provide support to the maximum degree possible; and
 - (e) the *firm's capital resources* and *capital resources requirement* are adjusted at the time of the *securitisation* on the basis that the *firm* has provided support to the maximum degree possible, whether by an immediate deduction from capital or appropriate *risk weighting*.
- 9.6.7 G A waiver of the right to future margin income may not breach the prohibition against implicit support:
- (1) the degree of support that can be given can be defined precisely by reference to the *securitisation* contractual documentation, albeit the amount of support may not be ascertainable in absolute monetary terms; and

(2) no adjustment to the *firm's capital resources* or *capital resources requirement* is required, as a *firm* should not in any case reflect future margin income in its income or *capital resources*.

9.6.8 G For the purposes of *BIPRU* 9.6.2(2), *firms* will be expected to include disclosure of implicit support in accordance with the general and technical requirements on public disclosure, as outlined in *BIPRU* 11 (Disclosure).

9.7 Recognition of credit assessments of *ECAIs*

9.7.1 R An *ECAI's* credit assessment may be used to determine the *risk weight* of a *securitisation position* in accordance with *BIPRU 9.9* only if the *ECAI* is an *eligible ECAI*.

[**Note:** *BCD Article 97(1)*]

9.7.2 R (1) A *firm* may not use a credit assessment of an *eligible ECAI* to determine the *risk weight* of a *securitisation position* in accordance with *BIPRU 9.9* unless it complies with the principles of credibility and transparency as elaborated in (2) to (4).

(2) There must be no mismatch between the types of payments reflected in the credit assessment and the types of payment to which the *firm* is entitled under the contract giving rise to the *securitisation position* in question.

(3) The credit assessment must be available publicly to the market. Credit assessments may only be treated as publicly available if:

(a) they have been published in a publicly accessible forum, and

(b) they are included in the *ECAI's* transition matrix.

(4) Credit assessments that are made available only to a limited number of entities may not be treated as publicly available.

[**Note:** *BCD Article 97(5)* and Annex IX Part 3 point 1]

9.7.3 G The *guidance* in *BIPRU 3.3* (Recognition of ratings agencies) applies for the purposes of *BIPRU 9* as it does to *exposure risk weighting* in *BIPRU 3*, save that the reference in *BIPRU 3.3* to the Regulation 3 of the *ECAI SI* should be read as a reference to Regulation 4 of the *ECAI SI* for the purposes of *BIPRU 9*.

- 9.8 Use of ECAI credit assessments for the determination of applicable risk weights
- 9.8.1 R The use of *ECAIs*' credit assessments for the calculation of a *firm's risk weighted exposure amounts* under *BIPRU 9* must be consistent and in accordance with *BIPRU 9.8.2R-BIPRU 9.8.7R*. Credit assessments must not be used selectively.
- [**Note:** *BCD Article 99*]
- 9.8.2 R A *firm* may nominate one or more *eligible ECAIs* the credit assessments of which must be used in the calculation of its *risk weighted exposure amounts* under *BIPRU 9* (a *nominated ECAI*).
- [**Note:** *BCD Annex IX Part 3 point 2*]
- 9.8.3 R Subject to *BIPRU 9.8.5R-BIPRU 9.8.7R*, a *firm* must use credit assessments from *nominated ECAIs* consistently in respect of its *securitisation positions*.
- [**Note:** *BCD Annex IX Part 3 point 3*]
- 9.8.4 R Subject to *BIPRU 9.8.5R* and *BIPRU 9.8.6R*, a *firm* must not use an *ECAI's* credit assessments for its positions in some *tranches* and another *ECAI's* credit assessments for its positions in other *tranches* within the same structure that may or may not be *rated* by the first *ECAI*.
- [**Note:** *BCD Annex IX Part 3 point 4*]
- 9.8.5 R Where a position has two credit assessments by *nominated ECAIs*, the *firm* must use the less favourable credit assessment.
- [**Note:** *BCD Annex IX Part 3 point 5*]
- 9.8.6 R Where a position has more than two credit assessments by *nominated ECAIs*, the two most favourable credit assessments must be used. If the two most favourable assessments are different, the least favourable of the two must be used.
- [**Note:** *BCD Annex IX Part 3 point 6*]
- 9.8.7 R
- (1) Where credit protection eligible under *BIPRU 5* (Credit risk mitigation) and, if applicable, *BIPRU 4.10* (Credit risk mitigation under the IRB approach) is provided directly to the *SSPE*, and that protection is reflected in the credit assessment of a position by a *nominated ECAI*, the *risk weight* associated with that credit assessment may be used.
 - (2) If the protection is not eligible under *BIPRU 5* (Credit risk mitigation) and, if applicable, *BIPRU 4.10* (Credit risk mitigation under the IRB approach), the credit assessment must not be recognised.

- (3) In the situation where the credit protection is not provided to the *SSPE* but rather is provided directly to a *securitisation position*, the credit assessment must not be recognised.

[**Note:** *BCD* Annex IX Part 3 point 7]

9.9 Calculation of risk-weighted exposure amounts for securitisation positions

9.9.1 R To calculate the *risk weighted exposure amount* of a *securitisation position*, the relevant *risk weight* must be assigned to the *exposure* value of the position in accordance with *BIPRU 9.9-BIPRU 9.14* based on the credit quality of the position.

[**Note:** *BCD* Article 96(1) (part) and Annex XI, Part 4 point 1]

9.9.2 R For the purpose of *BIPRU 9.9.1R*, the credit quality of a position may be determined by reference to an *ECAI* credit assessment or otherwise, as set out in *BIPRU 9.9-BIPRU 9.14*.

[**Note:** *BCD* Article 96(1) (part)]

9.9.3 R (1) Where there is an *exposure* to different *tranches* in a *securitisation*, the *exposure* to each *tranche* must be considered a separate *securitisation position*.

(2) The providers of credit protection to *securitisation positions* must be treated as holding positions in the *securitisation*.

(3) *Securitisation positions* include *exposures* to a *securitisation* arising from interest rate or currency derivative contracts.

[**Note:** *BCD* Article 96(2)]

9.9.4 R Subject to *BIPRU 9.9.5R*,

(1) where a *firm* calculates *risk weighted exposure amounts* under the *standardised approach* to *securitisations* outlined in *BIPRU 9.11*, the *exposure* value of an on-balance sheet *securitisation position* must be its balance sheet value;

(2) where a *firm* calculates *risk weighted exposure amounts* under the *IRB approach* to *securitisations* outlined in *BIPRU 9.12*, the *exposure* value of an on-balance sheet *securitisation position* must be measured gross of value adjustments;

(3) the *exposure* value of an off-balance sheet *securitisation position* must be its nominal value multiplied by a conversion figure as prescribed in this chapter; and

(4) the conversion figure referred to in (3) must be 100% unless otherwise specified.

[**Note:** *BCD* Annex IX Part 4 point 2]

- 9.9.5 R The *exposure* value of a *securitisation position* arising from a *financial derivative instrument* must be determined in accordance with *BIPRU* 13 (Treatment of derivative instruments).
- [Note: *BCD* Annex IX Part 4 point 3]
- 9.9.6 R Where a *securitisation position* is subject to funded credit protection, the *exposure* value of that position may be modified in accordance with and subject to the requirements of *BIPRU* 5 (Credit risk mitigation) as further specified in *BIPRU* 9.11.13R and *BIPRU* 9.14.
- [Note: *BCD* Annex IX Part 4 point 4]
- 9.9.7 R Where a *securitisation position* is subject to funded or unfunded credit protection the *risk weight* to be applied to that position may be modified in accordance with *BIPRU* 5 (Credit risk mitigation) and, if applicable, *BIPRU* 4.10 (Credit risk mitigation under the IRB approach) read in conjunction with *BIPRU* 9.14.
- [Note: *BCD* Article 96(3)]
- 9.9.8 R (1) Where a *firm* has two or more overlapping positions in a *securitisation* the *firm* must, to the extent that the positions overlap, include in its calculation of *risk weighted exposure amounts* only the position, or portion of a position, producing the higher *risk weighted exposure amounts*.
- (2) For the purposes of (1), overlapping means that the positions, wholly or partially, represent an *exposure* to the same risk such that to the extent of the overlap there is a single *exposure*.
- [Note: *BCD* Annex IX Part 4 point 5]
- 9.9.9 R Subject to the provisions of *GENPRU* that deal with the deduction of *securitisation positions* at stage M in the relevant *capital resources table*, the *risk weighted exposure amount* must be included in the *firm's* total of *risk weighted exposure amounts* for the purposes of the calculation of its *credit risk capital requirement*.
- [Note: *BCD* Article 96(4)]

- 9.10 Reduction in risk-weighted exposure amounts
- 9.10.1 R *BIPRU* 9.10 applies as follows:
- (1) *BIPRU* 9.10.2R and *BIPRU* 9.10.3R apply to both the *standardised approach* and the *IRB approach*; and
 - (2) *BIPRU* 9.10.4R-*BIPRU* 9.10.7R apply to the *IRB approach*.
- 9.10.2 R In respect of a *securitisation position* in respect of which a 1250% *risk weight* is assigned, a *firm* may, as an alternative to including the position in its calculation of *risk weighted exposure amounts*, deduct from its *capital resources* the *exposure* value of the position. For these purposes, the calculation of the *exposure* value may reflect eligible funded protection in a manner consistent with *BIPRU* 9.14.
- [**Note:** *BCD* Annex IX Part 4 points 35, 74 and 75(b)]
- 9.10.3 R Where a *firm* applies *BIPRU* 9.10.2R, 12.5 times the amount deducted in accordance with that paragraph must, for the purposes of *BIPRU* 9.11.5R and *BIPRU* 9.12.8R, be subtracted from the amount specified in whichever of those *rules* applies as the maximum *risk weighted exposure amount* to be calculated by a *firm* to which one of those *rules* applies.
- [**Note:** *BCD* Annex IX Part 4 point 36 and point 76]
- 9.10.4 R The *risk weighted exposure amount* of a *securitisation position* to which a 1250% *risk weight* is assigned may be reduced by 12.5 times the amount of any value adjustments made by the *firm* in respect of the *securitised exposures*.
- [**Note:** *BCD* Annex IX Part 4 point 72 (part)]
- 9.10.5 R To the extent that value adjustments are taken account of for the purposes of *BIPRU* 9.10.4R they must not be taken account of for the purposes of the calculation indicated in *BIPRU* 4.3.8R (Treatment of expected loss amounts).
- [**Note:** *BCD* Annex IX Part 4 point 72 (part)]
- 9.10.6 R The *risk weighted exposure amount* of a *securitisation position* may be reduced by 12.5 times the amount of any value adjustments made by the *firm* in respect of the position.
- [**Note:** *BCD* Annex IX Part 4 point 73]
- 9.10.7 R For the purposes of *BIPRU* 9.10.2R (as it applies to the *IRB approach*):
- (1) the *exposure* value of the position may be derived from the *risk weighted exposure amounts* taking into account any reductions made in accordance with *BIPRU* 9.10.4R-*BIPRU* 9.10.6R;

- (2) where the *supervisory formula method* is used to calculate *risk weighted exposure amounts* and $L \leq K_{IRBR}$ and $[L+T] > K_{IRBR}$ the position may be treated as two positions with L equal to K_{IRBR} for the more senior of the positions.

[Note: BCD Annex IX Part 4 point 75(a) and (c)]

9.11 Calculation of risk weighted exposure amounts under the standardised approach to securitisations

9.11.1 R Subject to *BIPRU 9.11.5R*, the *risk weighted exposure amount* of a *rated securitisation position* must be calculated by applying to the *exposure* value the *risk weight* associated with the *credit quality step* with which the credit assessment has been determined to be associated, as prescribed in *BIPRU 9.11.2R* or *BIPRU 9.11.3R*.

[**Note:** *BCD Annex IX Part 4 point 6*]

9.11.2 R Table: Positions other than ones with short-term credit assessments
This table belongs to *BIPRU 9.11.1R*

<i>Credit Quality step</i>	1	2	3	4	5 and below
<i>Risk weight</i>	20%	50%	100%	350%	1250%

9.11.3 R Table: Positions with short-term credit assessments
This table belongs to *BIPRU 9.11.1R*

<i>Credit quality step</i>	1	2	3	All other credit assessments
<i>Risk weight</i>	20%	50%	100%	1250%

9.11.4 R Subject to *BIPRU 9.11.6R-BIPRU 9.11.12R*, the *risk weighted exposure amount* of an *unrated securitisation position* must be calculated by applying a *risk weight* of 1250%.

[**Note:** *BCD Annex IX Part 4 point 7*]

Originator and sponsor firms

- 9.11.5 R For an *originator* or *sponsor*, the *risk weighted exposure amounts* calculated in respect of its positions in a *securitisation* may be limited to the *risk weighted exposure amounts* which would be calculated for the *securitised exposures* had they not been *securitised* subject to the presumed application of a 150% *risk weight* to all past due items and items belonging to regulatory high risk categories (see *BIPRU 3.4.104R* and *BIPRU 3 Annex 3R*) amongst the *securitised exposures*.

[**Note:** *BCD Annex IX Part 4 point 8*]

Treatment of unrated securitisation positions

- 9.11.6 R (1) A *firm* having an *unrated securitisation position* may apply the treatment set out in this paragraph for calculating the *risk weighted exposure amount* for that position provided the composition of the pool of *exposures securitised* is known at all times.
- (2) A *firm* may apply the weighted-average *risk weight* that would be applied to the *securitised exposures* referred to in (1) under the *standardised approach* by a *firm* holding the *exposures* multiplied by a concentration ratio.
- (3) This concentration ratio is equal to the sum of the nominal amounts of all the *tranches* divided by the sum of the nominal amounts of the *tranches* junior to, or *pari passu* with, the *tranche* in which the position is held including that *tranche* itself.
- (4) The resulting *risk weight* must not be higher than 1250% or lower than any *risk weight* applicable to a *rated* more senior *tranche*.
- (5) Where the *firm* is unable to determine the *risk weights* that would be applied to the *securitised exposures* under the *standardised approach*, it must apply a *risk weight* of 1250% to the position.

[**Note:** *BCD Annex IX Part 4 points 9 and 10*]

- 9.11.7 G (1) This provision contains *guidance* on the requirement in *BIPRU 9.11.6R(1)* that the composition of the pool of *exposures securitised* must be known at all times.
- (2) The composition should be known sufficiently at the time of purchase for the *firm* to be able accurately to calculate the *risk weighted exposure amounts* of the pool under the *standardised approach*.
- (3) Thereafter, any change to the composition of the pool during the life of the transaction that would lead to an increase in the *risk weighted exposure amounts* of the pool of *exposures* under the *standardised approach* should be either:
- (a) prohibited by the documentation; or
- (b) included in the *firm's* capital calculations.

- (4) It would be sufficient for the purposes of (2) for the composition of the pool to be reported to the *firm* at least daily, via information service providers, secure web-sites or other appropriate sources.

Treatment of securitisation positions in a second loss tranche or better in an ABCP programme

- 9.11.8 R Subject to the availability of a more favourable treatment by virtue of the provisions concerning *liquidity facilities* in BIPRU 9.11.10R-BIPRU 9.11.12R, a *firm* may apply to *securitisation positions* meeting the conditions set out in BIPRU 9.11.9R a *risk weight* that is the greater of:

- (1) 100%, or
- (2) the highest of the risk weights that would be applied to any of the *securitised exposures* under the *standardised approach* by a *firm* holding the *exposures*.

[Note: BCD Annex IX Part 4 point 11]

- 9.11.9 R For the treatment in BIPRU 9.11.8R to be available,:

- (1) the *securitisation position* must be in an ABCP programme;
- (2) the *securitisation position* must be in a *tranche* which is economically in a second loss position or better in the *securitisation* and the first loss *tranche* must provide meaningful *credit enhancement* to the second loss *tranche*;
- (3) the *securitisation position* must be of a quality the equivalent of investment grade or better; and
- (4) the *firm* in question must not hold a position in the first loss *tranche*.

[Note: BCD Annex IX Part 4 point 12]

Treatment of unrated liquidity facilities

- 9.11.10 R When the conditions in this paragraph have been met, and in order to determine its *exposure* value, a conversion figure of 20% may be applied to the nominal amount of a *liquidity facility* with an original maturity of one year or less and a conversion figure of 50% may be applied to the nominal amount of a *liquidity facility* with an original maturity of more than one year. The *risk weight* to be applied is the highest *risk weight* that would be applied to any of the *securitised exposures* under the *standardised approach* by a *firm* holding the *exposures*. Those conditions are as follows:

- (1) the *liquidity facility* documentation must clearly identify and limit the circumstances under which the facility may be drawn;

- (2) it must not be possible for the facility to be drawn so as to provide credit support by covering losses already incurred at the time of draw – for example, by providing liquidity in respect of *exposures* in default at the time of draw or by acquiring assets at more than fair value;
- (3) the facility must not be used to provide permanent or regular funding for the *securitisation*;
- (4) repayment of draws on the facility must not be subordinated to the claims of investors other than to claims arising in respect of interest rate or currency derivative contracts, fees or other such payments, nor be subject to waiver or deferral;
- (5) it must not be possible for the facility to be drawn after all applicable *credit enhancements* from which the *liquidity facility* would benefit are exhausted; and
- (6) the facility must include a provision that results in an automatic reduction in the amount that can be drawn by the amount of *exposures* that are in *default*, where *default* has the meaning given to it for the purposes of the *IRB approach*, or where the pool of *securitised exposures* consists of *rated* instruments, that terminates the facility if the average quality of the pool falls below investment grade.

[Note: BCD Annex IX Part 4 point 13]

Liquidity facilities that may be drawn only in the event of a general market disruption

- 9.11.11 R To determine its *exposure* value a conversion figure of 0% may be applied to the nominal amount of a *liquidity facility* that may be drawn only in the event of a general market disruption (i.e. where more than one *SSPE* across different transactions are unable to roll over maturing commercial paper and that inability is not the result of an impairment of the *SSPE*'s credit quality or of the credit quality of the *securitised exposures*), provided that the conditions set out in *BIPRU* 9.11.10R are satisfied.

[Note: BCD Annex IX Part 4 point 14]

Cash advance facilities

- 9.11.12 R To determine its *exposure* value, a conversion figure of 0% may be applied to the nominal amount of a *liquidity facility* that is unconditionally cancellable provided that the conditions set out at *BIPRU* 9.11.10R are satisfied and that repayment of draws on the facility are senior to any other claims on the cash flows arising from the *securitised exposures*.

[Note: BCD Annex IX Part 4 point 15]

Standardised approach: recognition of credit risk mitigation on securitisation positions

- 9.11.13 R Where a *firm* calculates the *risk weighted exposure amount* of a *securitisation position* under the *standardised approach*, where credit protection is obtained on a *securitisation position*, the calculation of *risk weighted exposure amounts* may be modified in accordance with *BIPRU 5* (Credit risk mitigation).

[**Note:** *BCD* Annex IX Part 4 point 34]

- 9.12 Calculation of risk-weighted exposure amounts under the IRB approach
- 9.12.1 R *BIPRU 9.12 applies to the calculation of risk weighted exposure amounts of securitisation positions under the IRB approach.*
- [Note: BCD Annex IX Part 4 point 37 (part)]
- Hierarchy of methods
- 9.12.2 R For a *rated position* or a position in respect of which an inferred *rating* may be used, the *ratings based method* must be used to calculate the *risk weighted exposure amount*.
- [Note: BCD Annex IX Part 4 point 38]
- 9.12.3 R For an *unrated position* the *supervisory formula method* must be used except where a *firm* uses the *ABCP internal assessment approach*.
- [Note: BCD Annex IX Part 4 point 39]
- 9.12.4 G In cases where both the *ABCP internal assessment approach* and the *supervisory formula method* are available, a *firm* should determine the most appropriate approach and apply that approach consistently.
- 9.12.5 R A *firm* other than an *originator* or a *sponsor* may not use the *supervisory formula method* unless its *IRB permission* expressly permits it to do so.
- [Note: BCD Annex IX Part 4 point 40]
- 9.12.6 R Subject to any *IRB permission* of the type described in *BIPRU 9.12.28G*, in the case of an *originator* or *sponsor* unable to calculate K_{IRB} and which has not obtained approval to use the *ABCP internal assessment approach*, and in the case of other *firms* where they have not obtained approval to use the *supervisory formula method* or, for positions in *ABCP programmes*, the *ABCP internal assessment approach*, a *risk weight* of 1250% must be assigned to *securitisation positions* which are *unrated* and in respect of which an inferred *rating* may not be used.
- [Note: BCD Annex IX Part 4 point 41]
- Use of inferred ratings
- 9.12.7 R When the following minimum operational requirements are satisfied a *firm* must attribute to an *unrated position* an inferred credit assessment equivalent to the credit assessment of those *rated positions* (the ‘reference positions’) which are the most senior positions which are in all respects subordinate to the *unrated securitisation position* in question:

- (1) the reference positions must be subordinate in all respects to the *unrated securitisation position*;
- (2) the maturity of the reference positions must be equal to or longer than that of the *unrated position* in question; and
- (3) on an ongoing basis, any inferred *rating* must be updated to reflect any changes in the credit assessment of the reference positions.

[Note: BCD Annex IX Part 4 point 42]

Maximum risk-weighted exposure amounts

- 9.12.8 R For an *originator*, a *sponsor*, or for other *firms* which can calculate K_{IRB} , the *risk weighted exposure amounts* calculated in respect of its positions in a *securitisation* may be limited to that which would produce an amount in respect of its *credit risk capital requirement* equal to the sum of 8% of the *risk weighted exposure amounts* which would be produced if the *securitised* assets had not been *securitised* and were on the balance sheet of the *firm* plus the *expected loss* amounts of those *exposures*.

[Note: BCD Annex IX Part 4 point 45]

Ratings based method

- 9.12.9 R *BIPRU* 9.12.10R to *BIPRU* 9.12.19R apply to the calculation of *risk weighted exposure amounts* of *securitisation positions* under the *ratings based method*.
- 9.12.10 R Under the *ratings based method*, the *risk weighted exposure amount* of a *rated securitisation position* must be calculated by applying to the *exposure* value the *risk weight* associated with the *credit quality step* with which the credit assessment is associated as prescribed in *BIPRU* 9.12.11R and *BIPRU* 9.12.12R multiplied by 1.06.

[Note: BCD Annex IX Part 4 point 46]

- 9.12.11 R Table: Positions other than ones with short-term credit assessments
This table belongs to *BIPRU* 9.12.10R

Credit Quality Step (CQS)	Risk weight		
	A	B	C
CQS 1	7%	12%	20%
CQS 2	8%	15%	25%

Credit Quality Step (CQS)	Risk weight		
	CQS 3	10%	18%	35%
CQS 4	12%	20%	35%
CQS 5	20%	35%	35%
CQS 6	35%	50%	50%
CQS 7	60%	75%	75%
CQS 8	100%	100%	100%
CQS 9	250%	250%	250%
CQS 10	425%	425%	425%
CQS 11	650%	650%	650%
Below CQS 11	1250%	1250%	1250%

9.12.12 R Table: Positions with short term credit assessments
This table belongs to BIPRU 9.12.10R

Credit Quality Step (CQS)	Risk weight		
	A	B	C
CQS 1	7%	12%	20%
CQS 2	12%	20%	35%
CQS 3	60%	75%	75%
All other credit	1250%	1250%	1250%

Credit Quality Step (CQS)	Risk weight		
assessments			

9.12.13 R Subject to *BIPRU 9.12.16R* and *BIPRU 9.12.17R*, the *risk weights* in column A of each table in *BIPRU 9.12.11R* and *BIPRU 9.12.12R* must be applied where the position is in the most senior *tranche* of a *securitisation*.

[**Note:** *BCD Annex IX Part 4 point 47 (part)*]

9.12.14 R When determining under *BIPRU 9.12.13R* whether a *tranche* is the most senior for these purposes, a *firm* need not take into consideration amounts due under interest rate or currency derivative contracts, fees due, or other similar payments.

[**Note:** *BCD Annex IX Part 4 point 47 (part)*]

9.12.15 G A senior *liquidity facility* need not be taken into account for the purposes of determining the most senior *tranche* under *BIPRU 9.12.13R*.

9.12.16 R A firm may apply a *risk weight* of 6% to a position in the most senior *tranche* of a *securitisation* where that *tranche* is senior in all respects to another *tranche* of the *securitisation positions* which would receive a *risk weight* of 12% under *BIPRU 9.12.10R*, provided that:

- (1) it can be demonstrated that this is justified due to the loss absorption qualities of subordinate *tranches* in the *securitisation*; and
- (2) either the position has an external credit assessment which has been determined to be associated with credit quality step 1 in *BIPRU 9.12.11R* and *BIPRU 9.12.12R* or, if it is unrated, requirements (1) to (3) in *BIPRU 9.12.7R* are satisfied where ‘reference positions’ are taken to mean positions in the subordinate *tranche* which would receive a *risk weight* of 12% under *BIPRU 9.12.10R*.

[**Note:** *BCD Annex IX Part 4 point 48*]

9.12.17 R The *risk weights* in column C of each table in *BIPRU 9.12.11R* and *BIPRU 9.12.12R* must be applied where the position is in a *securitisation* where the effective number of *exposures securitised* is less than six. In calculating the effective number of *exposures securitised* multiple *exposures* to one obligor must be treated as one *exposure*. The effective number of *exposures* is calculated as:

$$N = ((\sum_i)(EAD_i))^2 / ((\sum_i)(EAD_i^2))$$

where EAD_i represents the sum of the *exposure* values of all *exposures* to the i^{th} obligor.

[**Note:** BCD Annex IX Part 4 point 49 (part)]

- 9.12.18 R In the case of *resecuritisation*, the *firm* must look at the number of *securitisation exposures* in the pool and not the number of underlying *exposures* in the original pools from which the underlying *securitisation exposures* stem. If the portfolio share associated with the largest *exposure*, C_1 , is available, the *firm* may compute N as $1/C_1$.

[**Note:** BCD Annex IX Part 4 point 49 (part)]

- 9.12.19 R The *risk weights* in Column B in the tables in BIPRU 9.12.11R and BIPRU 9.12.12R must be applied to all other positions.

[**Note:** BCD Annex IX Part 4 point 50]

The ABCP internal assessment approach

- 9.12.20 R (1) If:
- (a) a *firm's IRB permission* allows it to use this treatment; and
 - (b) the conditions in (2)-(16) are satisfied,
- a *firm* may attribute to an *unrated position* in an *asset backed commercial paper programme* a derived *rating* as laid down in (3).
- (2) Positions in the commercial paper issued from the programme must be *rated positions*.
 - (3) Under the *ABCP internal assessment approach*, the *unrated position* must be assigned by the *firm* to one of the rating grades described in (5). The position must be attributed a derived rating that is the same as the credit assessments corresponding to that *rating grade* as laid down in (5). Where this derived rating is, at the inception of the *securitisation*, at the level of investment grade or better, it must be treated in the same way as an eligible credit assessment by an *eligible ECAI* for the purposes of calculating *risk weighted exposure amounts*.
 - (4) The internal assessment methodology must be used in the *firm's* internal risk management processes, including its decision making, management information and capital allocation processes.
 - (5) The *firm's* internal assessment methodology must include rating grades. There must be a correspondence between such rating grades and the credit assessments of *eligible ECAIs*. This correspondence must be explicitly documented.
 - (6) The *firm* must be able to satisfy the *FSA* that its internal assessment of the credit quality of the position reflects the publicly available assessment methodology of one or more *eligible ECAIs*, for the *rating* of securities backed by the *exposures* of the type *securitised*.

- (7) If a *firm's IRB permission* permits this, a *firm* need not comply with the requirement for the assessment methodology of the *ECAI* to be publicly available where it can demonstrate that due to the specific features of the *securitisation* – for example its unique structure - there is as yet no publicly available *ECAI* assessment methodology.
- (8) The *ECAIs*, the methodology of which must be reflected as required by (6), must include those *ECAIs* which have provided an external rating for the commercial paper issued from the programme. Quantitative elements – such as stress factors – used in assessing the position to a particular credit quality must be at least as conservative as those used in the relevant assessment methodology of the *ECAIs* in question.
- (9) In developing its internal assessment methodology the *firm* must take into consideration relevant published ratings methodologies of the *eligible ECAIs* that rate the commercial paper of the ABCP programme. This consideration must be documented by the *firm* and updated regularly, as outlined in (15).
- (10) The *ABCP programme* must have collections policies and processes that take into account the operational capability and credit quality of the servicer. The programme must mitigate seller/servicer risk through various methods, such as triggers based on current credit quality that would preclude commingling of funds.
- (11) The *ABCP programme* must incorporate structural features – for example wind down triggers - into the purchase of *exposures* in order to mitigate potential credit deterioration of the underlying portfolio.
- (12) The *ABCP programme* must incorporate underwriting standards in the form of credit and investment guidelines. In deciding on an asset purchase, the programme administrator must consider the type of asset being purchased, the type and monetary value of the *exposures* arising from the provision of liquidity facilities and *credit enhancements*, the loss distribution, and the legal and economic isolation of the transferred assets from the entity selling the assets. A credit analysis of the asset seller's risk profile must be performed and must include analysis of past and expected future financial performance, current market position, expected future competitiveness, leverage, cash flow, and interest coverage, and debt rating. In addition, a review of the seller's underwriting standards, servicing capabilities, and collection processes must be performed.
- (13) The *ABCP programme's* underwriting standards must establish minimum asset eligibility criteria that, in particular,
 - (a) exclude the purchase of assets that are significantly past due or defaulted;
 - (b) limit excess concentration to individual obligor or geographic area; and
 - (c) limit the tenor of the assets to be purchased.

- (14) The aggregated estimate of loss on an asset pool that the *ABCP programme* is considering purchasing must take into account all sources of potential risk, such as credit risk and *dilution risk*. If the seller-provided *credit enhancement* is sized based on only credit-related losses, then a separate reserve must be established for *dilution risk*, if *dilution risk* is material for the particular *exposure* pool. In addition, in sizing the required enhancement level, the programme must review several years of historical information, including losses, delinquencies, dilutions, and the turnover rate of the receivables.
- (15) Internal or external auditors, an *ECAI*, or the *firm's* internal credit review or risk management function must perform regular reviews of the internal assessment process and the quality of the internal assessments of the credit quality of the *firm's exposures* to an *ABCP programme*. If the *firm's* internal audit, credit review, or risk management functions perform the review, then these functions must be independent of the *ABCP programme* business line, as well as the customer relationship.
- (16) The *firm* must track the performance of its internal ratings over time to evaluate the performance of its internal assessment methodology and must make adjustments, as necessary, to that methodology when the performance of the *exposures* routinely diverges from that indicated by the internal ratings.

[Note: BCD Annex IX Part 4 points 43 and 44]

Supervisory formula method

- 9.12.21 R Subject to any *permission* of the type described in *BIPRU* 9.12.28G, under the *supervisory formula method*, the *risk weight* for a *securitisation position* must be the greater of 7% or the *risk weight* to be applied in accordance with *BIPRU* 9.12.22R.

[Note: BCD Annex IX Part 4 point 52]

- 9.12.22 R (1) Subject to any *permission* of the type described in *BIPRU* 9.12.28G, the *risk weight* to be applied to the *exposure* amount must be:

$$12.5 (S[L+T] - S[L]) / T$$

- (2) The remaining provisions of this paragraph define the terms used in the formulae in (1) and (3).

$$(3) \quad S[x] = \begin{cases} x & \text{when } x \leq IRBR \\ K_{IRBR} + K[x] - K[K_{IRBR}] + (d \cdot K_{IRBR} \omega) (1 - e^{\omega(K_{IRBR} - x)/K_{IRBR}}) & \text{when } K_{IRBR} < x \end{cases}$$

$$(4) \quad h = (1 - K_{IRBR} / ELGD)^N$$

$$(5) \quad c = K_{IRBR} / (1 - h)$$

$$(6) \quad v = \frac{(ELGD - K_{IRBR}) K_{IRBR} + 0.25(1 - ELGD) K_{IRBR}}{N}$$

$$(7) \quad f = \left(\frac{v + K_{IRBR}^2}{1 - h} - c^2 \right) + \frac{(1 - K_{IRBR}) K_{IRBR} - v}{(1 - h) \tau}$$

$$(8) \quad g = \frac{(1 - c)c}{f} - 1$$

$$(9) \quad a = g \cdot c$$

$$(10) \quad b = g \cdot (1 - c)$$

$$(11) \quad d = 1 - (1 - h) \cdot (1 - \text{Beta}[K_{IRBR}; a, b])$$

$$(12) \quad K[x] = (1 - h) \cdot ((1 - \text{Beta}[x; a, b]) x + \text{Beta}[x; a + 1, b] c).$$

$$(13) \quad \tau = 1000,$$

$$(14) \quad \omega = 20.$$

(15) In these expressions, $\text{Beta}[x; a, b]$ refers to the cumulative beta distribution with parameters a and b evaluated at x.

(16) T (the thickness of the *tranche* in which the position is held) is measured as the ratio of (a) the nominal amount of the *tranche* to (b) the sum of the *exposure* values of the *exposures* that have been *securitised*. For these purposes the *exposure* value of a *financial derivative instrument* must, where the current replacement cost is not a positive value, be the potential future credit exposure calculated in accordance with BIPRU 13 (Treatment of derivative instruments).

(17) K_{IRBR} is the ratio of (a) K_{IRB} to (b) the sum of the *exposure* values of the *exposures* that have been *securitised*. K_{IRBR} is expressed in decimal form (for example, K_{IRB} equal to 15% of the pool would be expressed as K_{IRBR} of 0.15).

- (18) L (the *credit enhancement* level) is measured as the ratio of the nominal amount of all *tranches* subordinate to the *tranche* in which the position is held to the sum of the *exposure* values of the *exposures* that have been *securitised*. Capitalised future income must not be included in the measured L. Amounts due by counterparties to *financial derivative instruments* that represent *tranches* more junior than the *tranche* in question may be measured at their current replacement cost (without the potential future credit exposures) in calculating the enhancement level.
- (19) N is the effective number of exposures calculated in accordance with BIPRU 9.12.17R-BIPRU 9.12.18R.
- (20) ELGD, the *exposure-weighted average loss-given-default*, is calculated as follows:

$$ELGD = \frac{\sum_i LGD_i \cdot EAD_i}{\sum_i EAD_i}$$

- (21) In (20) LGD_i represents the average *LGD* associated with all *exposures* to the i^{th} obligor, where *LGD* is determined in accordance with BIPRU 4. In the case of *resecuritisation*, an *LGD* of 100% must be applied to the *securitised* positions. When default risk and *dilution risk* for purchased receivables are treated in an aggregate manner within a *securitisation* (e.g. a single reserve or over-collateralisation is available to cover losses from either source), the *LGD* input must be constructed as a weighted average of the *LGD* for credit risk and the 75% *LGD* for *dilution risk*. The weights are the stand-alone capital charges for credit risk and *dilution risk* respectively.

[Note: BCD Annex IX Part 4 point 53 (part)]

Simplified inputs

- 9.12.23 R (1) Under the *supervisory formula method*, if the *exposure* value of the largest *securitised exposure*, C_1 , is no more than 3% of the sum of the *exposure* values of the *securitised exposures*, then for the purposes of the *supervisory formula method* the *firm* may set *LGD* equal 50% and N equal to either:

(a)
$$N = \left(C_1 C_m + \left(\frac{C_m - C_1}{m - 1} \right) \max \{1 - m C_1, 0\} \right)^{-1}; \text{or}$$

(b) $N = 1 / C_1$.

- (2) C_m is the ratio of the sum of the *exposure* values of the largest 'm' *exposures* to the sum of the *exposure* values of the *exposures securitised*. The level of 'm' may be set by the *firm*.

- (3) For *securitisations* involving *retail exposures*, the *supervisory formula method* may be implemented using the simplifications: $h = 0$ and $v = 0$.

[Note: BCD Annex IX Part 4 point 53 (part)]

- 9.12.24 G Where a *securitisation* of *retail exposures* has a sufficiently low value of N for the simplification in *BIPRU* 9.12.23R(3) to result in a material change in the capital charge as compared to the position if the approach in *BIPRU* 9.12.23R were not taken, a *firm* should discuss with the *FSA* the suitability of its use.

Liquidity Facilities

- 9.12.25 R The provisions in *BIPRU* 9.12.26R to *BIPRU* 9.12.28G apply for the purposes of determining the *exposure* value of an *unrated securitisation position* in the form of certain types of *liquidity facility*.

[Note: BCD Annex IX Part 4 point 55]

Liquidity facilities only available in the event of general market disruption

- 9.12.26 R A conversion figure of 20% may be applied to the nominal amount of a *liquidity facility* that may only be drawn in the event of a general market disruption and that meets the conditions to be an eligible *liquidity facility* set out in *BIPRU* 9.11.10R.

[Note: BCD Annex IX Part 4 point 56]

Cash advance facilities

- 9.12.27 R A conversion figure of 0% may be applied to the nominal amount of a *liquidity facility* that meets the conditions set out in *BIPRU* 9.11.12R.

[Note: BCD Annex IX Part 4 point 57]

Exceptional treatment for liquidity facilities where K_{IRB} cannot be calculated

- 9.12.28 G (1) When it is not practical for the *firm* to calculate the *risk weighted exposure amounts* for the *securitised exposures* as if they had not been *securitised* and the position does not qualify for the *ABCP internal assessment approach*, a *firm* may apply to the *FSA* for a variation of its *IRB permission* under which, on an exceptional basis, it may temporarily apply the method in (2) for the calculation of *risk weighted exposure amounts* for an *unrated securitisation position* in the form of a *liquidity facility* that meets the conditions to be a *liquidity facility* set out in *BIPRU* 9.11.10R or that falls within the terms of *BIPRU* 9.12.26R.
- (2) Under the method in this paragraph, the highest *risk weight* that would be applied under the *standardised approach* to any of the *securitised exposures* had they not been *securitised* may be applied to the *securitisation position* represented by the *liquidity facility*. To determine the *exposure* value of the position a conversion figure of 50% may be applied to the nominal amount of the *liquidity facility* if the facility has an original maturity of one year or less. If the *liquidity facility* complies with the conditions in *BIPRU* 9.12.26R a conversion figure of 20% may be applied. In other cases a conversion factor of 100% must be applied.

[**Note:** *BCD* Annex IX Part 4 points 58 and 59]

9.13 Securitisations of revolving exposures with early amortisation provisions

- 9.13.1 R Where there is a *securitisation of revolving exposures* subject to an *early amortisation provision*, the *originator* must calculate an additional *risk weighted exposure amount* in accordance with this section in respect of the risk that the levels of credit risk to which it is exposed may increase following the operation of the *early amortisation provision*. Accordingly this section sets out how an *originator* must calculate a *risk weighted exposure amount* when it sells *revolving exposures* into a *securitisation* that contains an *early amortisation provision*.

[**Note:** BCD Article 100(1), Annex IX Part 4 points 16 and 68]

Additional capital requirements for securitisations of revolving exposures with early amortisation provisions

- 9.13.2 R A *firm* must calculate a *risk weighted exposure amount* in respect of the sum of the *originator's* interest and the investors' interest.

[**Note:** BCD Annex IX Part 4 point 17]

- 9.13.3 R For *securitisation* structures where the *securitised exposures* comprise *revolving exposures* and non-revolving *exposures*, an *originator* must apply the treatment set out in this section to that portion of the underlying pool containing *revolving exposures*.

[**Note:** BCD Annex IX Part 4 point 18]

- 9.13.4 R For the purposes of this section, subject to *BIPRU* 9.13.6R:

- (1) *originator's* interest means the exposure value of that notional part of a pool of drawn amounts sold into a *securitisation*, the proportion of which in relation to the amount of the total pool sold into the structure determines the proportion of the cash-flows generated by principal and interest collections and other associated amounts which are not available to make payments to those having *securitisation positions* in the *securitisation*;
- (2) to qualify as such the *originator's* interest may not be subordinate to the investors' interest; and
- (3) investors' interest means the exposure value of the remaining notional part of the pool of drawn amounts.

[**Note:** BCD Annex IX Part 4 point 19]

- 9.13.5 R Subject to *BIPRU* 9.13.7R, the *exposure* of the *originator* associated with its rights in respect of the *originator's* interest must not be treated as a *securitisation position* but as a pro rata *exposure* to the *securitised exposures* as if they had not been *securitised*.

[Note: BCD Annex IX Part 4 point 20]

- 9.13.6 R (1) For *firms* using the *IRB approach* set out in *BIPRU 4*, this paragraph applies in place of *BIPRU 9.13.4R*.
- (2) For the purposes of this section, *originator's* interest means the sum of:
- (a) the exposure value of that notional part of a pool of drawn amounts sold into a *securitisation*, the proportion of which in relation to the amount of the total pool sold into the structure determines the proportion of the cash-flows generated by principal and interest collections and other associated amounts which are not available to make payments to those having *securitisation positions* in the *securitisation*; and
 - (b) the exposure value of that part of the pool of undrawn amounts of the credit lines, the drawn amounts of which have been sold into the *securitisation*, the proportion of which to the total amount of such undrawn amounts is the same as the proportion of the exposure value described in (a) to the exposure value of the pool of drawn amounts sold into the *securitisation*.
- (3) To qualify as such the *originator's* interest may not be subordinate to the investors' interest.
- (4) Investors' interest means the exposure value of the notional part of the pool of drawn amounts not falling within (2)(a) plus the exposure value of that part of the pool of undrawn amounts of credit lines, the drawn amounts of which have been sold into the *securitisation*, not falling within (2)(b).

[Note: BCD Annex IX Part 4 points 69 and 70]

- 9.13.7 R For *firms* using the *IRB approach* set out in *BIPRU 4*, this paragraph applies in place of *BIPRU 9.13.5R*. The *exposure* of the *originator* associated with its rights in respect of that part of the *originator's* interest described in *BIPRU 9.13.6R(2)(a)* must not be treated as a *securitisation position* but as a *pro rata exposure* to the *securitised* drawn amounts as if they had not been *securitised* in an amount equal to that described in *BIPRU 9.13.6R(2)(a)*. The *originator* must also be considered to have a *pro rata exposure* to the undrawn amounts of the credit lines, the drawn amounts of which have been sold into the *securitisation*, in an amount equal to that described in *BIPRU 9.13.6R(2)(b)*.

[Note: BCD Annex IX Part 4 point 71]

Exemptions from early amortisation treatment

- 9.13.8 R *Originators* of the following types of *securitisation* are exempt from the capital requirement in *BIPRU 9.13.1R*:

- (1) *securitisations of revolving exposures* whereby investors remain fully exposed to all future draws by borrowers so that the risk on the underlying facilities does not return to the *originator* even after an early amortisation event has occurred; and
- (2) *securitisations* where any *early amortisation provision* is solely triggered by events not related to the performance of the *securitised* assets or the *originator*, such as material changes in tax laws or regulations.

[Note: BCD Annex IX Part 4 point 21]

Maximum capital requirement

9.13.9 R For an *originator* subject to the capital requirement in *BIPRU* 9.13.1R the total of the *risk weighted exposure amounts* in respect of its positions in the investors' interest (as defined in *BIPRU* 9.13.4R or *BIPRU* 9.13.6R) and the *risk weighted exposure amounts* calculated under *BIPRU* 9.13.1R must be no greater than the greater of:

- (1) the *risk weighted exposure amounts* calculated in respect of its positions in the investors' interest (as so defined); and
- (2) the *risk weighted exposure amounts* that would be calculated in respect of the *securitised exposures* by a *firm* holding the *exposures* as if they had not been *securitised* in an amount equal to the investors' interest (as so defined).

[Note: BCD Annex IX Part 4 point 22]

9.13.10 R Deduction of net gains, if any, arising from the capitalisation of future income required under *GENPRU* 2.2.90R (Core tier one capital: profit and loss account and other reserves: Securitisation) must be treated outside the maximum amount indicated in *BIPRU* 9.13.9R.

[Note: BCD Annex IX Part 4 point 23]

Calculation of risk-weighted exposure amounts

9.13.11 R The *risk weighted exposure amount* to be calculated in accordance with *BIPRU* 9.13.1R must be determined by multiplying the amount of the investors' interest (as defined in *BIPRU* 9.13.4R or *BIPRU* 9.13.6R) by the product of:

- (1) the appropriate conversion figure as indicated in *BIPRU* 9.13.16R, *BIPRU* 9.13.19R or *BIPRU* 9.13.20R; and
- (2) the weighted average *risk weight* that would apply to the *securitised exposures* if the *exposures* had not been *securitised*.

[Note: BCD Annex IX Part 4 point 24]

9.13.12 R An *early amortisation provision* must be treated as controlled for the purposes of this section where the following conditions are met:

- (1) the *originator* has an appropriate capital/liquidity plan in place to ensure that it has sufficient capital and liquidity available in the event of an early amortisation;
- (2) throughout the duration of the transaction there is a pro rata sharing between the *originator's* interest and the investors' interest (as defined in *BIPRU* 9.13.4R or *BIPRU* 9.13.6R) of payments of interest and principal, expenses, losses and recoveries based on the balance of receivables outstanding at one or more reference points during each month;
- (3) the amortisation period is considered sufficient for 90% of the total debt (*originator's* and investors' interest (as defined in *BIPRU* 9.13.4R or *BIPRU* 9.13.6R)) outstanding at the beginning of the early amortisation period to have been repaid or recognised as in default; and
- (4) the speed of repayment is no more rapid than would be achieved by straight-line amortisation over the period set out in (3).

[Note: *BCD* Annex IX Part 4 point 25]

9.13.13 R In the case of a *securitisation* meeting the following conditions:

- (1) it is subject to an *early amortisation provision*;
- (2) the *securitisation* is of *retail exposures* which are uncommitted and unconditionally cancellable without prior notice; and
- (3) the early amortisation is triggered by the *excess spread* level falling to a specified level

a *firm* must, to calculate the appropriate conversion figure referred to in *BIPRU* 9.13.11R, compare the three-month average *excess spread* level with the *excess spread* levels at which *excess spread* is required to be trapped.

[Note: *BCD* Annex IX Part 4 point 26]

9.13.14 R Where the *securitisation* does not require *excess spread* to be trapped, the trapping point is deemed to be 4.5 percentage points greater than the *excess spread* level at which an early amortisation is triggered.

[Note: *BCD* Annex IX Part 4 point 27]

9.13.15 R The conversion figure to be applied must be determined by the level of the actual three month average *excess spread* in accordance with *BIPRU* 9.13.16R.

[Note: *BCD* Annex IX Part 4 point 28]

9.13.16 R Table: Conversion figures
This table belongs to *BIPRU* 9.13.15R

	Securitisations subject to a controlled early amortisation provision	Securitisation subject to a non-controlled early amortisation provision
3 months average <i>excess spread</i>	Conversion figure	Conversion figure
Above level A	0%	0%
Level A	1%	5%
Level B	2%	15%
Level C	10%	50%
Level D	20%	100%
Level E	40%	100%

9.13.17 R In *BIPRU* 9.13.16R:

- (1) Level A means levels of *excess spread* less than 133.33% of the trapping level of *excess spread* but not less than 100% of that trapping level;
- (2) Level B means levels of *excess spread* less than 100% of the trapping level of *excess spread* but not less than 75% of that trapping level;
- (3) Level C means levels of *excess spread* less than 75% of the trapping level of *excess spread* but not less than 50% of that trapping level;
- (4) Level D means levels of *excess spread* less than 50% of the trapping level of *excess spread* but not less than 25% of that trapping level; and
- (5) Level E means levels of *excess spread* less than 25% of the trapping level of *excess spread*.

[**Note:** *BCD* Annex IX Part 4 point 29]

9.13.18 G In the case of a *securitisation* meeting the conditions in this paragraph, a *firm* may apply to the *FSA* for a *waiver* that would allow a treatment which approximates closely to that prescribed in *BIPRU* 9.13.13R to *BIPRU* 9.13.17R for determining the conversion figure indicated. If a *firm* wants such a *waiver*, it should satisfy the *FSA* that:

- (1) the *securitisation* is subject to an *early amortisation provision* of retail *exposures*;
- (2) those retail *exposures* are uncommitted and unconditionally cancellable without prior notice;
- (3) the *early amortisation* is triggered by a quantitative value in respect of something other than the three month average *excess spread*;
- (4) the *firm* can establish a quantitative measure equivalent, in relation to the value in (3), to the trapping level of *excess spread*; and
- (5) that treatment is a prudent measure of the risk that the levels of credit risk to which it is exposed may increase following the operation of the *early amortisation provision* (referred to in *BIPRU 9.13.1R*).

[Note: *BCD Annex IX Part 4 point 30*]

- 9.13.19 R All other *securitisations* subject to a controlled *early amortisation provision* of *revolving exposures* are subject to a credit conversion figure of 90%.

[Note: *BCD Annex IX Part 4 point 32*]

- 9.13.20 R All other *securitisations* subject to a non-controlled *early amortisation provision* of *revolving exposures* are subject to a credit conversion figure of 100%.

[Note: *BCD Annex IX Part 4 point 33*]

Liquidity plans

- 9.13.21 R A *firm* which is an *originator* of a revolving *securitisation* transaction involving *early amortisation provisions* should have liquidity plans to address the implications of both scheduled and early amortisation.

[Note: *BCD Annex V point 9*]

- 9.14 Recognition of credit risk mitigation on securitisation positions under the IRB approach
- 9.14.1 R This section applies to *credit risk mitigation* in relation to a *securitisation position* for a *firm* calculating *risk weighted exposure amounts* using the *IRB approach*.
[**Note:** *BCD* Annex IX Part 4 point 37 (part)]
- 9.14.2 R Where a *firm* uses the *ratings based method* to calculate the *risk weighted exposure amounts* of *securitisation positions*, the *firm* may recognise *credit risk mitigation* in accordance with *BIPRU* 9.14.4R to *BIPRU* 9.14.6R.
[**Note:** *BCD* Annex IX Part 4 point 51]
- 9.14.3 R Where a *firm* uses the *supervisory formula method* to calculate the *risk weighted exposure amounts* of *securitisation positions*, the *firm* may recognise *credit risk mitigation* in accordance with *BIPRU* 9.14.4R to *BIPRU* 9.14.5R and *BIPRU* 9.14.7R to *BIPRU* 9.14.13R.
[**Note:** *BCD* Annex IX Part 4 point 54]
- Funded protection
- 9.14.4 R Eligible funded protection is limited to that which is eligible for the calculation of *risk weighted exposure amounts* under the *standardised approach* as laid down under *BIPRU* 5 and recognition is subject to compliance with the relevant minimum requirements as laid down under *BIPRU* 5.
[**Note:** *BCD* Annex IX Part 4 point 60]
- Unfunded credit protection
- 9.14.5 R Eligible unfunded credit protection and unfunded protection providers are limited to those which are eligible under *BIPRU* 5 (Credit risk mitigation) and *BIPRU* 4.10 (Credit risk mitigation under the IRB approach) and recognition is subject to compliance with the relevant minimum requirements laid down under those provisions.
[**Note:** *BCD* Annex IX Part 4 point 61]
- Credit risk mitigation under the ratings based method
- 9.14.6 R Where *risk weighted exposure amounts* are calculated using the *ratings based method*, the *exposure* value and/or the *risk weighted exposure amount* for a *securitisation position* in respect of which credit protection has been obtained may be modified in accordance with the provisions of *BIPRU* 5 (Credit risk mitigation) as they apply for the calculation of *risk weighted exposure amounts* under the *standardised approach* set out in *BIPRU* 3.

[Note: BCD Annex IX Part 4 point 62]

Credit risk mitigation under the supervisory formula method – full credit protection

- 9.14.7 R *BIPRU 9.14.8R-BIPRU 9.14.10R* apply where *risk weighted exposure amounts* are calculated using the *supervisory formula method* where there is full credit protection.

[Note: BCD Annex IX Part 4 point 63 (part)]

- 9.14.8 R A *firm* must determine the effective *risk weight* of the position. It must do this by dividing the *risk weighted exposure amount* of the position by the *exposure* value of the position and multiplying the result by 100.

[Note: BCD Annex IX Part 4 point 63 (part)]

- 9.14.9 R In the case of funded credit protection, the *risk weighted exposure amount* of the *securitisation position* must be calculated by multiplying the funded protection-adjusted *exposure* amount of the position (E^* , as calculated under *BIPRU 5.4.28R(3)*, taking the amount of the *securitisation position* to be E) by the effective *risk weight*.

[Note: BCD Annex IX Part 4 point 64]

- 9.14.10 R In the case of unfunded credit protection, the *risk weighted exposure amount* of the *securitisation position* must be calculated by multiplying G_A (the amount of the protection adjusted for any currency mismatch and maturity mismatch in accordance *BIPRU 5.7.23R(2)*) by the *risk weight* of the protection provider; and adding this to the amount arrived at by multiplying the amount of the *securitisation position* minus G_A by the effective *risk weight*.

[Note: BCD Annex IX Part 4 point 65]

Credit risk mitigation under the supervisory formula method - partial protection

- 9.14.11 R *BIPRU 9.14.12R-BIPRU 9.14.13R* apply where *risk weighted exposure amounts* are calculated using the *supervisory formula method* where there is partial protection.

- 9.14.12 R If the *credit risk mitigation* covers the ‘first loss’ or losses on a proportional basis on the *securitisation position*, a *firm* may apply *BIPRU 9.14.7R* to *BIPRU 9.14.10R*.

[Note: BCD Annex IX Part 4 point 66]

- 9.14.13 R In other cases the *firm* must treat the *securitisation position* as two or more positions with the uncovered portion being the position with the lower credit quality. For the purposes of calculating the *risk weighted exposure amount* for this position, the provisions in *BIPRU 9.12.22R* to *BIPRU 9.12.24R* apply subject to the modifications that ‘T’ is adjusted to e^* in the case of funded credit protection; and to $T-g$ in the case of unfunded credit protection, where e^* denotes the ratio of E^* to the total notional amount of the underlying pool, where E^* is the adjusted *exposure amount* of the *securitisation position* calculated in accordance with *BIPRU 5.4.28R(3)* taking the amount of the *securitisation position* to be E ; and g is the ratio of the nominal amount of credit protection (adjusted for any currency or maturity mismatch in accordance with the provisions of *BIPRU 5 (Credit risk mitigation)*) to the sum of the *exposure amounts* of the *securitised exposures*. In the case of unfunded credit protection the *risk weight* of the protection provider must be applied to that portion of the position not falling within the adjusted value of ‘T’.

[Note: *BCD Annex IX Part 4 point 67*]

10 Concentration risk requirements

10.1 Application and Purpose

Application

- 10.1.1 R This chapter applies to a *BIPRU firm*. It applies irrespective of whether the *firm* adopts the *standardised approach* or the *IRB approach*. If it adopts the *IRB approach*, it applies irrespective of whether the *firm* adopts the *foundation IRB approach* or the *advanced IRB approach*.

Purpose

- 10.1.2 G This chapter sets out *rules and guidance* for *large exposures* and the *concentration risk capital component* (the *CNCOM*), implementing the *large exposures* requirements of articles 66(3) (in part) and 106 to 117 and paragraph 7 of Annex V of the *Banking Consolidation Directive* and articles 28 to 32 and Annex VI of the *Capital Adequacy Directive*.
- 10.1.3 G A *large exposure* may be in the form of a loan to a single borrower, or it may arise across many transactions involving different types of financial instruments with several *counterparties* within the same group of companies. Where a *firm's exposure* to its *counterparty* is large, it risks a large loss should the *counterparty* default. Such a loss may be sufficient on its own to threaten the solvency of the *firm*.
- 10.1.4 G The purpose of this chapter is to ensure that a *firm* manages its *exposure* to *counterparties* within appropriate limits set in relation to its *capital resources*.

Restricted application for UCITS investment firms

- 10.1.5 R This chapter only applies to a *UCITS investment firm* with respect to its *designated investment business*. For this purpose *scheme management activity* is excluded from *designated investment business*.

10.2 Identification of exposures

10.2.1 R Unless *BIPRU* 10.2.2R applies, an *exposure* is any of the items included in *BIPRU* 3.2.9R (Exposure classes for the purposes of the *standardised approach*) or the table in *BIPRU* 3.7.2R (Classification of off-balance-sheet items for the purposes of the *standardised approach*), whether held in the *trading book* or the *non-trading book*, without application of the *risk weight* or degrees of risk there provided for.

10.2.2 R An *exposure* does not include:

- (1) an *exposure* which is entirely deducted from a *firm's capital resources*;
- (2) in the case of *foreign currency* transactions, *exposures* incurred in the ordinary course of settlement during the 48 hours following payment; or
- (3) in the case of transactions for the purchase or sale of *securities*, *exposures* incurred in the ordinary course of settlement during the five working days following payment or delivery of the *securities*, whichever is earlier.

10.2.3 G An *exposure* does not include:

- (1) a transaction entered into by a *firm* as trustee or agent without personal liability on the part of the *firm*;
- (2) indemnities for lost share certificates; or
- (3) (where the *firm* acts as lessor, mortgagee or owner of goods under a hire-purchase arrangement) contingent liabilities for injuries, damage or loss on the part of the *counterparty* to that arrangement in respect of the goods that are the subject of that arrangement.

10.2.4 G If a *firm* takes a credit risk charge against an *exposure* equal to the value of that *exposure*, this can count as a capital deduction for the purposes of *BIPRU* 10.2.2R(1).

10.3 Identification of counterparties

10.3.1 R An individual *counterparty* may be a natural or legal *person*.

10.3.2 G Examples of a *counterparty* include:

- (1) the *customer* or borrower; this includes governments, local authorities, public sector entities, individual trusts, corporations, unincorporated businesses (whether as *sole traders* or *partnerships*) and non-profit making bodies;
- (2) where the *firm* is providing a guarantee, the *person* guaranteed;
- (3) for a *derivatives* contract, the *person* with whom the contract was made;
- (4) for exchange traded contracts novated through a central clearing mechanism, that central clearing mechanism;
- (5) where a bill held by a *firm* has been accepted by a *credit institution*, the acceptor; and
- (6) where a *firm* is funding the activities of a *company* that trades on an exchange (whether as principal or on behalf of clients), that *company*.

Identification of counterparties for guaranteed exposures

- 10.3.3 R
- (1) Where an *exposure* to a *counterparty* is guaranteed by a third party, a *firm* may treat the *exposure* as an *exposure* to the third party and not to the *counterparty*.
 - (2) In deciding whether or not to treat the *exposure* as an *exposure* to the third party a *firm* must ensure that the identification of *counterparties* for concentration risk purposes is applied in a consistent manner.
 - (3) Where the guarantee is denominated in a currency different from that in which the *exposure* is denominated, the amount of the *exposure* deemed to be covered must be calculated in accordance with the provisions on the treatment of currency mismatch for *unfunded credit protection* in *BIPRU 5* (Credit risk mitigation) and, if applicable, *BIPRU 4.10* (The IRB approach: Credit risk mitigation).
 - (4) A mismatch between the maturity of the *exposure* and the maturity of the protection must be treated in accordance with the provisions on the treatment for maturity mismatch in *BIPRU 5* and, if applicable, *BIPRU 4.10*.

- (5) Partial coverage must be treated in accordance with *BIPRU 5* and, if applicable, *BIPRU 4.10*.
- (6) A guarantee may only be treated in accordance with (1) if the *firm* complies with the eligibility requirements and other minimum requirements set out in *BIPRU 5* and, if applicable, *BIPRU 4.10* for the purposes of calculating *risk-weighted exposure amounts*.
- (7) For the purpose of this *rule*, guarantee includes a credit derivative recognised under *BIPRU 5* and, if applicable, *BIPRU 4.10*, other than a credit linked note.

10.3.4 G An example of the eligibility requirements and other minimum requirements set out in *BIPRU 5* as referred to in *BIPRU 10.3.3R(6)* is the requirement for a legal review in *BIPRU 5.2.3R*.

Groups of connected clients

10.3.5 G The *Glossary* defines a *group of connected clients*.

10.3.6 G Relationships between individual *counterparties* which might be considered to constitute a single risk for the purposes of the definition of *group of connected clients* include:

- (1) *undertakings* in the same *group*;
- (2) *companies* whose ultimate owner (whether wholly or significantly) is the same individual or individuals, and which do not have a formal group structure;
- (3) *companies* having common directors or management; and
- (4) *counterparties* linked by cross guarantees

10.3.7 G The *FSA* would not regard the normal business relationships between *companies* which are competitors, and to which none of the relationships listed in *BIPRU 10.3.6G* apply, as falling within the definition of *group of connected clients*.

Connected counterparties

10.3.8 R For the purposes of *BIPRU 10*, and in relation to a *firm*, a *connected counterparty* means another *person* ('P') to whom the *firm* has an *exposure* and who fulfils at least one of the following conditions:

- (1) P is *closely related* to the *firm*; or
- (2) P is an *associate* of the *firm*; or
- (3) the same *persons* significantly influence the *governing body* of P and of the *firm*; or

- (4) the *firm* has an *exposure* to P that was not incurred for the clear commercial advantage of the *firm* or the *firm's group* and which is not on an arm's length basis.

Exposures to counterparties, groups of connected clients and connected counterparties

- 10.3.9 R A *firm's total exposure* to a *counterparty* must be calculated by summing its *exposures* to that *counterparty*, including both *trading book exposures* and *non-trading book exposures*.
- 10.3.10 R A *firm's total exposure* to a *group of connected clients* must be calculated by summing its *exposures* to the individual *persons* within that *group of connected clients*, including both *trading book exposures* and *non-trading book exposures*.
- 10.3.11 R A *firm's total exposure* to *connected counterparties* must be calculated by summing its *exposures* to all the *firm's connected counterparties*, including both *trading book exposures* and *non-trading book exposures*.

Exposures to trustees

- 10.3.12 R If a *firm* has an *exposure* to a *person* ('A') when A is acting on his own behalf, and also an *exposure* to A when A acts in his capacity as trustee, custodian or general partner of an investment trust, unit trust, venture capital or other investment fund, pension fund or a similar fund (a "fund"), the *firm* may treat the latter *exposure* as if it was to the fund, unless such a treatment would be misleading.
- 10.3.13 G When considering whether the treatment described in *BIPRU* 10.3.12R is misleading, factors a *firm* should consider include:
- (1) the degree of independence of control of the fund, including the relation of the fund's board and senior management to the *firm* or to other funds or to both;
 - (2) the terms on which the *counterparty*, when acting as trustee, is able to satisfy its obligation to the *firm* out of the fund of which it is trustee;
 - (3) whether the beneficial owners of the fund are connected to the *firm*, or related to other funds managed within the *firm's group*, or both; and
 - (4) for a *connected counterparty*, whether the *exposure* arises from a transaction entered into on an arm's length basis.
- 10.3.14 G In deciding whether a transaction is at arm's length for the purposes of *BIPRU* 10.3.8R(4) and *BIPRU* 10.3.13G(4), the following factors should be taken into account:

- (1) the extent to which the *person* to whom the *firm* has an *exposure* ('A') can influence the *firm's* operations, through e.g. the exercise of voting rights;
- (2) the management role of A where A is also a director of the *firm*; and
- (3) whether the *exposure* would be subject to the *firm's* usual monitoring and recovery procedures if repayment difficulties emerged.

10.4 Measurement of exposures to counterparties and issuers

General

- 10.4.1 R Unless specifically mentioned, *BIPRU* 10.4 applies both to *non-trading book* and *trading book exposures*.
- 10.4.2 R For the purpose of calculating the value of an *exposure*, *exposures* are divided into *counterparty exposures* and *issuer exposures*.
- 10.4.3 R When calculating a *firm's total exposure* to a *counterparty* it must sum the *counterparty exposures* and the *issuer exposures* to that *counterparty*.
- 10.4.4 G The same asset may give rise to a *counterparty exposure* and an *issuer exposure*. For example a purchased *option* creates an *exposure* to the other party to the *option* and the issuer of the underlying *security*.

Definition of issuer exposures

- 10.4.5 R The *issuer exposure* to an individual *counterparty* must be calculated by summing the following items:
- (1) the excess — where positive — of the *firm's long positions* over its *short positions* in all the *CRD financial instruments* issued by the *counterparty* in question, in accordance with *BIPRU* 10.4.28R (Further details about the calculation of issuer exposures: Establishing the net position in the non-trading book) and *BIPRU* 10.4.30R (Further details about the calculation of issuer exposures: Establishing the net position in the trading book); and
 - (2) the *firm's net underwriting exposure* to that *counterparty*.

Definition of issuer exposures: Position risk

- 10.4.6 R An *issuer exposure* to a *person* in the *non-trading book* does not include an *exposure* that gives rise to a *counterparty exposure* to that *person*.
- 10.4.7 G In general an *issuer exposure* in the *non-trading book* means any *exposure* that, if it were in the *trading book* and subject to the *standard market risk PRR rules*:
- (1) (in the case of a *derivative* in relation to a *CRD financial instrument*) would give rise to a notional position in the *CRD financial instrument* underlying that *derivative*; or
 - (2) would give rise to a similar notional position in a *CRD financial instrument* other than the one that the *firm* actually holds.

- 10.4.8 G A credit linked note may be an example of an instrument falling within *BIPRU 10.4.7G(2)*.
- 10.4.9 G A *firm's* long physical *position* in a *security* held in the *non-trading book* is generally included as a *counterparty exposure* rather than an *issuer exposure*.
- 10.4.10 G *BIPRU 10.4.5R(1)* includes any *exposure* in the *trading book* or *non-trading book* that would give rise to a notional *position* under the *standard market risk PRR rules*.
- 10.4.11 G The netting of long and short *positions* under *BIPRU 10.4.5R(1)* includes the notional *positions* in the underlying which arise from *derivative transactions*.
- 10.4.12 R For the purposes of *BIPRU 10.4.5R(1)*, a *firm* may, when calculating its net *position* in *CRD financial instruments* in the *non-trading book*, include *counterparty exposures* excluded from the *issuer exposure* calculation under *BIPRU 10.4.6R*. However any *counterparty exposure* used in this way is still subject to the provisions of this chapter about *counterparty exposures*.
- 10.4.13 G This paragraph illustrates how *BIPRU 10.4.12R* works. Say that a *firm* has a holding of *shares* in its *non-trading book*. Say that the *firm* has bought a *put option* over those *shares*, which it also holds in its *non-trading book*. The holding of *shares* gives rise to a *counterparty exposure* to the issuer of those *shares* and the *option* gives rise to a *counterparty exposure* to the *person* who wrote the *option*. The *option* also gives rise to an *issuer exposure* to the issuer of the *shares*. The *firm* may use *BIPRU 10.4.12R* to eliminate that *issuer exposure* by netting its *position* to zero by taking into account its long *non-trading book position* in those *shares*. If it does so, the *firm* will still have *counterparty exposures* to the issuer of the *shares* and the counterparty under the *option*.
- 10.4.14 G Another example of how *BIPRU 10.4.12R* works is this. Say that a *firm* has a long *non-trading book position* in a *debt security* together with an offsetting credit derivative. If the conditions in *BIPRU 10.3.3R* (Identification of counterparties for guaranteed exposures) are met the *firm* may, for the purposes of the calculation of the *counterparty exposure*, treat itself as having an *exposure* to the provider of the credit derivative rather than to the issuer of the *debt security*. This means that the *counterparty exposure* to the issuer of the *debt security* is zero. In calculating the *issuer exposure* the *firm* may net the long *position* in the *debt security* against the short notional *position* arising out of the credit derivative. The effect is that the *issuer exposure* to the issuer of the *debt security* is also zero. Hence the *firm* has no *exposure* to the issuer of the *debt security*.

- 10.4.15 R To the extent that *BIPRU* 10.4 does not otherwise explain what *positions* are included in *BIPRU* 10.4.5R(1) or how to calculate a net *position* for the purpose of *BIPRU* 10.4.5R(1), a *firm* must apply the provisions of the applicable *standard market risk PRR rules* or the ones that would apply if the *position* were in the *trading book*.
- 10.4.16 R A *firm* must not offset *exposures* in the *non-trading book* and *trading book* against each other for the purpose of calculating an *issuer exposure* except to the extent allowed by the *standard market risk PRR rules*.
- 10.4.17 R For the purposes of this chapter, the *counterparties* with respect to an *exposure* falling into *BIPRU* 10.4.5R(1) are the *persons* who are or would be treated as an obligor under the *standard market risk PRR rules* in question.

Definition of issuer exposures: Underwriting

- 10.4.18 G In accordance with *BIPRU* 7.8 (Securities underwriting), a *firm* should include *net underwriting exposures* to an issuer in the calculation of its *total exposure* to that issuer.

Definition of counterparty exposures

- 10.4.19 R A *counterparty exposure* means, with respect to the *non-trading book*, any *exposure* as defined in *BIPRU* 10.2 (Identification of exposures) held in the *non-trading book*.
- 10.4.20 R A *counterparty exposure* means, with respect to the *trading book*, any *exposure* as defined in *BIPRU* 10.2 (Identification of exposures) due to the transactions, agreements and contracts referred to in *BIPRU* 14.2.2R (List of *trading book exposures* that give rise to a counterparty risk credit charge) and held in the *trading book*, including credit derivatives.
- 10.4.21 G For example *BIPRU* 10.4.19R to *BIPRU* 10.4.20R mean that a *share* only gives rise to a *counterparty exposure* when it is held in the *non-trading book*.

Calculation of counterparty exposures

- 10.4.22 R Subject to *BIPRU* 10.4.23R to *BIPRU* 10.4.24R, the value of a *firm's counterparty exposures*, whether in its *non-trading book* or its *trading book*, is the amount at risk calculated in line with *GENPRU* 1.3 (Valuation).
- 10.4.23 R A *firm* must calculate the value of its *counterparty exposures* in its *trading book* in the manner laid down in *BIPRU* 14 (Capital requirements for settlement and counterparty risk) for the calculation of *exposure* values. For these purposes the reference in *BIPRU* 14.2.11R (How to calculate *exposure* values and *risk-weighted exposure amounts* for the purpose of calculating the *counterparty risk capital component*) to the provisions of the *IRB approach* does not apply.

- 10.4.24 R *Counterparty exposures* arising from *financial derivative instruments* must be calculated in accordance with one of the methods set out in *BIPRU 13* (Financial derivatives, SFTs and long settlement transactions). For the purposes of this chapter, *BIPRU 13.6.6R* (Scope of *CCR internal model method*) also applies.
- 10.4.25 R A *firm* must not offset *exposures* in the *non-trading book* and *trading book* for the purpose of calculating *counterparty exposures* except to the extent permitted under the *standardised approach* or, if applicable, the *IRB approach*.
- 10.4.26 R For the purposes of this chapter, the *counterparty* with respect to a *counterparty exposure* is the *person* who would be treated as the *person* to which the *firm* has the *exposure* under the *standardised approach* or, if applicable, the *IRB approach*.

Further details about the calculation of issuer exposures: General

- 10.4.27 R *BIPRU 10.4.28R* to *BIPRU 10.4.42R* apply to *issuer exposures* arising under *BIPRU 10.4.5R(1)*.

Further details about the calculation of issuer exposures: Establishing the net position in the non-trading book

- 10.4.28 R A *firm* must calculate the value of an *exposure* to the issuer of a *CRD financial instrument* which is held in the *firm's non-trading book* as the sum of the excess, where positive, of the book value of all long *positions* over all short *positions* (the net long *position*), for each identical *CRD financial instrument* issued by that issuer.
- 10.4.29 R For the purposes of *BIPRU 10.4.28R*, short *positions* in one *CRD financial instrument* may be used to offset long *positions* in a non-identical *CRD financial instrument* issued by the same issuer if both the *CRD financial instrument* are denominated in the same currency, and:
- (1) where both the *CRD financial instrument* are fixed rate, they are within the same residual maturity time band, one year or less, or over one year; or
 - (2) where both the *CRD financial instrument* are index linked, they are within the same residual maturity time band referred to in (1); or
 - (3) both the *CRD financial instrument* are floating rate.

Further details about the calculation of issuer exposures: Establishing the net position in the trading book

- 10.4.30 R A *firm* must calculate the value of an *exposure* to the issuer of a *CRD financial instrument* which is held in the *firm's trading book* by calculating the excess of the current market value of all long *positions* over all short *positions* in all the *CRD financial instruments* issued by that issuer.

Further details about the calculation of issuer exposures: Netting

- 10.4.31 R For the purposes of *BIPRU* 10.4.28R and *BIPRU* 10.4.30R, the short *positions* must be netted against the long *positions* in *CRD financial instruments* with the highest *specific risk PRAs*.

Further details about the calculation of issuer exposures: Netting between different issuers

- 10.4.32 R A *firm* must not offset an *exposure* to one issuer against an *exposure* to another issuer (whether in the *trading book* or the *non-trading book*) even where:
- (1) the issuers are a *group of connected clients*; and
 - (2) the *exposures* are non-identical *exposures* which meet the conditions in *BIPRU* 10.4.29R.

Further details about the calculation of issuer exposures: Forward agreements

- 10.4.33 R A *firm* must include as a long *position* a commitment by it to buy:
- (1) a *debt security* or an equity at a future date; and
 - (2) under a note issuance facility, at the request of the issuer, a *security* which is unsold on the issue date.
- 10.4.34 R A *firm* must include as a short *position* a commitment by it to sell a *debt security* or an equity at a future date.

Further details about the calculation of issuer exposures: Interest rate, foreign currency and equity swaps

- 10.4.35 G An interest rate leg of an equity *swap*, or an interest rate or currency *swap*, does not generate an *issuer exposure*.
- 10.4.36 R Where the equity leg of an equity *swap* is based on the change in value of an individual equity, it must be treated as giving rise to an *exposure* to the issuer of the equity.

Further details about the calculation of issuer exposures: Option positions

- 10.4.37 R When determining its *exposure* to an issuer arising from an *option*, a *firm* must value an *option* as the amount of principal underlying the *option*.
- 10.4.38 R A *firm* must treat:
- (1) a written put *option* as a long *position* in the underlying *security* valued at the strike price or the market price of the underlying *security*, whichever is lower;

- (2) a purchased put *option* as a short position in the underlying *security* valued at the strike price or the market price of the underlying *security*, whichever is lower; and
- (3) a purchased call *option* as a long *position* in the underlying *security* equal to the book value of the *option* provided that the contract has been given a book value in the *firm's* accounts.

10.4.39 G A written call *option* does not generate an *issuer exposure*.

- 10.4.40 R
- (1) This *rule* applies in relation to an *option* if a *firm*:
 - (a) has a *CAD 1 permission*;
 - (b) the scope of the *CAD 1 waiver* covers that *option*; and
 - (c) the *CAD 1 permission* is for a *CAD 1 model* for option risk aggregation as described in *BIPRU 7.9.7G* (Types of *CAD 1 model*).
 - (2) This *rule* also applies in relation to an *option* if a *firm*:
 - (a) has a *VaR model permission*; and
 - (b) the scope of the *VaR model permission* covers that *option*.
 - (3) A *firm* may take as the exposure value of an *option* the delta weighted value of the notional underlying the *option* calculated using the models described in (1) and (2), to the extent that those values are relevant for the calculations in *BIPRU 10.4.37R*.

Further details about the calculation of issuer exposures: Indices and baskets of equities or securities

10.4.41 R Subject to *BIPRU 10.4.42R*, a *firm* must treat an index or basket of debt *securities* or equities as giving rise to a series of *exposures* to the issuers of the underlying *securities* or equities in accordance with the provisions of *BIPRU 7.2* (Interest rate PRR) or *BIPRU 7.3* (Equity PRR and basic interest rate PRR for equity derivatives).

10.4.42 R A *qualifying equity index* does not generate an *exposure* of the type described in *BIPRU 10.4.41R*.

Securities financing transactions

10.4.43 R A *firm* with *securities financing transactions* in its *trading book* or its *non-trading book* must calculate its exposure to:

- (1) the issuer of the *security* it has sold in a *repurchase agreement*; and

- (2) the counterparty to the *securities financing transaction* (subject to *BIPRU 10.3.3R* (Identification of counterparties for guaranteed exposures) and *BIPRU 10.6* (Exemptions)).

Treatment of accrued interest and dividends due

- 10.4.44 R Subject to *BIPRU 10.4.45R*, when calculating an *exposure*, a *firm* must include accrued interest and dividends due.
- 10.4.45 R A *firm* may use the following method of calculating the total amount of a *firm's exposures* in the *non-trading book* to a *counterparty*, *connected counterparties* or a *group of connected clients* as an alternative to that in *BIPRU 10.4.44R*:
- (1) if the total amount of the *exposures* is less than 20% of the *firm's capital resources* (ignoring accrued interest), the accrued interest element need not be included in the calculation of the amount of the *exposures* in the *non-trading book*; and
 - (2) if the total amount of the *exposures* (ignoring accrued interest) is more than 20% (but less than 25%) of the *firm's capital resources*, the *firm* must be able to demonstrate that the total amount of the *exposures*, including the accrued interest element, meet the limits in *BIPRU 10.5* (Limits on exposures and large exposures) and that it meets any related *CNCOM*.
- 10.4.46 G The reason for *BIPRU 10.4.45R* is the systems difficulties of including accrued interest in the total amount of *exposures* in the *non-trading book*.

Exposures to undisclosed counterparties

- 10.4.47 R A *firm* must not incur an *exposure* to an undisclosed *counterparty* unless:
- (1) it has satisfied itself that it will continue to meet the limits in *BIPRU 10.5* (Limits on exposures and large exposures) for *non-trading book exposures* and *trading book exposures* and will continue to meet any *CNCOM*; and
 - (2) it has made and retained a record of the steps it has taken to comply with (1).

10.5 Limits on exposures and large exposures

Definition of large exposure

- 10.5.1 R A *large exposure* of a *firm* means its *total exposure* to a *counterparty*, *connected counterparties* or a *group of connected clients*, whether in the *firm's non-trading book* or *trading book* or both, which in aggregate equals or exceeds 10% of the *firm's capital resources*.

Definition of capital resources

- 10.5.2 R A *firm* must calculate its *capital resources* for the purposes of this chapter in accordance with *GENPRU 2.2* (Capital resources) and *BIPRU 10.5.3R* to *BIPRU 10.5.5R*

- 10.5.3 R Subject to *BIPRU 10.5.4R*, for the purposes of this chapter, a *firm's capital resources* mean *capital resources* calculated at stage (N) of the calculation in the *capital resources table* (Total tier one capital plus tier two capital after deductions).

- 10.5.4 R For the purposes of monitoring against the *trading book* limits and charge regime, as set out in *BIPRU 10.5.11R* to *BIPRU 10.5.22R*, and calculating a *firm's CNCOM*, a *firm's capital resources* may include *tier three capital resources*, in which case a *firm's capital resources* mean *capital resources* calculated at stage (T) of the *capital resources table* (Total capital after deductions).

- 10.5.5 R A *firm* must not take into account the following items:
- (1) surplus provisions (see *GENPRU 2.2.190R* to *GENPRU 2.2.193R*);
or
 - (2) *expected loss* amounts and other negative amounts (see *GENPRU 2.2.236R*); or
 - (3) *securitisation positions* (see *GENPRU 2.2.237R*).

Non-trading book limits

- 10.5.6 R A *firm* must ensure that the total amount of its *exposures* to the following does not exceed 25% of its *capital resources* (as determined under *BIPRU 10.5.2R*, *BIPRU 10.5.3R* and *BIPRU 10.5.5R*):
- (1) a *counterparty*; or
 - (2) a *group of connected clients*; or
 - (3) its *connected counterparties*.

- 10.5.7 G If a *connected counterparty* is also a member of a *group of connected clients* the limit in *BIPRU 10.5.6R* covers the aggregate of the total amount of the *firm's exposures* to its *connected counterparties* and of the total amount of its *exposures* to that *group of connected clients*.
- 10.5.8 R A *firm* must not incur *large exposures* which in total exceed 800% of its *capital resources* (as determined under *BIPRU 10.5.2R*, *BIPRU 10.5.3R* and *BIPRU 10.5.5R*).
- 10.5.9 R If a *firm* exceeds (or is aware that it will exceed) the limits in *BIPRU 10.5.6R* or *BIPRU 10.5.8R* it must notify the *FSA* without delay.
- 10.5.10 G A report under *BIPRU 10.5.9R* should be made in exceptional circumstances only. A *firm* which makes such a report should also provide the *FSA* with an explanation as to how the limits came to be exceeded, and a plan of action for bringing its *exposures* within the limits. The *FSA* may, where the circumstances warrant it, allow a *firm* a limited period of time in which to comply with the limits.

Trading book limits

- 10.5.11 R *Exposures* in a *firm's trading book* are exempt from the 25% and 800% limits in *BIPRU 10.5.6R* and *BIPRU 10.5.8R* if:
- (1) the total amount of the *exposures* on the *firm's non-trading book* to the same *counterparty* or *group of connected clients* or to its *connected counterparties* does not exceed the limits laid down in those *rules*, calculated with reference to the definition of *capital resources* set out in *BIPRU 10.5.2R*, *BIPRU 10.5.3R* and *BIPRU 10.5.5R*, so that the excess arises entirely on the *trading book*; and
 - (2) the *firm* meets the additional capital requirements relating to the *concentration risk capital component (CNCOM)* in relation to the relevant *trading book exposures*.
- 10.5.12 R If a *trading book concentration risk excess* with respect to a *counterparty* or *group of connected clients* or to its *connected counterparties* has existed for 10 *business days* or less, the *firm* must ensure that the total amount of its *trading book exposures* to that *counterparty* or *group of connected clients* or to its *connected counterparties* does not exceed 500% of the *firm's capital resources*.
- 10.5.13 R A *firm* must ensure that the total amount of its *trading book concentration risk excesses* that have persisted for more than 10 *business days* does not exceed 600% of its *capital resources*.
- 10.5.14 R Within 30 *business days* of the end of each third *Month*, a *firm* must notify the *FSA* of all cases of *trading book concentration risk excesses* in that three *Month* period, giving the amount of the excess and the name of the *counterparty*.

- 10.5.15 G A *trading book concentration risk excess* is defined in BIPRU 10.5.20R.
How to calculate the concentration risk capital component
- 10.5.16 G A *firm's CNCOM* should be calculated as part of its *credit risk capital requirement (CRCR)* in accordance with GENPRU 2.1 (Calculation of capital resources requirements).
- 10.5.17 R A *firm's CNCOM* is the sum of its *individual counterparty CNCOMs*.
- 10.5.18 R An *individual counterparty CNCOM* is the amount a *firm* must calculate in accordance with BIPRU 10.5.20R with respect to its *exposures* to a particular *counterparty* or a *group of connected clients* or to its *connected counterparties*.
- 10.5.19 G A *CNCOM* calculation on a *trading book exposure* is in addition to, and not instead of, any capital requirement arising under the *market risk capital requirement* or *counterparty risk capital component*.
- 10.5.20 R A *firm* must calculate its *individual counterparty CNCOM* for its *exposures* to a *counterparty* or *group of connected clients* or to its *connected counterparties* as follows:
- (1) break down its *total exposure* into its *trading book* and *non trading book* components;
 - (2) calculate 25% of the *firm's capital resources* and deduct those parts of the *total exposure* which are in the *non-trading book*;
 - (3) if the *non-trading book exposures* deducted in (2) equal 25% of the *firm's capital resources*, steps (4), (5) and (6) do not apply and if so the *trading book concentration risk excess* means, with respect to a *counterparty*, a *group of connected clients* or its *connected counterparties*, all *trading book exposures* to that *counterparty* or *group of connected clients* or to its *connected counterparties*;
 - (4) if the total amount of the *non-trading book exposures* deducted in (2) is less than 25% of the *firm's capital resources*, a *firm* must allocate (in the order set out in (6)) *trading book exposures* to the unutilised portion of the 25% limit to that *counterparty* or *counterparties* or to its *connected counterparties*;
 - (5) no further *trading book exposures* can be allocated once the 25% limit has been reached; the remaining *trading book exposures* constitute the *trading book concentration risk excess* with respect to that *counterparty* or *group of connected clients* or to its *connected counterparties*;

- (6) for the purposes of (4), a *firm* must allocate first the individual *trading book exposures* with the lowest capital requirements for *specific risk* under the *market risk capital requirement* and/or the lowest capital requirements under the *counterparty risk capital component* and allocate those *trading book exposures* with the highest capital requirements last;
- (7) the *individual counterparty CNCOM* is the sum of the capital requirements for each individual *exposure* included in the *trading book concentration risk excess* in accordance with (8) and (9) (each such capital requirement being an *individual CNCOM*);
- (8) if the *trading book concentration risk excess* has persisted for 10 *business days* or less (irrespective of the age of each component part), the *individual CNCOMs* must be calculated in accordance with this formula:

each *individual CNCOM* = capital requirement referred to in (6) x 200%;

- (9) if the *trading book concentration risk excess* has persisted for more than 10 *business days* (irrespective of the age of each component part), the *individual CNCOMs* must be calculated in accordance with this formula:

each *individual CNCOM* = capital requirement referred to in (6) x appropriate percentage in *BIPRU 10.5.21R*.

10.5.21 R The appropriate percentage referred to in *BIPRU 10.5.20R(9)* must be established in accordance with the following:

- (1) the individual *exposures* included in the *trading book concentration risk excess* must be assigned to the bands in the first column of the table in *BIPRU 10.5.22R*;
- (2) the maximum amount that may be put in any band other than the last equals the percentage of the *firm's capital resources* in column 1 of that table;
- (3) no amount may be allocated to the second or any later band unless the one before has been filled;
- (4) *exposures* must be assigned to the bands in the order established by *BIPRU 10.5.20R(6)*; and
- (5) for the purposes of (4), those *exposures* with the lowest capital requirements (as referred to in *BIPRU 10.5.20R(6)*) must be assigned first and those with the highest last.

- 10.5.22 R Percentages applicable under BIPRU 10.5.21R
This table belongs to *BIPRU 10.5.21R*

Excess exposure (as a percentage of the <i>firm's capital resources</i>)	Percentage
0% up to 40%	200%
Portion from 40% - 60%	300%
Portion from 60% - 80%	400%
Portion from 80% - 100%	500%
Portion from 100% - 250%	600%
Portion over 250%	900%

- 10.5.23 G The table in *BIPRU 10.5.24G* sets out an example of a *CNCOM* calculation.

- 10.5.24 G Example of a *CNCOM* calculation (all numbers £000s)
This table belongs to *BIPRU 10.5.23G*

Capital resources position		
(1)	<i>An firm's capital resources</i> comprises:	
		£
	<i>Tier one and tier two capital resources</i>	1000
	<i>Eligible tier three capital resources</i>	100
	<i>Amended capital resources</i>	1100
(2)	The components of the <i>large exposure</i> comprise:	
		£
	(a) <i>Non-trading book exposure</i>	200
	(b) Mark to market value of <i>trading book securities</i> :	

		% <i>specific</i> <i>risk</i> weight	
	Short: qualifying bond	1.00	(20)
	Long: qualifying commercial paper	0.25	100
	Long: equity	4.00	150
	Long: qualifying convertible	1.60	30
	Total net long securities position:		260
	Total net large exposures position [(a) + (b)]		460
Calculating the exposure for which incremental capital is needed			
(3)	The short position in the qualifying bond is offset against the highest specific risk weight items – in this case equities:		
			£
	Net long equity position (£150- £20)		130
(4)	The remaining items are ranked according to specific risk weight.		
	% <i>specific</i> <i>risk</i> weight	Security	£
	0.25	Qualifying commercial paper	100
	1.60	Qualifying convertible	30
	4.00	Equity (net)	130
(5)	The 'headroom' between the non-securities exposure and 25% of the amended <i>capital resources</i> is calculated.		
			£
	25% of amended capital base (1100)		275
	Non securities exposure		200
	Headroom		75

(6)	<p>Applying the securities positions in ascending order of specific <i>risk weight</i>, £75 of the £100 qualifying commercial paper may be counted before 25% of the amended capital base is reached.</p> <p>The remaining £25 of qualifying commercial paper, along with £30 qualifying convertible and £130 equity (net) are traded securities <i>exposures</i> in excess of the limit and should therefore be covered by incremental capital. The amount of incremental capital should be included in the calculation for determining how much <i>trading book</i> capital a <i>firm</i> should have.</p>		
(7)	<p>If the excess <i>exposure</i> has been outstanding for 10 days or less, the specific <i>risk weights</i> for the elements over 25% of amended <i>capital resources</i> should be doubled.</p> <p>The 25% limit (£275) is taken up by £200 <i>counterparty exposure</i> and £75 securities <i>exposure</i> within the limit. These two items, when added to the items in bold below, total £460. £460 is the total net <i>large exposures</i> position as set out in (2) above.</p>		
			£
	Qualifying commercial paper	£25 x 0.25% x 200% =	0.125
	Qualifying convertible	£30 x 1.60% x 200% =	0.960
	Equity	£130 x 4% x 200% +	10.400
	Additional capital requirement		11.485
(8)	<p>If the excess <i>exposure</i> has been outstanding for more than 10 days, the 25% limit (£275) is taken up by £200 <i>counterparty exposure</i> and £75 securities <i>exposure</i> within the limit. These two items, when added to the items in bold below, total £460. £460 is the total net <i>large exposures</i> position as set out in (2) above.</p>		
			£
	(a)	<p>Over 25% and up to 40% of amended capital base at 200% (40% of £1100 = £440)</p> <hr/> <p>Amount of <i>trading book concentration risk excess</i> = £185</p> <p>Proportion of Capital Base= 16.8%</p> <p>Appropriate % Multiplier Band = 200%</p>	

		£25 x 0.25% x 200% =	0.125
		£30 x 1.60% x 200% =	0.960
		£130 x 4.00% x 200% =	10.400
(b)	Excess exposure 40% - 60% of amended capital base at 300%		
		£20 x 4.00% x 300% =	2.400
Additional capital requirement [(a)+(b)]			13.885

10.6 Exemptions

General exemptions

- 10.6.1 R The *exposures* listed in *BIPRU* 10.6.3R, whether *trading book exposures* or *non-trading book exposures*, are exempt from the limits described in *BIPRU* 10.5 (Limits on exposures and large exposures), provided that the *exposures* are to *counterparties* which are not *connected counterparties*.
- 10.6.2 R (1) In *BIPRU* 10.6.3R and *BIPRU* 10.6.4R, references to guarantees include credit derivatives recognised under *BIPRU* 5 (Credit risk mitigation) and, if applicable, *BIPRU* 4.10 (The IRB approach: Credit risk mitigation), other than credit linked notes.
- (2) *BIPRU* 10.3.3R(6) (Compliance with minimum *credit risk mitigation* requirements) applies for the purpose of *BIPRU* 10.6.3R and *BIPRU* 10.6.4R.
- 10.6.3 R The *exposures* referred to in *BIPRU* 10.6.1R are as follows:
- (1) asset items constituting claims on central governments or *central banks* which claims would unsecured receive a 0% *risk weight* under the *standardised approach*;
 - (2) asset items constituting claims on *international organisations* or *multilateral development banks* which claims would unsecured receive a 0% *risk weight* under the *standardised approach*;
 - (3) asset items constituting claims carrying the explicit guarantees of central governments, *central banks*, *international organisations* or *multilateral development banks*, where unsecured claims on the entity providing the guarantee would receive a 0% *risk weight* under the *standardised approach*;
 - (4) other *exposures* attributable to, or guaranteed by, central governments, *central banks*, *international organisations* or *multilateral development banks* where unsecured claims on the entity to which the *exposure* is attributable or by which it is guaranteed would receive a 0% *risk weight* under the *standardised approach*;
 - (5) asset items constituting claims on and other *exposures* to central governments or *central banks* not within (1), which are denominated and, where applicable, funded in the national currencies of the borrowers;
 - (6) asset items constituting claims on and other *exposures* to *institutions*, with a maturity of one year or less, but not constituting such *institutions' capital resources*;

- (7) asset items constituting claims on *EEA States'* regional governments and local authorities which claims would receive a 0% *risk weight* under the *standardised approach*;
- (8) other *exposures* to or guaranteed by *EEA States'* regional governments and local authorities claims on which would receive a 0% *risk weight* under the *standardised approach*;
- (9) asset items constituting claims and other *exposures* on *recognised third-country investment firms, recognised clearing houses, designated clearing houses, recognised investment exchanges and designated investment exchanges* in *CRD financial instruments*, with a maturity of one year or less, but not constituting such institutions' *capital resources*;
- (10) *covered bonds* within the meaning of the second paragraph of that definition;
- (11) loans secured by mortgages on residential property and leasing transactions under which the lessor retains full ownership of the residential property leased for as long as the lessee has not exercised his option to purchase, in all cases up to 50% of the value of the residential property concerned;
- (12) the following, where they would receive a 50% *risk weight* under the *standardised approach*, and only up to 50% of the value of the property concerned:
 - (a) *exposures* secured by mortgages on offices or other commercial premises; and
 - (b) *exposures* related to property leasing transactions concerning offices or other commercial premises; and
- (13) bill endorsements on bills with a maturity of 1 year or less already endorsed by another *firm*.

10.6.4 R For the purposes of *BIPRU* 10.6.3R(11), the value of the property must be calculated on the basis of strict valuation standards laid down by law, regulation or administrative provisions. Valuation must be carried out at least once a year. For these purposes, residential property means a residence to be occupied or let by the borrower.

Parental guarantees

10.6.5 R A *firm* may treat as exempt from the limits in *BIPRU* 10.5 (Limits on exposures and large exposures) an *exposure* to a *counterparty* or to a *group of connected clients* if the following conditions are met:

- (1) the *parent undertaking* of the *firm* guarantees that *exposure*;

- (2) the *total exposure* to that *counterparty* or *group of connected clients* does not exceed 100% of the *firm's capital resources*;
- (3) the total amount of the *firm's exposures* to *connected counterparties* does not exceed 200% of the *firm's capital resources* (any *exposure* treated as exempt under this *rule* or under *BIPRU 10.6.7R* must be treated as being to the *parent undertaking* for the purpose of this paragraph (3) and included in the calculation of the limit in this paragraph (3));
- (4) the *firm* complies with whichever of *SYSC 3.1.1R* (Systems and controls) and *SYSC 4.1.1R* (General organisational requirements) applies to it; and
- (5) both the *firm* and the *parent undertaking* of the *firm* satisfy *BIPRU 3.2.27R* (Consolidation condition relating to zero *risk weights* for intra-group *exposures*).

10.6.6 R For the purposes of *BIPRU 10.6.5R*, *BIPRU 10.3.3R* (3) to (6) (Provisions relating to the treatment of guaranteed *exposures*) apply.

Capital maintenance arrangements

10.6.7 R A *firm* may treat as exempt from the limits in *BIPRU 10.5* (Limits on exposures and large exposures) an *exposure* to a *counterparty* which is not a *connected counterparty* if the following conditions are met:

- (1) the *exposure* is subject to a legally binding agreement by the *parent undertaking* of the *firm* that it will promptly on demand by the *firm* increase the *firm's capital resources* by:
 - (a) an amount that is sufficient to reverse completely the effect of any *loss* the *firm* may sustain in connection with that *exposure*; or
 - (b) the amount required to ensure that the *firm* complies with *GENPRU 2.1* (Calculation of capital resources requirements), *BIPRU 10* and any other requirements relating to *capital resources* or concentration risk imposed on the *firm* by or under the *regulatory system*;
- (2) the *firm* notifies the *FSA* in writing of its intention to enter into the agreement and of its terms at least one *Month* before the *firm* enters into it; and
- (3) the conditions in *BIPRU 10.3.3R*(6) (Compliance with minimum *credit risk mitigation* requirements) and *BIPRU 10.6.5R*(2) to (5) are met.

Collateral exemptions: Top slicing

10.6.8 G (1) 'Top slicing' involves systematically collateralising only part of an *exposure* to bring it within the limits in *BIPRU* 10.5 (Limits on exposures and large exposures).

(2) The practice of top-slicing can give rise to concerns and will be subject to review by the *FSA* when carrying out the *SREP*.

Exemptions for firms using the financial collateral simple method under the standardised approach

10.6.9 R A *firm* which uses the *financial collateral simple method* under the *standardised approach* may treat the following *exposures* as exempt from the limits described in *BIPRU* 10.5 (Limits on exposures and large exposures), provided that the *exposures* are to *counterparties* which are not *connected counterparties*:

(1) asset items and other *exposures* secured by collateral in the form of debt *securities* issued by central governments, *central banks*, *international organisations*, *multilateral development banks* or *EEA States'* regional governments or local authorities, which *securities* constitute claims on their issuer which would receive a 0% *risk weight* under the *standardised approach*;

(2) asset items and other *exposures* secured by collateral in the form of cash deposits placed with the *lending firm* or with a *credit institution* which is the *parent undertaking* or a *subsidiary undertaking* of the *lending firm*;

(3) asset items and other *exposures* secured by collateral in the form of certificates of deposit issued by the *lending firm* or by a *credit institution* which is the *parent undertaking* or a *subsidiary undertaking* of the *lending firm* and lodged with either of them; and

(4) *exposures* secured by collateral in the form of *securities* other than those referred to in (1).

10.6.10 R Cash received under a credit linked note issued by the *firm* and loans and deposits of a *counterparty* to or with the *firm* which are subject to an on-balance sheet netting agreement recognised under *BIPRU* 5 (Credit risk mitigation) must be treated as falling under *BIPRU* 10.6.9R(2).

- 10.6.11 R For the purposes of *BIPRU* 10.6.9R(4), the *securities* used as collateral must be valued at market price, have a value that exceeds the *exposures* guaranteed, and be either traded or effectively negotiable and regularly quoted on a *recognised investment exchange* or a *designated investment exchange*. The excess value required must be 100%. It must, however, be 150% in the case of *shares* and 50% in the case of debt *securities* issued by *institutions*, *EEA States'* regional governments or local authorities other than those referred to in *BIPRU* 10.6.9R(1), and in the case of debt *securities* issued by *multilateral development banks* other than those receiving a 0% *risk weight* under the *standardised approach*. Where there is a mismatch between the maturity of the *exposure* and the maturity of the credit protection, the collateral must not be recognised. Where the issuer of *securities* used as collateral is an *institution*, such collateral may not constitute the *institution's capital resources*.
- 10.6.12 R A *firm* may only recognise collateral for the purpose of *BIPRU* 10.6.9R if the collateral complies with the eligibility requirements and other minimum requirements set out in *BIPRU* 5 (Credit risk mitigation) for the purposes of calculating *risk-weighted exposure amounts* under the *standardised approach* using the *financial collateral simple method* or, if applicable, the method in *BIPRU* 5.5 (Other funded credit risk mitigation). In particular a *firm* may not recognise collateral for that purpose if it is not eligible under the *financial collateral simple method* or other applicable method.
- 10.6.13 G As indicated in *BIPRU* 5 (Credit risk mitigation), the *financial collateral simple method* will be available only to *firms* using the *standardised approach* and only in relation to *exposures* for which they adopt the *standardised approach*.
- Exemptions for firms using the financial collateral comprehensive method
- 10.6.14 R A *firm* which uses the *financial collateral comprehensive method* under the *standardised approach* or the *IRB approach* (but not the *advanced IRB approach*) may calculate the value of its *exposures* to a *counterparty* or to a *group of connected clients* (but not *connected counterparties*) as being the fully-adjusted value of the *exposures* to the *counterparty* or *group of connected clients* calculated in accordance with the *financial collateral comprehensive method* under *BIPRU* 5 (Credit risk mitigation) and, if relevant, *BIPRU* 4.10 (The IRB approach: Credit risk mitigation), taking into account the *credit risk mitigation*, volatility adjustments and any maturity mismatch (E*) in accordance with those *rules*.
- 10.6.15 R Where *BIPRU* 10.6.14R applies, *BIPRU* 10.6.9R does not apply.

10.6.16 R A *firm* may only recognise collateral for the purpose of *BIPRU* 10.6.14R if the collateral complies with the eligibility requirements and other minimum requirements set out in *BIPRU* 5 (Credit risk mitigation) and, if relevant, *BIPRU* 4.10 (The IRB approach: Credit risk mitigation) for the purposes of calculating *risk-weighted exposure amounts* under the *standardised approach* or, if applicable, the *IRB approach* using the *financial collateral comprehensive method*. In particular a *firm* may not recognise collateral for that purpose if it is not eligible under the *financial collateral comprehensive method*.

Exemptions for firms using own estimates of LGDs and conversion factors under the IRB approach

10.6.17 R A *firm* that uses own estimates of *LGDs* and *conversion factors* under the *IRB approach* for an *IRB exposure class* may recognise the effects described in (1) in calculating the value of its *exposures* to a *counterparty* or to a *group of connected clients* (but, subject to the *firm's IRB permission*, not *connected counterparties*) for the purposes of *BIPRU* 10.5 (Limits on exposures and large exposures) if:

- (1) the *firm* is able to satisfy the *FSA* that it can estimate the effects of financial collateral on its *exposures* separately from other *LGD*-relevant aspects;
- (2) the *firm* is able to demonstrate the suitability of the estimates produced; and
- (3) the *firm's IRB permission* specifically allows it.

10.6.18 G *BIPRU* 10.6.17R(3) means that a *firm* with an *IRB permission* may not use the approach in *BIPRU* 10.6.17R unless its *IRB permission* expressly says that it may do so.

10.6.19 R If a *firm* that uses own estimates of *LGDs* and *conversion factors* under the *IRB approach* uses its own estimates of the effects of financial collateral on its *exposures* for *large exposures* purposes, it must do so on a consistent basis and on a basis consistent with the approach adopted in the calculation of capital requirements. In particular, this approach must be adopted for all *exposures* the nominal value of which would be a *large exposure*. A *firm* may only use one of *BIPRU* 10.6.14R and *BIPRU* 10.6.17R. A *firm* must be able to satisfy the *FSA* that it is complying with this *rule*.

10.6.20 R A *firm* to which *BIPRU* 10.6.17R applies must still report to the *FSA* the gross value of its *exposures*.

10.6.21 R If a *firm* relies on *BIPRU* 10.6.17 the recognition of credit protection is subject to the relevant requirements of the *IRB approach*.

Stress testing of credit risk concentrations

- 10.6.22 R A *firm* which calculates the value of its *exposures* in accordance with *BIPRU* 10.6.17R must conduct periodic stress tests of its credit risk concentrations including in relation to the realisable value of any collateral taken.
- 10.6.23 R The stress tests required by *BIPRU* 10.6.22R must address:
- (1) risks arising from potential changes in market conditions that could adversely impact the *firm's* adequacy of *capital resources*; and
 - (2) risks arising from the realisation of collateral in stressed situations.
- 10.6.24 R A *firm* must be able to satisfy the *FSA* that the stress tests that the *firm* carries out in accordance with *BIPRU* 10.6.22R are adequate and appropriate for the assessment of such risks.
- 10.6.25 R In the event that a stress test carried out in accordance with *BIPRU* 10.6.22R indicates a lower realisable value of collateral taken than would be permitted to be taken into account under *BIPRU* 10.6.17R to *BIPRU* 10.6.21R as appropriate, the value of collateral permitted to be recognised in calculating the value of *exposures* for the purposes of *BIPRU* 10.5 (Limits on exposures and large exposures) is the lower value.
- 10.6.26 R A *firm* to which *BIPRU* 10.6.22R applies must include in its strategy to address concentration risk:
- (1) policies and procedures to address risks arising from maturity mismatches between *exposures* and any credit protection on those *exposures*;
 - (2) policies and procedures in the event that a stress test indicates a lower realisable value of collateral than taken into account under *BIPRU* 10.6.17R to *BIPRU* 10.6.21R; and
 - (3) policies and procedures relating to concentration risk arising from the application of *credit risk mitigation* techniques, and in particular large indirect credit *exposures* (for example to a single issuer of *securities* taken as collateral).
- 10.6.27 G A *firm* should determine the frequency needed for the stress testing of its credit risk concentrations with emphasis on having sufficient frequency to maintain the currency of its capital calculations. In any case such testing should be carried out at least once a year.

10.7 Treasury concession and intra-group securities financing transactions

Treasury concession

10.7.1 R Subject to *BIPRU* 10.11.1R (Notification procedures for *BIPRU* 10.7 to *BIPRU* 10.10), a *firm* may treat as exempt from the limits in *BIPRU* 10.5 (Limits on exposures and large exposures) an *exposure* to a *concentration risk group counterparty* provided that one or more of the following conditions is satisfied:

- (1) the *exposure* has an original maturity of one year or less and it is incurred in the course of the *firm* carrying on a treasury role for other members of its *group*;
- (2) the following conditions are satisfied:
 - (a) the *exposure* is a cash loan to a *parent undertaking* of the *firm* or to another member of the *firm's immediate group*;
 - (b) (if the loan is to a member of the *firm's immediate group* other than a *parent undertaking* of the *firm*) that member carries on a treasury role for the *firm's group*;
 - (c) the cash lent is surplus to the needs of the *firm*; and
 - (d) the amount of the surplus fluctuates regularly; or
- (3) the *exposure* arises from the *firm* or the *counterparty* operating a central risk management function for members of the *firm's group* for *exposures* arising from *derivatives*.

10.7.2 R The total amount of the *exposures* that a *firm* may treat as exempt under *BIPRU* 10.7.1R must not exceed 50% of the *firm's capital resources* as set out in stage (N) of the *capital resources table* (Total tier one capital plus tier two capital after deductions).

10.7.3 G Any *exposures* that would, but for *BIPRU* 10.7.2R, fall to be treated in accordance with *BIPRU* 10.7.1R remain subject to the limits in *BIPRU* 10.5 (Limits on exposures and large exposures).

Intra-group securities financing transactions

10.7.4 R Subject to *BIPRU* 10.11.1R (Notification procedures for *BIPRU* 10.7 to *BIPRU* 10.10), a *firm* may treat as exempt from the limits in *BIPRU* 10.5 (Limits on exposures and large exposures) an *exposure* in the form of a *securities financing transaction* provided that:

- (1) the *counterparty* is a *concentration risk group counterparty*;

- (2) the *firm* does not apply the *CCR internal model method* with respect to any *securities financing transactions* under this chapter;
- (3) the *exposure* in question is collateralised by collateral whose value equals or exceeds 90% of the amount of the *exposure*; and
- (4) (whether or not the *firm* uses the *financial collateral comprehensive approach*) the collateral is eligible under the *financial collateral comprehensive approach* and the *firm* meets the other minimum requirements under *BIPRU 5* (Credit risk mitigation) in relation to that collateral.

10.7.5 R The level of collateralisation referred to in *BIPRU 10.7.4R(3)* must be measured by reference to the gross amount of the *exposure* without taking into account the effects of netting and without applying volatility adjustments or adjustments for maturity mismatches under the *financial collateral comprehensive approach*.

10.7.6 R A *firm* using the exemption in *BIPRU 10.7.4R* must be able to demonstrate to the *FSA*:

- (1) (if the *firm* has an *CCR internal model method permission*) any roll-out programme as referred to in *BIPRU 13.6.13R* (Sequential implementation of the *CCR internal model method*) or any combination of the *CCR internal model method* with either or both of the *CCR mark to market method* or the *CCR standardised method*;
- (2) the selection of *counterparties* for *securities financing transactions*; and
- (3) the booking of its *securities financing transactions* and the way that it carries on its business with respect to them;

are not designed or chosen wholly or mainly with a view to coming within the limits in *BIPRU 10.5* (Limits on exposures and large exposures) or reducing capital requirements applicable to the *firm* under the *regulatory system* through the use of that exemption.

10.8 UK integrated groups

Application

10.8.1 R This section applies to a *firm* if:

- (1) it is a member of a *UK integrated group*; and
- (2) it gives notice in accordance with *BIPRU* 10.11.1R (Notification procedures for *BIPRU* 10.7 to *BIPRU* 10.10) that it will apply *BIPRU* 10.8.

10.8.2 R If this section applies to a *firm*, it must apply this section to all *exposures* to all its *concentration risk group counterparties* and not just some of them.

Guidance about UK integrated groups

10.8.3 G *Guidance* on the treatment of intra-group *exposures* under this chapter if this section applies can be found in *BIPRU* 10 Annex 1G (Treatment of exposures under the integrated groups regime for concentration risk).

Definition of UK integrated group

10.8.4 R An *undertaking* is a member of a *firm's UK integrated group* if, in relation to the *firm*, that *undertaking* satisfies the following conditions:

- (1) it is a *concentration risk group counterparty*;
- (2) it is an *institution, financial holding company, financial institution, asset management company* or *ancillary services undertaking*;
- (3) it is subject to the same risk evaluation, measurement and control procedures as the *firm*;
- (4) it is established in the *United Kingdom* and either it is incorporated in the *United Kingdom* or (if that *counterparty* is of a type that falls within the scope of that Regulation) the centre of its main interests is situated within the *United Kingdom* within the meaning of the Council Regulation of 29 May 2000 on insolvency proceedings (Regulation 1346/2000/EC); and
- (5) there is no current or foreseen material practical or legal impediment to the prompt transfer of *capital resources* or repayment of liabilities from the *counterparty* to the *firm*.

10.8.5 G *Firms* are referred to the *guidance* in *BIPRU* 3.2.30G and *BIPRU* 3.2.31G (*Guidance* relating to 0% risk weights for intra-group *exposures* under the *standardised approach*) on the prompt transfer of *capital resources* and repayment of liabilities.

Revised concentration risk limits for a UK integrated group

- 10.8.6 R A *firm* must ensure that the *rules* listed in *BIPRU* 10.8.7R are complied with on a consolidated basis in accordance with the following:
- (1) the *rules* apply in relation to the *firm's UK integrated group* rather than in relation to the *firm*;
 - (2) the *rules* apply in relation to *exposures* of members of the *UK integrated group* to members of the *residual block*; and
 - (3) the *UK integrated group* and the *residual block* must each be treated as a single *undertaking*.
- 10.8.7 R The *rules* referred to in *BIPRU* 10.8.6R are:
- (1) *BIPRU* 10.5.6R (25% *non-trading book* limit);
 - (2) *BIPRU* 10.5.11R (*trading book* limits) other than *BIPRU* 10.5.11R(2) (*CNCOM*);
 - (3) *BIPRU* 10.5.12R (500% limit for *trading book* excess *exposures*) with the deletion of the time limit set out in *BIPRU* 10.5.12R; and
 - (4) *BIPRU* 10.7 (Treasury concession and intra-group securities financing transactions).
- 10.8.8 G *Exposures* between members of the *UK integrated group* are exempt if this section applies.
- 10.8.9 G The 800% limit in *BIPRU* 10.5.8R and the 600% limit in *BIPRU* 10.5.13R do not apply to *exposures* to *concentration risk group counterparties* if this section applies.

Adjustments to the Treasury concession exemption

- 10.8.10 R A *firm* may only treat an *exposure* as exempt under *BIPRU* 10.7.1R (Treasury Concession) as applied under this section if the *exposure* is or (if that *rule* applied to the member of the *UK integrated group* in question) would be exempt under *BIPRU* 10.7.1R on a solo basis. The following adjustments apply:
- (1) the *exposure* must be to a *concentration risk group counterparty*; and
 - (2) the limit in *BIPRU* 10.7.2R (Exemption limited to 50% of a *firm's capital resources*) is calculated on a consolidated basis with respect to the *UK integrated group*.

Adjustments to the exemption for securities financing transactions

- 10.8.11 R A *firm* may only treat an *exposure* as exempt under *BIPRU* 10.7.4R (Intra-group securities financing transactions) as applied under this section if the *exposure* is or (if that *rule* applied to the *undertaking* in question) would be exempt under *BIPRU* 10.7.4R on a solo basis. *BIPRU* 10.7.6R (Abuse of the exemption) continues to apply. The exemption is not available if the *firm* uses the *CCR internal models method* for *securities financing transactions* for the purpose of this chapter.

Definition of residual block

- 10.8.12 R For the purposes of this section, a member of the *residual block* means, in relation to a *firm* and its *UK integrated group*, a *concentration risk group counterparty* of the *firm* which is not a member of the *firm's UK integrated group*.

Calculation of capital resources for a UK integrated group

- 10.8.13 R For the purposes of this section, a *firm* must calculate the capital resources of the *UK integrated group* in accordance with *GENPRU* 3 Annex 1R Part 2 (Method 2 of Annex I of the Financial Groups Directive (Deduction and aggregation Method)) and apply the limits set out in this section to those capital resources rather than the *capital resources* of the *firm*. For these purposes the definition of *solo capital resources* is adjusted so that the *rules* on which the calculation for each member of the *UK integrated group* is based are the ones that would apply under the procedure in *BIPRU* 8.6.6R to *BIPRU* 8.6.9R (Consolidated capital resources).
- 10.8.14 G The calculation of capital resources under *GENPRU* 3 Annex 1R Part 2 (Method 2 of Annex I of the Financial Groups Directive (Deduction and aggregation Method)) is based on the *solo capital resources* of members of a *financial conglomerate*. The definition of *solo capital resources* depends on what type of *undertakings* the *financial conglomerate* contains. For instance, if a *financial conglomerate* contains a *bank* the *solo capital resources* calculation for every group member in the *banking sector* and the *investment services sector* is based on the *capital resources* calculation for *banks*. The purpose of *BIPRU* 10.8.13R is to apply the corresponding procedure that applies under *BIPRU* 8.6 (Calculation of capital resources on a consolidated basis for *BIPRU firms*).

Exemption for intra-group exposures on a solo basis

- 10.8.15 R If this section applies to a *firm*, then subject to *BIPRU* 10.10 (Treatment of the trading book concentration risk excess under the integrated groups regime), it may, on a solo basis, treat an *exposure* to a *concentration risk group counterparty* as exempt from the limits in *BIPRU* 10.5 (Limits on exposures and large exposures).

10.8.16 G The purpose of *BIPRU* 10.8.15R is to reflect the fact that the limits in *BIPRU* 10.5 (Limits on exposures and large exposures) so far as they apply to *concentration risk group counterparties* are calculated on a consolidated basis with respect to a *firm's UK integrated group*. It is therefore necessary to switch them off on a purely solo basis.

10.9 Wider Integrated Group

Application

- 10.9.1 R This section applies to a *BIPRU firm* if:
- (1) it has a *wider integrated group waiver*; and
 - (2) it is a member of a *UK integrated group* and of a *wider integrated group*.

- 10.9.2 R If this section applies, *BIPRU 10.8* (UK Integrated Groups) does not apply.

- 10.9.3 R If this section applies to a *firm*, it must apply it to all *exposures* to all its *concentration risk group counterparties* and not just some of them.

Guidance about wider integrated groups

- 10.9.4 G *Guidance* on the treatment of intra-group *exposures* under *BIPRU 10* if this section applies can be found in *BIPRU 10 Annex 1G* (Treatment of exposures under the integrated groups regime for concentration risk).

Definition of wider integrated group

- 10.9.5 R The *wider integrated group* of a *firm* consists of each *concentration risk group counterparty* of the *firm* that is not a member of the *firm's UK integrated group* but satisfies all the conditions for membership of the *firm's UK integrated group* except for *BIPRU 10.8.4R(4)* (Establishment in the United Kingdom).

Definition of diverse block

- 10.9.6 R For the purposes of this section, and in relation to a *firm* and its *wider integrated group*, a *diverse block* means all *undertakings* in the *wider integrated group* designated as a single *diverse block* by the applicable *wider integrated group permission*.

Definition of residual block

- 10.9.7 R For the purposes of this section, and in relation to a *firm* and its *wider integrated group*, a member of the *residual block* means a *concentration risk group counterparty* of the *firm* which is not a member of the *firm's UK integrated group* or *wider integrated group*.

Revised concentration risk limits for a wider integrated group

- 10.9.8 R A *firm* to which this section applies must ensure that the *rules* listed in *BIPRU 10.9.9R* are complied with on a consolidated basis on the following basis:

- (1) the *rules* apply in relation to the *firm's UK integrated group* rather than in relation to the *firm*;
- (2) the *rules* apply in relation to *exposures* of the members of the *UK integrated group* to members of each of the following:
 - (a) each *diverse block*; and
 - (b) the *residual block*; and
- (3) the *UK integrated group*, each *diverse block* and the *residual block* must each be treated as separate single *undertakings*.

10.9.9 R The *rules* referred to in *BIPRU 10.9.8R* are:

- (1) *BIPRU 10.5.6R* (25% *non-trading book* limit);
- (2) *BIPRU 10.5.11R* (*trading book* limits) other than *BIPRU 10.5.11R(2)* (*CNCOM*);
- (3) *BIPRU 10.5.12R* (500% limit for *trading book* excess *exposures*) with the deletion of the time limit set out in *BIPRU 10.5.12R*; and
- (4) *BIPRU 10.7* (Treasury concession and intra-group securities financing transactions).

10.9.10 G *Exposures* between members of the *UK integrated group* are exempt if this section applies.

10.9.11 G The 800% limit in *BIPRU 10.5.8R* and the 600% limit in *BIPRU 10.5.13R* do not apply to *exposures* to *concentration risk group counterparties* if this section applies.

Adjustments to the Treasury concession and securities financing exemptions

10.9.12 R *BIPRU 10.8.10R* (Adjustments to the Treasury concession exemption) and *BIPRU 10.8.11R* (Adjustments to the exemption for securities financing transactions) apply for the purposes of this section in the same way that they apply for the purposes of *BIPRU 10.8* (UK Integrated Groups).

Calculation of capital resources for a UK integrated group

10.9.13 R *BIPRU 10.8.13R* (Calculation of capital resources for a UK integrated group) applies for the purposes of this section in the same way that it applies for the purposes of *BIPRU 10.8* (UK Integrated Groups).

How diverse blocks are chosen

- 10.9.14 G As part of the process of applying for a *wider integrated group waiver*, a *firm* should agree with the *FSA* the number, nature and size of the *diverse blocks*. The basis of the *diverse blocks* will depend on the nature, scale and diversity of the business of the *firm*, its *UK integrated group* and its *wider integrated group*. The different *diverse blocks* are taken to reflect different groupings of risk, reflecting appropriately low levels of correlation. In general, the *FSA* will expect to permit a *firm* to establish no more than four *diverse blocks*. However, there may be circumstances in which the nature and scale of a *firm*, its *UK integrated group* and its *wider integrated group* would warrant the creation of additional *diverse blocks*. Each member of a *firm's wider integrated group* will be allocated to a *diverse block*. Blocks may be diverse according to geography, business or a combination of both.

Exemption for intra-group exposures on a solo basis

- 10.9.15 R If this section applies to a *firm*, then subject to *BIPRU* 10.10 (Treatment of the trading book concentration risk excess under the integrated groups regime), it may, on a solo basis, treat an *exposure* to a *concentration risk group counterparty* as exempt from the limits in *BIPRU* 10.5 (Limits on exposures and large exposures).
- 10.9.16 G The purpose of *BIPRU* 10.9.15R is to reflect the fact that the limits in *BIPRU* 10.5 (Limits on exposures and large exposures) so far as they apply to *concentration risk group counterparties* are calculated on a consolidated basis with respect to a *firm's UK integrated group*. It is therefore necessary to switch them off on a purely solo basis.

- 10.10 Treatment of the trading book concentration risk excess under the integrated groups regime
- 10.10.1 R *BIPRU* 10.10 applies to a *firm* applying the treatments set out in *BIPRU* 10.8 (UK Integrated Groups) or *BIPRU* 10.9 (Wider Integrated Group).
- 10.10.2 R A *firm* must calculate the *CNCOM* that would have applied if *BIPRU* 10.5.11R(2) (Additional capital requirements relating to the *concentration risk capital component*) applied in relation to the *UK integrated group* in question.
- 10.10.3 R A *firm* must then calculate the percentage of the amount calculated under *BIPRU* 10.10.2R which is attributable to *exposures* of the *firm*.
- 10.10.4 R A *firm* must add the result of the calculation in *BIPRU* 10.10.3R to the *CNCOM* applied to the *firm* on a solo basis in accordance with *BIPRU* 10.5.16R to *BIPRU* 10.5.22R (How to calculate the concentration risk capital component).

10.11 Notification procedures for BIPRU 10.7 to BIPRU 10.10

- 10.11.1 R (1) A *firm* may not apply *BIPRU* 10.7 (Treasury concession and intra-group securities financing transactions) or *BIPRU* 10.8 (UK integrated groups) unless it has given one *Month's* prior notice to the *FSA* that it intends do so.
- (2) The written notice referred to in (1) must explain how the *firm* meets the conditions for the application of the treatment in question and how it will ensure that it will still meet the requirements of *BIPRU* 10 on a continuing basis when using the relevant treatment.
- (3) A *firm* may stop applying *BIPRU* 10.7 or *BIPRU* 10.8 if it has given one *Month's* prior notice to the *FSA* that it intends do so.
- (4) If a *firm* stops applying *BIPRU* 10.7 or *BIPRU* 10.8 it may start to apply it again if it notifies the *FSA* under (1) that it intends do so.
- (5) A *firm* need only give the *FSA* the notice required in (1) once rather than with respect to each *exposure*.
- 10.11.2 R A *firm* must notify the *FSA* if it becomes aware that any *exposure* that it has treated as exempt under *BIPRU* 10.7 (Treasury concession and intra-group securities financing transactions) or any *counterparty* that it has been treating as a member of its *UK integrated group* or, if *BIPRU* 10.9 (Wider Integrated Group) applies, its *wider integrated group* has ceased to meet the conditions for application of the relevant treatment.

10.12 Systems and controls and general

Systems and controls

- 10.12.1 R A *firm* must have sound administrative and accounting procedures and adequate internal control mechanisms for the purposes of identifying and recording all *large exposures* and subsequent changes to them, and for that of monitoring those *large exposures* in the light of the *firm's* own *exposure* policies.
- 10.12.2 R A *firm* must take reasonable care to establish and maintain adequate systems and controls to identify, monitor, and control *exposures* to a *parent undertaking* of the *firm*, a *subsidiary undertaking* of the *firm*, or a *subsidiary undertaking* of the *firm's* *parent undertaking*.

Concentration risk policies

- 10.12.3 R A *firm* must be able to demonstrate to the *FSA* that:
- (1) it has written policies and procedures to address and control the concentration risk arising from:
 - (a) *exposures* to *counterparties* and *groups of connected clients*;
 - (b) *counterparties* in the same economic sector or geographic region;
 - (c) the same activity or *commodity*; and
 - (d) the application of *credit risk mitigation* techniques, including in particular risks associated with large indirect credit exposures (for example to a single collateral issuer); and
 - (2) those policies and procedures are implemented.

Reporting

- 10.12.4 R Other than in relation to *repurchase transactions* or *securities or commodities lending or borrowing transactions*, *exposures* must be reported on a gross basis, not including the recognition of *credit risk mitigation*.

Artificial transactions

- 10.12.5 R In line with the general principle in *GEN 2.2.1R* (Purposive interpretation) a *firm* must not, with a view to avoiding the additional capital requirements that it would otherwise incur on *exposures* exceeding the limits laid down in *BIPRU 10.5* (Limits on exposures and large exposures) once those *exposures* have been maintained for more than ten *business days*:

- (1) temporarily transfer the *exposures* in question to another *person* (whether in the same *group* or not); or
- (2) undertake artificial transactions to close out the *exposure* during the ten *business day* period and create a new *exposure*.

10.12.6 R A *firm* must notify the *FSA* if it enters into a transfer, transaction or arrangement of the type mentioned in *BIPRU* 10.12.5R.

Annex 1 G Treatment of exposures under the integrated groups regime for concentration risk

No UK Integrated Group and no Wider Integrated Group		
Situation	Exposure from / to	Summary of the available modifications
1	Intra group <i>exposures</i> but no UKIG or WIG in place	<p>The <i>firm</i> is not subject to an integrated groups treatment of <i>large exposures</i>. The normal <i>large exposure</i> limits (BIPRU 10.5) apply to connected <i>exposures</i> of the <i>firm</i> at the solo level. (This assumes that no other <i>large exposure</i> exemptions are utilised.)</p> <p>Although a <i>firm's exposures</i> to connected counterparties may not qualify for an integrated groups treatment, they may still qualify for a treasury and intra-group securities financing transaction concession (BIPRU 10.7).</p>
UK Integrated Group established but no Wider Integrated Group in place		
Situation	Exposure from / to	Summary of the available modifications
2	UKIG <i>firm</i> to another UKIG firm (they are members of the same UKIG) (No WIG in place)	<p><i>Exposures</i> between members of a <i>firm's</i> UKIG are exempt from the <i>large exposure</i> limits. This means that the 25%, 800%, 500% and 600% limits are disapplied and that the <i>exposures</i> are not included in the notional <i>CNCOM</i>. (BIPRU 10.8.8 G)</p>
3	UKIG <i>firm</i> to an <i>undertaking</i> within its <i>residual block</i> (no WIG in place]	<p>In situation 3, there is a UKIG and a <i>residual block</i>. But no WIG has been established.</p> <p>The UKIG's <i>exposures</i> to <i>undertakings</i> within its <i>residual block</i> are exempt from the normal <i>large exposures</i> limits at the solo level. Instead, the total of the UKIG's <i>exposures</i> to its <i>residual block</i> is subject to the following limits (BIPRU 10.8.6 -7 R):</p> <ul style="list-style-type: none"> ○ BIPRU 10.5.6R (25% <i>non-trading book</i> limit); ○ BIPRU 10.5.11 R(<i>trading book</i> limits) other than BIPRU 10.5.11 R(2) (<i>CNCOM</i>); ○ BIPRU 10.5.12 R (500% limit for <i>trading book excess exposures</i>) with the deletion of the time limit set out in BIPRU 10.5.12R; and ○ BIPRU 10.7 (Treasury concession and intra – group securities financing transactions). <p>The capital resources to which the limits apply are those</p>

		<p>of the UKIG, rather than those of the solo <i>firm</i> (<i>BIPRU</i> 10.8.6 (3) R and <i>BIPRU</i> 10.8.13R).</p> <p><i>BIPRU</i> 10.7 (Treasury concession and intra-group securities financing transactions) may be applied to exposures of the UKIG to its <i>residual block</i> if the requisite conditions are satisfied.</p> <p>In respect of the treasury concession (<i>BIPRU</i> 10.7.1 – 3), the UKIG's <i>exposures</i> to <i>undertakings</i> within its <i>residual block</i> may be exempt from the 25 % limit, subject to a maximum of 50% of the capital resources of the UKIG. These exempt <i>exposures</i> would also be exempt for the purposes of calculating the notional <i>CNCOM</i>. Any <i>exposure</i> that meets the treasury concession conditions but is above the 50% limit would not be exempt from the <i>large exposure</i> limits. They would not be exempt from the notional <i>CNCOM</i>. The UKIG <i>exposures</i> that were eligible for a treasury concession, but which, together with other such <i>exposures</i>, exceeded the 50% limit are not exempt and are treated as other <i>exposures</i> of the UKIG and remain subject to the 25% limit.</p>
4	A <i>firm</i> in the <i>residual block</i> to another <i>undertaking</i> in the <i>residual block</i>	Not within the scope of the preferential <i>large exposure</i> treatments.
5	A <i>firm</i> in the <i>residual block</i> to an <i>undertaking</i> which is a member of the UKIG	
UK Integrated Group in place, Wider Integrated Group waiver granted		
Situation	Exposure from / to	Summary of the available modifications
6	UKIG <i>firm</i> to another UKIG member (within the same UKIG) (WIG in place)	<i>Exposures</i> between members of a <i>firm's</i> UKIG are exempt from the <i>large exposure</i> limits (<i>BIPRU</i> 10.9.8R). (The modifications available are the same as those noted for Situation 2.)
7	UKIG <i>firm</i> to an <i>undertaking</i> in its WIG (WIG in place)	<p>In situation 7 there is a UKIG, WIG (comprising <i>diverse blocks</i> agreed under the WIG waiver) and a <i>residual block</i>.</p> <p>The aggregate <i>exposure</i> of the UKIG to each individual <i>diverse block</i> within the WIG is subject to the following limits (<i>BIPRU</i> 10.9.8 – 9R):</p>

		<ul style="list-style-type: none"> ○ <i>BIPRU 10.5.6 R (25% non- trading book limit);</i> ○ <i>BIPRU 10.5.11 R (trading book limits) other than BIPRU 10.5.11 R(2) (CNCOM);</i> ○ <i>BIPRU 10.5.12 R (500% limit for trading book excess exposures) with the deletion of the time limit set out in BIPRU 10.5.12R; and</i> ○ <i>BIPRU 10.7 (Treasury concession and intra-group securities financing transactions).</i> <p>The capital resources to which these limits apply are those of the UKIG, rather than those of the solo <i>firm</i> (<i>BIRPU 10.9.8(3) and BIPRU 10.9.13 R</i>).</p> <p><i>BIPRU 10.7 (Treasury concession and intra-group securities financing transactions) may also be applied to the exposures of the UKIG to each of its diverse blocks within the WIG if the requisite conditions are satisfied.</i></p> <p>In respect of the treasury concession (<i>BIPRU 10.7.1 – 6</i>), where there is a WIG, the UKIG's <i>exposures</i> to each individual <i>diverse block</i> may be exempt from the 25% limit up to a maximum amount of 50% of the capital resources of the UKIG. Exempt exposures are also exempt for the purpose of calculating the notional <i>CNCOM</i> for each <i>diverse block</i>. The UKIG <i>exposures</i> to the individual <i>diverse blocks</i> that were eligible for the treasury concession, but which together with other such <i>exposures</i> exceed the 50% limit, are not exempt and are treated as otheor exposures of the UKIG and remain subject to the 25% limit.</p>
8	<p>UKIG <i>firm</i> to a <i>undertaking</i> within its <i>residual block</i></p> <p>(WIG in place)</p>	<p>In situation 8, there is a UKIG, WIG (comprising <i>diverse blocks</i> agreed under the WIG waiver) and <i>residual block</i>.</p> <p>The UKIG's <i>exposures</i> to members of its <i>residual block</i> are exempt from the normal <i>large exposures</i> limits at the solo level. Instead, the total of the UKIG's <i>exposures</i> to the <i>residual block</i> is subject to the following limits (<i>BIPRU 10.9.8 – 10.9.11 G</i>)</p> <ul style="list-style-type: none"> ○ <i>BIPRU 10.5.6R (25 % non-trading book limit);</i> ○ <i>BIPRU 10.5.11 R(trading book limits) other than BIPRU 10.5.11 R(2) (CNCOM);</i> ○ <i>BIPRU 10.5.12 R (500% limit for trading book excess exposures) with the deletion of the time</i>

		<p>limit set out in <i>BIPRU</i> 10.5.12R; and</p> <ul style="list-style-type: none"> ○ <i>BIPRU</i> 10.7 (Treasury concession and intra – group securities financing transactions). <p>The capital resources to which these limits apply are those of the UKIG, rather than those of the solo <i>firm</i> (<i>BIPRU</i> 10.9.8R and <i>BIPRU</i> 10.9.13R).</p> <p><i>BIPRU</i> 10.7 (Treasury concession and intra-group securities financing transactions) may also be applied to exposures of the UKIG to its <i>residual block</i> if the requisite conditions are satisfied.</p> <p>In respect of the treasury concession (<i>BIPRU</i> 10.7.1 – 6), where, subject to meeting the treasury concession conditions, the UKIG's <i>exposures</i> to undertakings within its <i>residual block</i> may be exempt from the 25 % limit, subject to a maximum of 50% of the capital resources of the UKIG. These exempt <i>exposures</i> would also be exempt for the purposes of calculating the notional <i>CNCOM</i>. Any <i>exposure</i> that meets the treasury concession conditions but is above the 50% limit would not be exempt from the <i>large exposure</i> limits. They would not be exempt from the notional <i>CNCOM</i>. UKIG <i>exposures</i> that were eligible for a treasury concession, but which, together with other such <i>exposures</i>, exceeded the 50% limit are not exempt and are treated as other <i>exposures</i> of the UKIG and remain subject to the 25% limit.</p>
9	WIG <i>firm</i> to an undertaking in the UKIG	Not within the scope of the preferential <i>large exposure</i> treatments.
10	WIG <i>firm</i> to another undertaking in the same WIG (either within the same <i>diverse block</i> or between <i>diverse blocks</i>)	
11	WIG <i>firm</i> to an undertaking within the <i>residual block</i>	
12	A <i>firm</i> within the <i>residual block</i> to an undertaking within the	

	UKIG	
13	A <i>firm</i> within the <i>residual block</i> to an <i>undertaking</i> within the WIG	
14	A <i>firm</i> within the <i>residual block</i> to an <i>undertaking</i> in the <i>residual block</i>	
This table assumes that <i>BIPRU</i> Transitional TP17 and <i>BIPRU</i> Transitional TP18 have not been applied.		

BIPRU 11 Disclosure (Pillar 3)

11.1 Application and purpose

Application

11.1.1 R *BIPRU 11 applies to a BIPRU firm.*

Purpose

11.1.2 G The purpose of *BIPRU 11* is to implement:

- (1)
 - (a) Article 68(3);
 - (b) Article 72;
 - (c) Articles 145 to 149; and
 - (d) Annex XII;of the *Banking Consolidation Directive*; and
- (2)
 - (a) Article 2, in part;
 - (b) Point 3 of Article 23, in part; and
 - (c) Article 39;of the *Capital Adequacy Directive*.

11.2 Basis of disclosures

Disclosure on an individual basis

11.2.1 R The following must comply with the obligations laid down in *BIPRU* 11.3 on an individual basis:

(1) a *firm* which is neither a *parent undertaking* nor a *subsidiary undertaking*;

(2) a *firm* which is excluded from a *UK consolidation group* or *non-EEA sub-group* pursuant to *BIPRU* 8.5; and

[Note: *BCD* Article 68(3)]

(3) a *firm* which is part of a *group* which has been granted an *investment firm consolidation waiver* under *BIPRU* 8.4;

[Note: *CAD* Article 23]

EEA parent institutions

11.2.2 R A *firm* which is an *EEA parent institution* must comply with the obligations laid down in *BIPRU* 11.3 on the basis of its consolidated financial situation.

[Note: *BCD* Article 72(1)]

11.2.3 R A *firm* which is a significant subsidiary of an *EEA parent institution* must disclose the information specified in *BIPRU* 11.4.5R on an individual or sub-consolidated basis.

Firms controlled by an EEA parent financial holding company

11.2.4 R A *firm controlled* by an *EEA parent financial holding company* must comply with the obligations laid down in *BIPRU* 11.3 on the basis of the consolidated financial situation of that *EEA parent financial holding company*.

[Note: *BCD* Article 72(2)]

11.2.5 R A *firm* which is a significant subsidiary of an *EEA parent financial holding company* must disclose the information specified in *BIPRU* 11.4.5R on an individual or sub-consolidated basis.

Waiver: Comparable disclosures provided on a consolidated basis by a parent undertaking established in a third country

11.2.6 G A *firm* which is included within comparable disclosures provided on a consolidated basis by a *parent undertaking* whose head office is not in an *EEA State* may apply for a *waiver* from the relevant disclosure requirements in *BIPRU* 11.2.2R - *BIPRU* 11.2.5R. The *FSA's* approach to granting

waivers is set out in the Supervision manual (see *SUP* 8).

[**Note:** *BCD* Article 72(3)]

- 11.2.7 G A *firm* applying for a *waiver* from one or more of the disclosure requirements in *BIPRU* 11.2.2R - *BIPRU* 11.2.5R will need to:
- (1) satisfy the *FSA* that it is included within comparable disclosures provided on a consolidated basis by a *parent undertaking* whose head office is not in an *EEA State*; and
 - (2) notify the *FSA* of the location where the comparable disclosures are provided.

11.3 Disclosures: Information to be disclosed; Frequency, media and location of disclosures; Verification

Information to be disclosed

11.3.1 R A *firm* must publicly disclose the information laid down in *BIPRU* 11.5 subject to the provisions laid down in *BIPRU* 11.3.5R to *BIPRU* 11.3.7R.

[**Note:** *BCD* Article 145(1), *CAD* Article 39]

- 11.3.2 R
- (1) A *firm* which has an *IRB permission* must publicly disclose the information laid down in *BIPRU* 11.6.1R to *BIPRU* 11.6.4R.
 - (2) A *firm* which recognises *credit risk mitigation* in accordance with *BIPRU* 5 must publicly disclose the information laid down in *BIPRU* 11.6.5R.
 - (3) A *firm* using the *advanced measurement approach* for the calculation of its *operational risk requirement* must publicly disclose the information laid down in *BIPRU* 11.6.6R.

[**Note:** *BCD* Article 145(2), *CAD* Article 39]

Disclosure policy

11.3.3 R A *firm* must adopt a formal policy to comply with the disclosure requirements laid down in *BIPRU* 11.3.1R and *BIPRU* 11.3.2R and have policies for assessing the appropriateness of its disclosures, including their verification and frequency.

[**Note:** *BCD* Article 145(3)]

Rating decisions

11.3.4 R A *firm* must, if requested, explain its rating decisions to SMEs and other corporate applicants for loans, providing an explanation in writing when asked. The administrative costs of the explanation have to be at an appropriate rate to the size of the loan.

[**Note:** *BCD* Article 145(4)]

Exemption from disclosure: Materiality

11.3.5 R A *firm* may omit one or more of the disclosures listed in *BIPRU* 11.5 if the information provided by such disclosures is not, in the light of the criterion specified in *BIPRU* 11.4.1R, regarded as material.

[**Note:** *BCD* Article 146(1)]

Exemption from disclosure: Proprietary or confidential information

11.3.6 R A *firm* may omit one or more items of information included in the

disclosures listed in *BIPRU* 11.5 and *BIPRU* 11.6 if those items include information which, in the light of the criteria specified in *BIPRU* 11.4.2R and *BIPRU* 11.4.3R, is regarded as proprietary or confidential.

[**Note:** *BCD* Article 146(2)]

- 11.3.7 R In the exceptional cases referred to in *BIPRU* 11.3.6R, a *firm* must:
- (1) state in its disclosures:
 - (a) the fact that the specific items of information are not disclosed; and
 - (b) the reason for non-disclosure; and
 - (2) publish more general information about the subject matter of the disclosure requirement, except where these are to be classified as secret or confidential under the criteria set out in *BIPRU* 11.4.2R and *BIPRU* 11.4.3R.

[**Note:** *BCD* Article 146(3)]

Frequency of publication

- 11.3.8 R A *firm* must:
- (1) publish the disclosures required under *BIPRU* 11.3.1R to *BIPRU* 11.3.5R on an annual basis at a minimum;
 - (2) publish disclosures as soon as practicable.

[**Note:** *BCD* Article 147(1)]

- 11.3.9 R A *firm* must also determine whether more frequent publication than is provided for in *BIPRU* 11.3.8R is necessary in the light of the criteria set out in *BIPRU* 11.4.4R.

[**Note:** *BCD* Article 147(2)]

Media and location of publication

- 11.3.10 R
- (1) A *firm* may determine the appropriate medium, location and means of verification to comply effectively with the disclosure requirements laid down in *BIPRU* 11.3.1R to *BIPRU* 11.3.4R.
 - (2) To the degree feasible, a *firm* must provide all disclosures in one medium or location.
 - (3) Equivalent disclosures made by a *firm* under accounting, *listing* or other requirements may be deemed to constitute compliance with *BIPRU* 11.3.1R to *BIPRU* 11.3.4R.
 - (4) If disclosures are not included in the financial statements, a *firm*

must indicate where they can be found.

[**Note:** *BCD* Article 148]

- 11.4 Technical criteria on disclosure: General criteria
- Criterion for materiality
- 11.4.1 R A *firm* must regard information as material in disclosures if its omission or misstatement could change or influence the assessment or decision of a user relying on that information for the purpose of making economic decisions.
- [**Note:** *BCD* Annex XII Part 1 point 1]
- Criteria: Proprietary or confidential information
- 11.4.2 R (1) A *firm* must regard information as proprietary information if sharing that information with the public would undermine its competitive position.
- (2) Proprietary information may include information on products or systems which, if shared with competitors, would render a *firm's* investments therein less valuable.
- [**Note:** *BCD* Annex XII Part 1 point 2]
- 11.4.3 R A *firm* must regard information as confidential if there are obligations to customers or other counterparty relationships binding the *firm* to confidentiality.
- [**Note:** *BCD* Annex XII Part 1 point 3]
- Criteria: Frequency of publication
- 11.4.4 R (1) A *firm* must assess the need to publish some or all disclosures more frequently than annually in the light of the relevant characteristics of its business such as:
- (a) scale of operations;
 - (b) range of activities;
 - (c) presence in different countries;
 - (d) involvement in different financial sectors;
 - (e) participation in international financial markets; and
 - (f) participation in payment, settlement and clearing systems.
- (2) In making its assessment under (1) a *firm* must pay particular attention to the possible need for more frequent disclosure of:
- (a) items of information laid down in *BIPRU* 11.5.3R(2) and *BIPRU* 11.5.3R(5), and *BIPRU* 11.5.4R(2) – *BIPRU*

11.5.4R(5);

- (b) information on risk exposure and other items prone to rapid change.

[**Note:** *BCD Annex XII Part 1 point 4*]

Disclosures: Significant subsidiaries

11.4.5 R A *firm* which is a significant subsidiary of:

- (1) an *EEA parent institution*; or
- (2) an *EEA parent holding company*;

must disclose the information specified in *BIPRU 11.5.3R* to *BIPRU 11.5.4R* on an individual or sub-consolidated basis.

[**Note:** *BCD Annex XII Part 1 point 5*]

11.5 Technical criteria on disclosure: General requirements

Disclosure: Risk management objectives and policies

11.5.1 R A *firm* must disclose its risk management objectives and policies for each separate category of risk, including the risks referred to under *BIPRU* 11.5.1R to *BIPRU* 11.5.17R. These disclosures must include:

- (1) the strategies and processes to manage those risks;
- (2) the structure and organisation of the relevant risk management function or other appropriate arrangements;
- (3) the scope and nature of risk reporting and measurement systems; and
- (4) the policies for hedging and mitigating risk, and the strategies and processes for monitoring the continuing effectiveness of hedges and mitigants.

[**Note:** *BCD* Annex XII Part 2 point 1]

Disclosure: Scope of application of directive requirements

11.5.2 R A *firm* must disclose the following information regarding the scope of application of the requirements of the *Banking Consolidation Directive*:

- (1) the name of the *firm* which is the subject of the disclosures;
- (2) an outline of the differences in the basis of consolidation for accounting and prudential purposes, with a brief description of the entities that are:
 - (a) fully consolidated;
 - (b) proportionally consolidated;
 - (c) deducted from *capital resources*;
 - (d) neither consolidated nor deducted;
- (3) any current or foreseen material practical or legal impediment to the prompt transfer of *capital resources* or repayment of liabilities among the *parent undertaking* and its *subsidiary undertakings*;
- (4) the aggregate amount by which the actual *capital resources* are less than the required minimum in all *subsidiary undertakings* not included in the consolidation, and the name or names of such *subsidiary undertakings*; and
- (5) if applicable, the circumstance of making use of the provisions laid down in *BIPRU* 2.1 (Solo consolidation waiver).

[Note: BCD Annex XII Part 2 point 2]

Disclosure: Capital resources

- 11.5.3 R A *firm* must disclose the following information regarding its *capital resources*:
- (1) summary information on the terms and conditions of the main features of all *capital resources* items and components thereof;
 - (2) *tier one capital resources* less any *innovative tier one capital resources*, with separate disclosure of all positive items and deductions;
 - (3) the total amount (for the purposes of (3), the total amount must be stated gross of deductions) of:
 - (a) *tier two capital resources* plus any *innovative tier one capital resources*; and
 - (b) *tier three capital resources*;
 - (4) deductions from *tier one capital resources* and *tier two capital resources*, with separate disclosure of items referred to in *GENPRU 2.2.236R*; and
 - (5) total *capital resources*, net of deductions in *GENPRU 2.2* and limits laid down in *GENPRU 2.2.25R* to *GENPRU 2.2.30R* and *GENPRU 2.2.42R* to *GENPRU 2.2.50R*.

[Note: BCD Annex XII Part 2 point 3]

Disclosure: Compliance with BIPRU 3, BIPRU 4, BIPRU 6, BIPRU 7, BIPRU 10 and the overall Pillar 2 rule

- 11.5.4 R A *firm* must disclose the following information regarding compliance with *BIPRU 3*, *BIPRU 4*, *BIPRU 6*, *BIPRU 7*, *BIPRU 10* and the *overall Pillar 2 rule*:
- (1) a summary of the *firm's* approach to assessing the adequacy of its internal capital to support current and future activities;
 - (2) for a *firm* calculating *risk weighted exposure amounts* in accordance with the *standardised approach* to credit risk, 8% of the *risk weighted exposure amounts* for each of the *standardised credit risk exposure classes*;
 - (3) for a *firm* calculating *risk weighted exposure amounts* in accordance with the *IRB approach*, 8% of the *risk weighted exposure amounts* for each of the *IRB exposure classes*;

[Note: BCD Annex XII Part 2 point 4 (part)]

- (4) the *firm's* minimum capital requirements for the following:
- (a) in respect of its *trading-book* business, its:
 - (i) *interest rate PRR*;
 - (ii) *equity rate PRR*;
 - (iii) *option PRR*;
 - (iv) *collective investment schemes PRR*;
 - (v) *counterparty risk capital component*;
 - (vi) *concentration risk capital component*; and
 - (b) in respect of all of its business activities, its:
 - (i) *commodity PRR*; and
 - (ii) *foreign exchange PRR*;
- (5) its *operational risk capital requirement* calculated in accordance with the *basic indicator approach*, the *standardised approach* and the *advanced measurement approach* and disclosed separately.

[Note: BCD Annex XII Part 2 point 4(part)]

11.5.5 R For *retail exposures*, the requirement under *BIPRU 11.5.4R(3)* applies to each of the following categories:

- (1) *exposures to retail SMEs*;
- (2) *retail exposures* secured by real estate collateral;
- (3) *qualifying revolving retail exposures*; and
- (4) other *retail exposures*.

[Note: BCD Annex XII Part 2 point 4(part)]

11.5.6 R For *equity exposures*, the requirement under *BIPRU 11.5.4R(3)* applies to:

- (1) each of the approaches (the simple risk weight approach, the PD/LGD approach and the internal models approach) provided for in *BIPRU 4.7.5R to BIPRU 4.7.6R*, *BIPRU 4.7.9R to BIPRU 4.7.11R*, *BIPRU 4.7.14R to BIPRU 4.7.16R*, *BIPRU 4.7.24R to BIPRU 4.7.25R*;
- (2) exchange traded *exposures*, private *equity exposures* in sufficiently

diversified portfolios, and other *exposures*;

- (3) *exposures* subject to supervisory transition regarding capital requirements; and
- (4) *exposures* subject to grandfathering provisions regarding capital requirements.

[**Note:** BCD Annex XII Part 2 point 4(part)]

11.5.7 R A *firm* must disclose the following information regarding its *exposure* to *counterparty credit risk*:

- (1) a discussion of the methodology used to assign internal capital and credit limits for counterparty credit *exposures*;
- (2) a discussion of policies for securing collateral and establishing credit reserves;
- (3) a discussion of policies with respect to *wrong-way risk exposures*;
- (4) a discussion of the impact of the amount of collateral the *firm* would have to provide given a downgrade in its credit rating;
- (5) gross positive fair value of contracts, netting benefits, netted current credit *exposure*, collateral held and 'net derivatives credit *exposure*', where 'net derivatives credit *exposure*' is the credit *exposure* on derivatives transactions after considering both the benefits from legally enforceable netting agreements and collateral arrangements;
- (6) measures for exposure value under the *CCR mark to market method*, the *CCR standardised method* or the *CCR internal model method*, whichever is applicable;
- (7) the notional value of credit derivative hedges, and the distribution of current credit *exposure* by types of credit *exposure*;
- (8) credit derivative transactions (notional), segregated between use for the *firm's* own credit portfolio, as well as in its intermediation activities, including the distribution of the credit derivatives products used, broken down further by protection bought and sold within each product group; and
- (9) the estimate of alpha (α) if the *firm's CCR internal model method permission* permits it to estimate α .

[**Note:** BCD Annex XII Part 2 point 5]

Disclosure: Credit risk and dilution risk

11.5.8 R A *firm* must disclose the following information regarding its *exposure* to

credit risk and *dilution risk*:

- (1) the definitions for accounting purposes of past due and impaired;
- (2) a description of the approaches and methods adopted for determining value adjustments and provisions;
- (3) the total amount of *exposures* after accounting offsets and without taking into account the effects of *credit risk mitigation*, and the average amount of the *exposures* over the period broken down by different types of *exposure* classes;
- (4) the geographic distribution of the *exposures*, broken down in significant areas by material *exposure* classes, and further detailed if appropriate;
- (5) the distribution of the *exposures* by industry or counterparty type, broken down by *exposure* classes, and further detailed if appropriate;
- (6) the residual maturity breakdown of all the *exposures*, broken down by *exposure* classes, and further detailed if appropriate;
- (7) by significant industry or counterparty type, the amount of:
 - (a) impaired *exposures* and past due *exposures*, provided separately;
 - (b) value adjustments and provisions; and
 - (c) charges for value adjustments during the period;
- (8) the amount of the impaired *exposures* and past due *exposures*, provided separately, broken down by the significant geographical areas including, if practical, the amounts of value adjustments and provisions related to each geographical area;
- (9) the reconciliation of changes in the value adjustments and provisions for impaired *exposures*, shown separately; and
- (10) value adjustments and recoveries recorded directly to the income statement must be disclosed separately.

[**Note:** *BCD* Annex XII Part 2 point 6 (part)]

11.5.9 R The information to be disclosed under *BIPRU* 11.5.8R(9) must comprise:

- (1) a description of the type of value adjustments and provisions;
- (2) the opening balances;
- (3) the amounts taken against the provisions during the period;
- (4) the amounts set aside or reversed for estimated probable losses on

exposures during the period, any other adjustments including those determined by exchange rate differences, business combinations, acquisitions and disposals of *subsidiary undertakings*, and transfers between provisions; and

- (5) the closing balances.

[Note: BCD Annex XII Part 2 point 6 (part)]

Disclosure: Firms calculating risk weighted exposure amounts in accordance with the standardised approach

11.5.10 R For a *firm* calculating *risk weighted exposure amounts* in accordance with the *standardised approach* to credit risk, the following information must be disclosed for each of the *standardised credit risk exposure classes*;

- (1) the names of the *nominated ECAIs* and export credit agencies and the reasons for any changes;
- (2) the *standardised credit risk exposure classes* for which each *ECAI* or export credit agency is used;
- (3) a description of the process used to transfer the issuer and issue credit assessments onto items not included in the *trading book*;
- (4) the association of the external rating of each *nominated ECAI* or export credit agency with the *credit quality steps* prescribed in *BIPRU 3*, taking into account that this information need not be disclosed if the *firm* complies with the *credit quality assessment scale*; and
- (5) the *exposure* values and the *exposure* values after *credit risk mitigation* associated with each *credit quality step* prescribed in *BIPRU 3*, as well as those deducted from *capital resources*.

[Note: BCD Annex XII Part 2 point 7]

Disclosure: Firms calculating risk weighted exposure amounts using the IRB approach

11.5.11 R A *firm* calculating *risk weighted exposure amounts* for *specialised lending exposures* in accordance with *BIPRU 4.5.8R* to *BIPRU 4.5.10R* or *equity exposures* in accordance with *BIPRU 4.7.9R* to *BIPRU 4.7.10R* (the simple risk weight approach) must disclose the *exposures* assigned:

- (1) to each category of the table in *BIPRU 4.5.9R*; or
- (2) to each *risk weight* mentioned in *BIPRU 4.7.9R* to *BIPRU 4.7.10R*.

[Note: BCD Annex XII Part 2 point 8]

Disclosure: Market risk

11.5.12 R A *firm* must disclose its *capital resources requirements* separately for each risk referred to in (1) and (2).

(1) in respect of its *trading-book* business, its:

- (a) *interest rate PRR*;
- (b) *equity rate PRR*;
- (c) *option PRR*;
- (d) *collective investment schemes PRR*;
- (e) *counterparty risk capital component*; and
- (f) *concentration risk capital component*; and

(2) in respect of all of its business activities, its:

- (a) *commodity PRR*; and
- (b) *foreign exchange PRR*.

[**Note:** BCD Annex XII Part 2 point 9]

Disclosure: Use of VaR model for calculation of market risk capital requirement

11.5.13 R The following information must be disclosed by a *firm* which calculates its *market risk capital requirement* using a *VaR model*:

(1) for each sub-portfolio covered:

- (a) the characteristics of the models used;
- (b) a description of stress testing applied to the sub-portfolio;
- (c) a description of the approaches used for backtesting and validating the accuracy and consistency of the internal models and modelling processes;

(2) the scope of the *firm's VaR model permission*; and

(3) a description of the extent and methodologies for compliance with the requirements set out in *GENPRU 1.3.13R(2)* and (3) and *GENPRU 1.3.14R* to *GENPRU 1.3.34R*.

[**Note:** BCD Annex XII Part 2 point 10]

Disclosure: Operational risk

11.5.14 R The following information must be disclosed by a *firm* on *operational risk*:

- (1) the approaches for the assessment of the *operational risk requirement* that the *firm* qualifies for; and
- (2) if the *firm* uses the *advanced measurement approach*:
 - (a) a description of the methodology used in the *advanced measurement approach*, including a discussion of relevant internal and external factors considered in the *firm's* measurement approach; and
 - (b) in the case of partial use, the scope and coverage of the different methodologies used.

[**Note:** BCD Annex XII Part 2 point 11]

Disclosure: Non-trading book exposures in equities

11.5.15 R A *firm* must disclose the following information regarding the *exposures* in *equities* not included in the *trading book*:

- (1) the differentiation between *exposures* based on their objectives, including for capital gains relationship and strategic reasons, and an overview of the accounting techniques and valuation methodologies used, including key assumptions and practices affecting valuation and any significant changes in these practices;
- (2) the balance sheet value, the fair value and, for those exchange-traded, a comparison to the market price where it is materially different from the fair value;
- (3) the types, nature and amounts of exchange-traded *exposures*, private *equity exposures* in sufficiently diversified portfolios, and other *exposures*;
- (4) the cumulative realised gains or losses arising from sales and liquidations in the period; and
- (5) the total unrealised gains or losses, the total latent revaluation gains or losses, and any of these amounts included in *tier one, tier two or tier three capital resources*.

[**Note:** BCD Annex XII Part 2 point 12]

Disclosures: Exposures to interest rate risk in the non-trading book

11.5.16 R A *firm* must disclose the following information on its *exposure* to interest rate risk on positions not included in the *trading-book*:

- (1) the nature of the interest rate risk and the key assumptions (including assumptions regarding loan prepayments and behaviour of non-maturity deposits), and frequency of measurement of the interest rate risk; and
- (2) the variation in earnings, economic value or other relevant measure used by the management for upward and downward rate shocks according to management's method for measuring the interest rate risk, broken down by currency.

[Note: BCD Annex XII Part 2 point 13]

Disclosures: Securitisation

11.5.17 R A *firm* calculating *risk weighted exposure amounts* in accordance with BIPRU 9 must disclose the following information:

- (1) a description of the *firm's* objectives in relation to *securitisation* activity;
- (2) the roles played by the *firm* in the *securitisation* process;
- (3) an indication of the extent of the *firm's* involvement in each of them;
- (4) the approaches to calculating *risk weighted exposure amounts* that the *firm* follows for its *securitisation* activities;
- (5) a summary of the *firm's* accounting policies for *securitisation* activities, including:
 - (a) whether the transactions are treated as sales or financings;
 - (b) the recognition of gains on sales;
 - (c) the key assumptions for valuing retained interests; and
 - (d) the treatment of *synthetic securitisations* if this is not covered by other accounting policies;
- (6) the names of the *ECAIs* used for *securitisations* and the types of *exposure* for which each agency is used;
- (7) the total outstanding amount of *exposures securitised* by the *firm* and subject to the *securitisation* framework (broken down into *traditional* and *synthetic*), by *exposure* type;
- (8) for *exposures securitised* by the *firm* and subject to the *securitisation* framework, a breakdown by *exposure* type of the amount of impaired and past due *exposures securitised*, and the losses recognised by the *firm* during the period;

- (9) the aggregate amount of *securitisation positions* retained or purchased, broken down by *exposure* type;
- (10) the aggregate amount of *securitisation positions* retained or purchased:
 - (a) broken down into a meaningful number of *risk weight* bands; and
 - (b) with separate disclosure of *positions* that have been *risk weighted* at 1250% or deducted;
- (11) the aggregate outstanding amount of *securitised revolving exposures* segregated by the *originator's* interest and the investors' interest; and
- (12) a summary of the *securitisation* activity in the period, including the amount of *exposures securitised* (by *exposure* type), and recognised gain or loss on sale by *exposure* type.

[Note: BCD Annex XII Part 2 point 14]

11.6 Qualifying requirements for the use of particular instruments or methodologies

Disclosures: Firms using the IRB approach

- 11.6.1 R A *firm* calculating *risk weighted exposure amounts* in accordance with the *IRB approach* must disclose the following information:
- (1) the scope of the *firm's IRB permission*;
 - (2) an explanation and review of:
 - (a) the structure of internal *rating systems* and relation between internal and external ratings;
 - (b) the use of internal estimates other than for calculating *risk weighted exposure amounts* in accordance with the *IRB approach*;
 - (c) the process for managing and recognising *credit risk mitigation*; and
 - (d) the control mechanisms for *rating systems* including a description of independence, accountability, and *rating systems* review;
 - (3) a description of the internal ratings process, provided separately for the following *IRB exposure classes*:
 - (a) central governments and *central banks*;
 - (b) *institutions*;
 - (c) corporate, including SMEs, *specialised lending* and purchased corporate receivables;
 - (d) retail, for *exposures to retail SMEs exposures, retail exposures* secured by real estate collateral, *qualifying revolving retail exposures*, and other *retail exposures*; and
 - (e) *equities*;
 - (4) the *exposure* values for each of the *IRB exposure classes*;
 - (5) for each of the *IRB exposure classes* central governments and *central banks, institutions, corporate* and *equity*, and across a sufficient number of *obligor grades* (including *default*) to allow for a meaningful differentiation of credit risk, a *firm* must disclose:
 - (a) the total *exposures* (for the *IRB exposure classes* central governments and *central banks, institutions* and *corporate*

exposures, the sum of outstanding loans and *exposure* values for undrawn commitments; for *equity exposures*, the outstanding amount);

- (b) for a *firm* using own *LGD* estimates for the calculation of *risk weighted exposure amounts*, the *exposure*-weighted average *LGD* in percentage;
 - (c) the *exposure*-weighted average *risk weight*; and
 - (d) for a *firm* using own estimates of *conversion factors* for the calculation of *risk weighted exposure amounts*, the amount of undrawn commitments and *exposure*-weighted average *exposure* values for each *IRB exposure class*;
- (6) for the *retail exposure* class and for each of the categories of:
- (a) *exposures* to *retail SMEs*;
 - (b) *retail exposures* secured by real estate collateral;
 - (c) *qualifying revolving retail exposures*; and
 - (d) other *retail exposures*;

either the disclosures outlined under (5) (if applicable, on a pooled basis), or an analysis of *exposures* (outstanding loans and *exposure* values for undrawn commitments) against a sufficient number of *EL* grades to allow for a meaningful differentiation of credit risk (if applicable, on a pooled basis);

- (7) the actual value adjustments in the preceding period for each *IRB exposure class* (for *retail exposures*, for each of the categories in (6)(a) to (d)) and how they differ from past experience;
- (8) a description of the factors that impacted on the loss experience in the preceding period (for example, whether the *firm* experienced higher than average *default* rates, or higher than average *LGDs* and *conversion factors*); and
- (9) the *firm's* estimates against actual outcomes over a longer period including, at a minimum, information on estimates of losses against actual losses in each *IRB exposure class* (for *retail exposures*, for each of the categories in (6)(a) to (d)) over a period sufficient to allow for a meaningful assessment of the performance of the internal rating processes for each *IRB exposure class* (for *retail exposures*, for each of the categories in (6)(a) to (d)).

[**Note:** *BCD* Annex XII Part 3 point 1 (part)]

11.6.2 R For the purposes of *BIPRU* 11.6.1R(3), the description must include the

types of *exposure* included in the *IRB exposure class*, the definitions, methods and data for estimation and validation of *PD* and, if applicable, *LGD* and *conversion factors*, including assumptions employed in the derivation of these variables, and the descriptions of material deviations from the definition of *default*, including the broad segments affected by such deviations.

[Note: BCD Annex XII Part 3 point 1 (part)]

- 11.6.3 R For the purposes of *BIPRU* 11.6.1R(4), where a *firm* uses its own estimates of *LGDs* or *conversion factors* for the calculation of *risk weighted exposure amounts* for *exposures* falling into the *sovereign, institutional and corporate IRB exposure class*, the *firm* must disclose those *exposures* separately from *exposures* for which it does not use such estimates.

[Note: BCD Annex XII Part 3 point 1 (part)]

- 11.6.4 R For the purposes of *BIPRU* 11.6.1R(9), where appropriate, a *firm* must further decompose the information to provide analysis of *PD* and, for a *firm* using own estimates of *LGDs* and/or *conversion factors*, *LGD* and *conversion factor* outcomes against estimates provided in the quantitative risk assessment disclosures under *BIPRU* 11.6.1R to *BIPRU* 11.6.4R.

[Note: BCD Annex XII Part 3 point 1 (part)]

Disclosures: Credit risk mitigation

- 11.6.5 R A *firm* applying *credit risk mitigation* techniques must disclose the following information:
- (1) the policies and processes for, and an indication of the extent to which the *firm* makes use of, on- and off-balance sheet netting;
 - (2) the policies and processes for collateral valuation and management;
 - (3) a description of the main types of collateral taken by the *firm*;
 - (4) the main types of guarantor and credit derivative counterparty and their creditworthiness;
 - (5) information about *market risk* or credit risk concentrations within the credit mitigation taken;
 - (6) for *firms* calculating *risk weighted exposure amounts* using the *standardised approach* to credit risk or the *IRB approach*, but not providing own estimates of *LGDs* or *conversion factors* in respect of the *exposure class*, separately for each *exposure class*, the total *exposure* value (after, where applicable, on- or off-balance sheet netting) that is covered – after the application of volatility adjustments – by eligible financial collateral, and other eligible

collateral; and

- (7) for *firms* calculating *risk weighted exposure amounts* using the *standardised approach* or the *IRB approach*, separately for each *exposure* class, the total *exposure* (after, where applicable, on- or off-balance sheet netting) that is covered by guarantees or credit derivatives; for *equity exposures*, this requirement applies to each of the approaches (the simple risk weight approach, the PD/LGD approach and the internal models approach) provided for in *BIPRU 4.7.5R* to *BIPRU 4.7.6R*, *BIPRU 4.7.9R* to *BIPRU 4.7.11R*, *BIPRU 4.7.14R* to *BIPRU 4.7.16R*, *BIPRU 4.7.24R* to *BIPRU 4.7.25R*.

[**Note:** *BCD Annex XII Part 3 point 2*]

Disclosure: Insurance for the purpose of mitigating operational risk

- 11.6.6 R A *firm* using the *advanced measurement approach* for the calculation of its *operational risk requirement* must disclose a description of the use of insurance for the purpose of mitigating the risk.

[**Note:** *BCD Annex XII Part 3 point 3*]

- 13 The calculation of counterparty risk exposure values for financial derivatives, securities financing transactions and long settlement transactions
- 13.1 Application and Purpose
- Application
- 13.1.1 R *BIPRU 13 applies to a BIPRU firm.*
- 13.1.2 R (1) *BIPRU 13 applies to items in the non-trading book.*
(2) *BIPRU 13 applies to trading book items for the purposes of BIPRU 14.*
- 13.1.3 G The requirement to calculate the *counterparty credit risk* capital charge for *trading book* items is set out in *BIPRU 14*.
- Purpose
- 13.1.4 G *BIPRU 13 implements:*
- (1) Article 78(2) and (4);
- (2) point 3 of Part 1, and Parts 2, 3, 5, 6 and 7 of Annex III; and
- (3) Annex IV;
- of the *Banking Consolidation Directive*.
- 13.1.5 G *BIPRU 13.3 sets out the calculations of exposure values for financial derivative instruments, long settlement transactions and certain other transactions under the standardised approach and, subject to BIPRU 4, under the IRB approach. BIPRU 13.4, 13.5 and 13.6 set out the provisions relating to the CCR mark to market method, the CCR standardised method and the CCR internal model method in turn.*
- 13.1.6 G *BIPRU 13.8 sets out a summary of the treatment of securities financing transactions.*

13.2 Unusual Transactions

- 13.2.1 R If the calculation of the amount of an *exposure* or of a combination of *exposures* under *BIPRU 13* would materially understate the amount of the *counterparty credit risk* the *firm* must increase the amount of the *credit risk capital requirement* by an amount sufficient to compensate for that understatement.
- 13.2.2 R If a *firm* in relation to an *exposure* covered by *BIPRU 13*:
- (1) has an *exposure* of a non-standard type; or
 - (2) an *exposure* that is part of a non-standard arrangement; or
 - (3) has an *exposure* that, taken together with other *exposures* (whether or not they are subject to *BIPRU 13*), gives rise to a non-standard *counterparty credit risk*; or
 - (4) is subject to the *rule* in *BIPRU 13.2.1R*;
- it must notify the *FSA* as soon as practicable of that fact, the counterparty involved, the nature of the *exposure* or arrangement and the treatment of those *exposures* it has adopted for the purpose of the calculation of the *credit risk capital requirement*.
- 13.2.3 R *BIPRU 13.2.2R* does not apply to *exposures* which are within the scope of a *firm's CCR internal model method permission*.
- 13.2.4 R A *firm* must judge the question of what is non-standard for the purposes of *BIPRU 13.2.2R* by reference to the standards:
- (1) prevailing at the time the *rule* is being applied; and
 - (2) of *firms* generally who carry on business which might give rise to *exposures* covered by *BIPRU 13* rather than merely by reference to the *firm's* own business.
- 13.2.5 G The methodologies which have been developed assume instruments with standard characteristics. There are many examples, however, of instruments which, although based on a standard contract, contain structural features which make the *rules*, as stated, inappropriate. In such circumstances a *firm* should consult the *FSA*.

- 13.3 Calculation of exposure values for financial derivatives and long settlement transactions: General provisions
- Financial derivative instruments
- 13.3.1 R *A firm must determine the exposure value of a financial derivative instrument in accordance with BIPRU 13, with the effects of contracts of novation and other netting agreements taken into account for the purposes of those methods in accordance with BIPRU 13.*
- [Note: BCD Article 78(2) first sentence]
- 13.3.2 R Subject to BIPRU 13.3, a firm must determine the exposure value for financial derivative instruments with the CCR mark to market method, the CCR standardised method or the CCR internal model method.
- [Note: BCD Annex III, Part 2 point 1]
- Definition of financial derivative instrument
- 13.3.3 R Each of the following is a financial derivative instrument:
- (1) an interest-rate contract, being:
 - (a) a single-currency interest rate swap;
 - (b) a basis-swap;
 - (c) a forward rate agreement;
 - (d) an interest-rate future;
 - (e) a purchased interest-rate option; and
 - (f) other contracts of similar nature;
 - (2) a foreign currency contract or contract concerning gold, being:
 - (a) a cross-currency interest-rate swap;
 - (b) a forward foreign currency contract;
 - (c) a currency future;
 - (d) a currency option purchased;
 - (e) other contracts of a similar nature; and
 - (f) a contract concerning gold of a nature similar to (2)(a) to (e).
 - (3) a contract of a nature similar to those in 1(a) to (e) and 2(a) to (d) concerning other reference items or indices, including as a minimum

all instruments specified in points 4 to 7, 9 and 10 of Section C of Annex I to the *MIFID* not otherwise included in (1) or (2).

[**Note:** *BCD* Annex IV]

Long settlement transactions

- 13.3.4 R *Long settlement transaction* means a transaction where a counterparty undertakes to deliver a *security*, a *commodity*, or a *foreign currency* amount against cash, other *financial instruments*, or *commodities*, or vice versa, at a settlement or delivery date that is contractually specified as more than the lower of the market standard for this particular transaction and five business days after the date on which the *firm* enters into the transaction.

[**Note:** *BCD* Annex III Part 1 point 3]

- 13.3.5 R A *firm* must calculate the *exposure* value of a *long settlement transaction* in accordance with either:
- (1) *BIPRU* 13; or
 - (2) the *master netting agreement internal models approach*, if it has a *master netting agreement internal models approach waiver* which permits it to apply that approach.

[**Note:** *BCD* Article 78(2) second sentence, in respect of *long settlement transactions*]

- 13.3.6 R A *firm* may determine *exposures* arising from *long settlement transactions* using any of the *CCR mark to market method*, the *CCR standardised method* and the *CCR internal model method*, regardless of the methods chosen for treating *financial derivatives instruments* and *repurchase transactions*, *securities* or *commodities lending or borrowing transactions*, and *margin lending transactions*. In calculating capital requirements for *long settlement transactions*, a *firm* that uses the *IRB approach* may apply the *risk weights* under the *standardised approach* on a permanent basis and irrespective of the materiality of such positions.

[**Note:** *BCD* Annex III Part 2 point 7]

- 13.3.7 G A *firm* is not required to calculate the *exposure* value of a transaction as a *long settlement transaction* for the purposes of *BIPRU* 13 if the transaction is a *financial derivative instrument* or a *securities financing transaction* and the *firm* chooses to calculate the capital requirement for the transaction according to the methods applicable to those *exposures*.

General netting

- 13.3.8 R Under the *CCR mark to market method*, the *CCR standardised method* and the *CCR internal model method*, a *firm* must determine the *exposure* value for a given counterparty as equal to the sum of the *exposure* values calculated for each *netting set* with that counterparty.

[**Note:** BCD Annex III Part 2 point 5]

- 13.3.9 R A *firm* may only recognise netting for the purposes of BIPRU 13.4, BIPRU 13.5 and BIPRU 13.6 if the requirements in BIPRU 13.7 are met.

Combined use

- 13.3.10 R The combined use of the *CCR mark to market method*, the *CCR standardised method* and the *CCR internal model method* is not permitted. The combined use of the *CCR mark to market method* and the *CCR standardised method* is permitted where one of the methods is used for the cases set out in BIPRU 13.5.9 to BIPRU 13.5.10R.

[**Note:** BCD Annex III Part 2 point 1(part)]

- 13.3.11 G The combined use of different approaches may be used across a group as described in BIPRU 8.7.8R and BIPRU 8.7.9R.

Exposure to a central counterparty

- 13.3.12 R Notwithstanding BIPRU 13.3.1R and BIPRU 13.3.5R, a *firm* may determine the *exposure* value of a credit risk *exposure* outstanding with a *central counterparty* in accordance with BIPRU 13.3.13R, provided that the *central counterparty's counterparty credit risk exposures* with all participants in its arrangements are fully collateralised on a daily basis.

[**Note:** BCD Article 78(4) in respect of *financial derivatives* and *long settlement transactions*]

- 13.3.13 R A *firm* may attribute an *exposure* value of zero for CCR to derivative contracts and *long settlement transactions*, or to other *exposures* arising in respect of those contracts or transactions (but excluding an *exposure* arising from collateral held to mitigate losses in the event of the default of other participants in the *central counterparty's* arrangements) where they are outstanding with a *central counterparty* and have not been rejected by the *central counterparty*.

[**Note:** BCD Annex III Part 2 point 6 in respect of *financial derivatives* and *long settlement transactions*]

Exceptions

- 13.3.14 R When a *firm* purchases credit derivative protection against a *non-trading book exposure*, or against a *CCR exposure*, it must compute its capital requirement for the hedged asset in accordance with:

- (1) BIPRU 5.7.16R to BIPRU 5.7.25R and BIPRU 4.10.49(4) to (6) (Unfunded credit protection: Valuation and calculation of risk-weighted exposure amounts and expected loss amounts);
- (2) BIPRU 4.4.79R (Double default); or

- (3) *BIPRU 4.10.40R to BIPRU 4.10.48R* (Unfunded credit protection: Minimum requirements for assessing the effect of guarantees and credit derivatives).

[**Note:** *BCD Annex III Part 2 point 3 (part)*]

- 13.3.15 R In the cases in *BIPRU 13.3.14R*, a *firm* must set the *exposure* value for *CCR* for these credit derivatives to zero.

[**Note:** *BCD Annex III Part 2 point 3 (part)*]

- 13.3.16 R A *firm* must set the *exposure* value for *CCR* from sold credit default swaps in the *non-trading book*, where they are treated as credit protection provided by the *firm* and subject to a capital requirement for credit risk for the full notional amount, to zero.

[**Note:** *BCD Annex III Part 2 point 4*]

13.4 CCR mark to market method

General

13.4.1 R The *rules* in *BIPRU* 13.4 set out the *CCR mark to market method*.

13.4.2 R A *firm* must obtain the current replacement cost of all contracts with positive values by attaching *current market values* to contracts (marking to market).

[**Note:** *BCD* Annex III Part 3, Step (a)]

13.4.3 R A *firm* must obtain a figure for potential future credit *exposure* by multiplying the notional principal amounts or underlying values by the percentages in the table in *BIPRU* 13.4.5R.

[**Note:** *BCD* Annex III Part 3, Step (b) (part)]

13.4.4 R *BIPRU* 13.4.3R does not apply in the case of single-currency "floating/floating" interest rate swaps.

[**Note:** *BCD* Annex III Part 3, Step (b) (part)]

Table: multiples to be applied to notional principal amounts or underlying values

13.4.5 R This table belongs to *BIPRU* 13.4.5R

Residual maturity	Interest-rate contracts	Contracts concerning <i>foreign currency</i> rates and gold	Contracts concerning equities	Contracts concerning precious metals except gold	Contracts concerning <i>commodities</i> other than precious metals
One year or less	0%	1%	6%	7%	10%
Over one year, not exceeding five years	0,5%	5%	8%	7%	12%
Over five years	1.5%	7.5%	10%	8%	15%

[**Note:** *BCD* Annex III Part 3, Table 1]

13.4.6 R A *firm* must treat a contract which does not fall within one of the five categories indicated in the table in *BIPRU* 13.4.5R as a contract concerning

commodities other than precious metals.

[**Note:** *BCD* Annex III Part 3, Table 1 footnote 25]

- 13.4.7 R For contracts with multiple exchanges of principal, a *firm* must multiply the percentages in the table in *BIPRU* 13.4.5R by the number of remaining payments still to be made according to the contract.

[**Note:** *BCD* Annex III Part 3, Table 1 footnote 26]

- 13.4.8 R For contracts that are structured to settle outstanding *exposure* following specified payment dates and where the terms are reset such that the market value of the contract is zero on these specified dates, a *firm* must treat the residual maturity as equal to the time until the next reset date.

[**Note:** *BCD* Annex III Part 3, Table 1 footnote 27 (part)]

- 13.4.9 R In the case of interest-rate contracts that meet the criteria in *BIPRU* 13.4.8R and have a remaining maturity of over one year, a *firm* must apply a percentage no lower than 0.5%.

[**Note:** *BCD* Annex III Part 3, Table 1 footnote 27 (part)]

- 13.4.10 R For the purpose of calculating the potential future credit *exposure* in accordance with *BIPRU* 13.4.3R a *firm* may apply the percentages in the table in *BIPRU* 13.4.11R instead of those prescribed in the table in *BIPRU* 13.4.5R provided that it makes use of the *commodity extended maturity ladder approach* for contracts relating to commodities other than gold.

Table: alternative multiples to be applied to notional principal amounts or underlying values

- 13.4.11 R This table belongs to *BIPRU* 13.4.10R

Residual maturity	Precious metals (except gold)	Base metals	Agricultural products (softs)	Other, including energy products
One year or less	2%	2,5%	3%	4%
Over one year, not exceeding five years	5%	4%	5%	6%
Over five years	7.5%	8%	9%	10%

[Note: BCD Annex III Part 3, Table 2]

- 13.4.12 R A *firm* must calculate the *exposure* value as the sum of:
- (1) the current replacement cost calculated under BIPRU 13.4.2R; and
 - (2) the potential future credit *exposure* calculated under BIPRU 13.4.3R.

[Note: BCD Annex III Part 3, Step (c)]

- 13.4.13 G Contracts with a negative replacement cost should still be subject to an add-on if there is a possibility of the replacement costs becoming positive before maturity. Written options should therefore be exempt from add-ons.
- 13.4.14 G For the purposes of calculating the replacement cost, where an *exposure* relates to collateral posted to cover a negative mark to market position on a derivative contract, the negative mark to market *exposure* may be offset against the collateral *exposure* if the requirements in BIPRU 5 are met.

Alternative approach

- 13.4.15 R A *firm* must ensure that the notional amount to be taken into account is an appropriate yardstick for the risk inherent in the contract. Where, for instance, the contract provides for a multiplication of cash flows, a *firm* must adjust the notional amount in order to take into account the effects of the multiplication on the risk structure of that contract.

[Note: BCD Annex III Part 2 point 8]

Netting: Contracts for novation

- 13.4.16 R The single net amounts fixed by contracts for novation, rather than the gross amounts involved, may be weighted. For the purposes of the *CCR mark to market method*, a *firm* may obtain:
- (1) in BIPRU 13.4.2R, the current replacement cost; and
 - (2) in BIPRU 13.4.3R, the notional principal amounts or underlying values;

by taking account of the contract for novation.

[Note: BCD Annex III Part 7 point c(i)]

Netting: Other netting agreements

- 13.4.17 R In application of the *CCR mark to market method*:
- (1) in BIPRU 13.4.2R a *firm* may obtain the current replacement cost for the contracts included in a netting agreement by taking account of the actual hypothetical net replacement cost which results from the agreement; in the case where netting leads to a net obligation for the *firm* calculating the net replacement cost, the current replacement

cost is calculated as "0"; and

- (2) in *BIPRU* 13.4.3R a *firm* may reduce the figure for potential future credit *exposure* for all contracts included in a netting agreement according to the following formula:

$$PCE_{\text{red}} = 0.4 * PCE_{\text{gross}} + 0.6 * NGR * PCE_{\text{gross}},$$

where:

- (a) PCE_{red} = the reduced figure for potential future credit *exposure* for all contracts with a given counterparty included in a legally valid bilateral netting agreement;
- (b) PCE_{gross} = the sum of the figures for potential future credit *exposure* for all contracts with a given counterparty which are included in a legally valid bilateral netting agreement and are calculated by multiplying their notional principal amounts by the percentages set out in the table in *BIPRU* 13.4.5R; and
- (c) NGR = "net-to-gross ratio": the quotient of the net replacement cost for all contracts included in a legally valid bilateral netting agreement with a given counterparty (numerator) and the gross replacement cost for all contracts included in a legally valid bilateral netting agreement with that counterparty (denominator).

[**Note:** *BCD* Annex III Part 7 point c(ii) (part)]

- 13.4.18 R For the calculation of the potential future credit exposure according to the formula in *BIPRU* 13.4.17R perfectly matching contracts included in the netting agreement may be taken into account as a single contract with a notional principal equivalent to the net receipts.

[**Note:** *BCD* Annex III Part 7 point c(ii) (part)]

- 13.4.19 R For the purposes of *BIPRU* 13.4.18R a perfectly matching contract is a forward *foreign currency* contract or similar contract in which a notional principal is equivalent to cash flows if the cash flows fall due on the same value date and fully or partly in the same currency.

[**Note:** *BCD* Annex III Part 7 point c(ii) (part)]

13.5 CCR standardised method

Scope

13.5.1 R A *firm* may use the *CCR standardised method* only for *financial derivative instruments* and *long settlement transactions*.

[**Note:** *BCD Annex III Part 5 point 1 (part)*]

Derivation of risk position: payment legs

- 13.5.2 R
- (1) When a *financial derivative instrument* transaction with a linear risk profile stipulates the exchange of a *financial instrument* for a payment, the payment Part is referred to as the *payment leg*.
 - (2) Transactions that stipulate the exchange of payment against payment consist of two *payment legs*.
 - (3) The *payment legs* consist of the contractually agreed gross payments, including the notional amount of the transaction.
 - (4) A *firm* may disregard the *interest rate risk* from *payment legs* with a remaining maturity of less than one year for the purposes of the calculations in *BIPRU 13.5*.
 - (5) A *firm* may treat transactions that consist of two *payment legs* that are denominated in the same currency, such as interest rate swaps, as a single aggregate transaction. The treatment for *payment legs* applies to the aggregate transaction.

[**Note:** *BCD Annex III Part 5 point 2*]

Derivation of risk position: mapping

- 13.5.3 R
- (1) Transactions with a linear risk profile with equities (including equity indices), gold, other precious metals or other *commodities* as the underlying financial instruments must be mapped to a *risk position* in the respective equity (or equity index) or *commodity* (including gold and other precious metals) and an interest rate *risk position* for the *payment leg*.
 - (2) If the *payment leg* is denominated in a *foreign currency*, it must be additionally mapped to a *risk position* in the respective currency.

[**Note:** *BCD Annex III Part 5 point 3*]

- 13.5.4 R
- (1) Transactions with a linear risk profile with a debt instrument as the underlying instrument must be mapped to an interest rate *risk position* for the debt instrument and another interest rate *risk position* for the *payment leg*.

- (2) Transactions with a linear risk profile that stipulate the exchange of payment against payment, including *foreign exchange* forwards, must be mapped to an interest rate *risk position* for each of the *payment legs*.
- (3) If the underlying debt instrument is denominated in a *foreign currency*, the debt instrument must be mapped to a *risk position* in that *foreign currency*.
- (4) If a *payment leg* is denominated in *foreign currency*, the *payment leg* must be again mapped to a *risk position* in that *foreign currency*.
- (5) The *exposure* value to be assigned to a *foreign exchange* basis swap transaction is zero.

[Note: BCD Annex III Part 5 point 4]

Derivation of risk position: calculating the size of the risk position

- 13.5.5 R A *firm* must calculate the *risk position* of the transaction or instrument in column 1 of the table in BIPRU 13.5.6R in accordance with column 2 of that table.
- 13.5.6 R This table belongs to BIPRU 13.5.5R.

Transaction or instrument	Calculation of size of <i>risk position</i>
Transaction with linear risk profile except for debt instruments.	The effective notional value (market price multiplied by quantity) of the underlying <i>financial instruments</i> (including <i>commodities</i>) converted to the <i>firm's</i> domestic currency.
Debt instruments and <i>payment legs</i> .	The effective notional value of the outstanding gross payments (including the notional amount) converted to the <i>firm's base currency</i> , multiplied by the modified duration of the debt instrument, or <i>payment leg</i> , respectively.
Credit default swap	The notional value of the reference debt instrument multiplied by the remaining maturity of the credit default swap.
Subject to BIPRU 13.5.9R to BIPRU 13.5.10R, <i>financial derivative instrument</i> with a non-linear risk	Equal to the delta equivalent effective notional value of the <i>financial instrument</i> that underlies

profile, including <i>options</i> and <i>swaptions</i> except in the case of an underlying debt instrument.	the transaction.
Subject to <i>BIPRU</i> 13.5.9R to <i>BIPRU</i> 13.5.10R, <i>financial derivative instrument</i> with a non-linear risk profile, including <i>options</i> and <i>swaptions</i> , of which the underlying is a debt instrument or a <i>payment leg</i> .	Equal to the delta equivalent effective notional value of the <i>financial instrument</i> or <i>payment leg</i> multiplied by the modified duration of the debt instrument, or <i>payment leg</i> , respectively.

[Note: *BCD* Annex III Part 5 points 5 to 9]

Derivation of risk position: effective notional value

13.5.7 R A firm may use the following formulae to determine the size and sign of a risk position:

(1) for all instruments other than debt instruments:

effective notional value, or delta equivalent

$$\text{notional value} = p_{\text{ref}}((\delta V)/(\delta p))$$

where:

- (a) P_{ref} = price of the underlying instrument, expressed in the reference currency;
- (b) V = value of the financial instrument (in the case of an option this is the option price; in the case of a transaction with a linear risk profile this is the value of the underlying instrument itself);
- (c) p = price of the underlying instrument, expressed in the same currency as V ;

(2) for debt instruments and the *payment legs* of all transactions:

effective notional value multiplied by the modified duration, or delta equivalent in notional value multiplied by the modified duration

$$(\delta V)/(\delta r)$$

where:

- (a) V = value of the financial instrument (in the case of an option this is the option price; in the case of a transaction with a linear risk profile this is the value of the underlying instrument itself or of the *payment leg*, respectively);

(b) r = interest rate level.

- (3) If V is denominated in a currency other than the reference currency, the derivative must be converted into the reference currency by multiplication with the relevant exchange rate.

[**Note:** *BCD Annex III Part 5 point 11*]

Derivation of risk position: treatment of collateral

- 13.5.8 R For the determination of *risk positions*, a *firm* must treat collateral received from a counterparty like a claim on the counterparty under a derivative contract (long position) that is due today, while collateral posted must be treated as an obligation to the counterparty (short position) that is due today.

[**Note:** *BCD Annex III Part 5 point 10*]

Derivation of risk position: non-linear risks

- 13.5.9 R A *firm* must apply the *CCR mark to market method* to transactions with a non-linear risk profile or for *payment legs* and transactions with debt instruments as underlying if:
- (1) the *firm* does not have a *CAD 1 model permission* or a *VaR model permission*; or
 - (2) where the *firm* does have a *CAD 1 model permission* or a *VaR model permission* but cannot determine the delta or the modified duration, respectively, with its *CAD 1 model permission* or *VaR model permission*.

[**Note:** *BCD Annex III Part 5 point 19 (part)*]

- 13.5.10 R A *firm* must not recognise netting for the purpose of applying the *CCR mark to market method* to an *exposure* treated under *BIPRU 13.5.9R* (that is, the *exposure* value must be determined as if there were a *netting set* that comprises just the individual transaction).

[**Note:** *BCD Annex III Part 5 point 19 (part)*]

Hedging sets: assignment

- 13.5.11 R A *firm* must group the *risk positions* into *hedging sets* and, for each *hedging set*, compute the absolute value amount of the sum of the resulting *risk positions*. This sum is termed the “net *risk position*” and is represented by:

$$((\Sigma_i)(RPT_{ij}) - (\Sigma_i)(RPC_{lj}))$$

in the formulae set out in *BIPRU 13.5.24R*.

[Note: BCD Annex III Part 5 point 12]

Hedging sets: description

- 13.5.12 R For interest rate *risk positions* from money deposits received from the counterparty as collateral, from *payment legs* and from underlying debt instruments, to which according to the table in *BIPRU 7.2.XR* a capital charge of 1.60% or less applies, there are six *hedging sets* for each currency, as set out in the table in *BIPRU 13.5.13R*. *Hedging sets* are defined by a combination of the criteria “maturity” and “referenced interest rates”.

[Note: BCD Annex III Part 5 point 13]

Table: Hedging sets

- 13.5.13 R This table belongs to BIPU 13.5.12R:

	Government referenced interest rates	Non-government referenced interest rates
Maturity	≤ 1 year	≤ 1 year
Maturity	$>1 - \leq 5$ years	$>1 - \leq 5$ years
Maturity	> 5 years	> 5 years

[Note: BCD Annex III Part 5 Table 4]

- 13.5.14 R For interest rate *risk positions* from underlying debt instruments or *payment legs* for which the interest rate is linked to a reference interest rate that represents a general market interest level, the remaining maturity is the length of the time interval up to the next re-adjustment of the interest rate. In all other cases, it is the remaining life of the underlying debt instrument, or in the case of a *payment leg* the remaining life of the transaction.

[Note: BCD Annex III Part 5 point 14]

- 13.5.15 R There is one *hedging set* for each issuer of a reference debt instrument that underlies a credit default swap.

[Note: BCD Annex III Part 5 point 15]

- 13.5.16 R Underlying financial instruments other than debt instruments must be assigned by a *firm* to the same respective *hedging sets* only if they are identical or similar instruments. In all other cases a *firm* must assign them to separate *hedging sets*.

[**Note:** *BCD* Annex III Part 5 point 17 (part)]

- 13.5.17 R (1) The similarity of instruments for the purposes of *BIPRU* 13.5.16R is established in accordance with (2) to (5).
- (2) For equities, similar instruments are those of the same issuer. An equity index is treated as a separate issuer.
- (3) For precious metals, similar instruments are those of the same metal. A precious metal index is treated as a separate precious metal.
- (4) For electric power, similar instruments are those delivery rights and obligations that refer to the same peak or off-peak load time interval within any 24 hour interval.
- (5) For *commodities*, similar instruments are those of the same *commodity*. A *commodity* index is treated as a separate *commodity*.

[**Note:** *BCD* Annex III Part 5 point 17 (part)]

Hedging sets: collateral

- 13.5.18 R (1) For interest rate *risk positions* from money deposits that are posted with a counterparty as collateral when that counterparty does not have debt obligations of low *specific risk* outstanding and from underlying debt instruments, to which according to the table in *BIPRU* 7.2.XR a capital charge of more than 1.60% applies, there is one *hedging set* for each issuer.
- (2) When a *payment leg* emulates such a debt instrument, there is also one *hedging set* for each issuer of the reference debt instrument.
- (3) A *firm* may assign *risk positions* that arise from debt instruments of a certain issuer, or from reference debt instruments of the same issuer that are emulated by *payment legs*, or that underlie a credit default swap, to the same *hedging set*.

[**Note:** *BCD* Annex III Part 5 point 16]

- 13.5.19 R A *firm* that makes use of collateral to mitigate its *CCR* must have internal procedures to verify that, prior to recognising the effect of collateral in its calculations, the collateral meets the legal certainty standards set out in *BIPRU* 5 modified, where relevant, by *BIPRU* 4.10.

[**Note:** *BCD* Annex III Part 5 point 21]

Hedging sets: netting

- 13.5.20 R A *firm* must have internal procedures to verify that, prior to including a transaction in a *hedging set*, the transaction is covered by a legally enforceable netting contract that meets the requirements set out in *BIPRU* 13.7.

[Note: BCD Annex III Part 5 point 20]

Credit conversion factors : Table

- 13.5.21 R A firm must apply the CCR multipliers for the different *hedging set* categories according to the Table in BIPRU 13.5.22R.

[Note: BCD Annex III Part 5 point 18]

- 13.5.22 R This table belongs to BIPRU 13.5.21R.

<i>Hedging set</i> categories	CCR Multiplier (CCRM)
(1) Interest Rates	0.2%
(2) Interest Rates for <i>risk positions</i> from a reference debt instrument that underlies a credit default swap and to which a capital charge of 1.60%, or less, applies under BIPRU 7.2.XR.	0.3%
(3) Interest Rates for <i>risk positions</i> from a debt instrument or reference debt instrument to which a capital charge of more than 1.60% applies under BIPRU 7.2.XR.	0.6%
(4) Exchange Rates	2.5%
(5) Electric power	4.0%
(6) Gold	5.0%
(7) Equity	7.0%
(8) Precious Metals (except gold)	8.5%
(9) Other <i>commodities</i> (excluding precious metals and electricity power)	10.0%
(10) Underlying instruments of <i>financial derivative instruments</i> that are not in any of the above categories.	10.0%

[Note: BCD Annex III Part 5 Table 5]

- 13.5.23 R A firm must assign underlying instruments of *financial derivatives instruments* (in line 10 of the Table in BIPRU 13.5.22R) to separate

individual *hedging sets* for each category of underlying instrument.

Exposure value

- 13.5.24 R A *firm* must calculate the *exposure* value separately for each *netting set*.

[**Note:** BCD Annex III Part 5 point 1, second sentence]

- 13.5.25 R A *firm* must determine the *exposure* value net of collateral, as follows:

$$\text{exposure value} = \beta^* \max(CMV - CMC; (\sum_i)((\sum_i)(RPT_{ij}) - (\sum_l)(RPC_{lj})) * CCRM_j)$$

where:

CMV = *current market value* of the portfolio of transactions within the *netting set* with a counterparty gross of collateral.

That is, where:

$$CMV = (\sum_i)(CMV_i)$$

where:

CMV_i = the *current market value* of transaction i;

CMC = the *current market value* of the collateral assigned to the *netting set*.

That is, where:

$$CMC = (\sum_l)(CMC_l)$$

where

CMC_l = the *current market value* of collateral l;

i = index designating transaction;

l = index designating collateral;

j = index designating *hedging set* category. These *hedging sets* correspond to risk factors for which *risk positions* of opposite sign can be offset to yield a net *risk position* on which the *exposure* measure is then based;

RPT_{ij} = *risk position* from transaction i with respect to *hedging set* j;

RPC_{lj} = *risk position* from collateral l with respect to *hedging set* j;

CCRM_j = CCR Multiplier set out in the Table in BIPRU 13.5.22R with respect to the *hedging set* j;

β = 1.4.

[**Note:** BCD Annex III Part 5 point 1 (part)]

- 13.5.26 R Collateral received from a counterparty has a positive sign; collateral posted to a counterparty has a negative sign.

[**Note:** BCD Annex III Part 5 point 1 (part)]

13.5.27 R A *firm* may only recognise collateral for this method if it is collateral that is eligible under *BIPRU* 5.X.XR [Annex VIII, Part 1, point 11] and *BIPRU* 14.2.12R to *BIPRU* 14.2.13R.

[**Note:** *BCD* Annex III Part 5 point 1 (part)]

13.5.28 G A worked example showing a US Dollar (USD)-based *firm*, single counterparty, single netting set, Risk-positions RP_{ij} by hedging sets j is set out in *BIPRU* 13 Ann 1G

13.6 CCR internal model method

Introduction

- 13.6.1 R *BIPRU 13.6 sets out the rules relating to the CCR internal model method.*
- 13.6.2 R *A firm may only use the CCR internal model method if it has a CCR internal model method permission.*
- 13.6.3 G *BIPRU 1.3 sets out the process for applying for a CCR internal model method permission.*
- 13.6.4 G *A firm's CCR internal model method permission will modify BIPRU 13.6.2R and will require the firm to use only the CCR internal model method, except to the extent that BIPRU 13 permits the firm to combine the use of the CCR internal model method with one or more other methods.*
- 13.6.5 R (1) *A reference in the Handbook to a provision of the CCR internal model method, in relation to a firm:*
- (a) *excludes any provision of the CCR internal model method set out in the Handbook which is not applied to that firm by its CCR internal model method permission;*
 - (b) *includes any additional provision contained in the CCR internal model method permission; and*
 - (c) *takes into account any other amendments made to the provisions in the Handbook relating to the CCR internal model method made by the CCR internal model method permission.*
- (2) *To the extent that a firm's CCR internal model method permission does not allow it to use a particular approach in the Handbook relating to the CCR internal model method, the Handbook provision does not apply to the firm.*

Scope

- 13.6.6 R *A firm may determine the exposure value for:*
- (1) *financial derivative instruments;*
 - (2) *repurchase transactions;*
 - (3) *securities or commodities lending or borrowing transactions;*
 - (4) *margin lending transactions; and*
 - (5) *long settlement transactions*
- using the CCR internal model method.*

[Note: BCD Annex III Part 2 point 2]

13.6.7 R A firm may use the *CCR internal model method* to calculate the *exposure* value for:

- (1) the transactions in *BIPRU* 13.6.6R(1); or
- (2) the transactions in *BIPRU* 13.6.6R(2), (3) and (4); or
- (3) the transactions in *BIPRU* 13.6.6R(1) to (4).

[Note: BCD Annex III Part 6 point 1 (part)]

13.6.8 R In each of *BIPRU* 13.6.7R(1), (2) and (3), a firm may include *long settlement transactions* as well.

[Note: BCD Annex III Part 6 point 1 (part)]

Use of other models

13.6.9 G Point 2 of Part 6 of Annex III of the *Banking Consolidation Directive* provides that a firm using the *CCR internal model method* may use a type of model other than the type set out in *BIPRU* 13.6. If the *FSA* agrees to this the details of the model and the necessary calculations will be set out in the *CCR internal model method permission*, which will modify *BIPRU* 13.6 to the extent necessary. The *FSA* would not expect to agree to such a request unless the firm was able to satisfy the *FSA* that the method was at least as conservative as the method set out in *BIPRU* 13.6 and in particular that, for every *counterparty*, any method was more conservative than alpha multiplied by *effective EPE* calculated according to the equation in *BIPRU* 13.6.27R.

[Note: BCD Annex III Part 6 point 2 (second sentence) and point 11]

Partial use

13.6.10 R For all *financial derivative instruments* and for *long settlement transactions* which are outside the scope of a firm's *CCR internal model method permission*, a firm must use the *CCR mark to market method* or the *CCR standardised method*.

[Note: BCD Annex III Part 6 point 3 first sentence]

13.6.11 R Under *BIPRU* 13.6.10R, combined use of the *CCR mark to market method* and the *CCR standardised method* is only permitted where one of the methods is used for the cases set out in *BIPRU* 13.5.9R to *BIPRU* 13.5.10R.

[Note: BCD Annex III Part 6 point 3 second sentence]

13.6.12 R Notwithstanding *BIPRU* 13.3.9R (Combined use), a firm may choose not to apply the *CCR internal model method* to *exposures* that are immaterial in

size and risk.

[Note: BCD Annex III Part 6 point 1 third sentence]

- 13.6.13 R If permitted by its *CCR internal model method permission*, and subject to its terms, a *firm* may carry out the implementation of the *CCR internal model method* sequentially across different transaction types; and during this period the *firm* may use the *CCR mark to market method* or the *CCR standardised method*.

[Note: BCD Annex III Part 6 point 2]

- 13.6.14 G After the initial period following the granting of its *CCR internal model method permission*, as referred to in BIPRU 13.6.13R, a *firm* should extend the use of the *CCR internal model method* to cover any new business within a product category covered by its *CCR internal model method permission*. Subject to BIPRU 13.6.10R to BIPRU 13.6.13R, the *firm* should do so within a reasonable period of time. If the *firm* decides to exclude any business on, for example, the basis of materiality, it should document its reasons clearly.
- 13.6.15 G In principle, the use of different measures of *exposure* within the *CCR internal model method* is possible within the same product category, including on a permanent basis. The *FSA* may allow a *firm*, through the *CCR internal model method permission*, to use a more conservative measure of *exposure* that is less risk sensitive (for instance a measure based on conservative haircuts) for certain parts of the business if justified on a cost-benefit basis. However, a *firm* would still need to meet the use test for these more conservative measures and would need to demonstrate that the aggregation of *CCR exposures* that come from different approaches and have different degrees of conservatism makes sense and is used for its *CCR* management purposes.
- 13.6.16 G The *FSA* may, through the *CCR internal model method permission*, require a *firm* to apply a multiplier to the measures of *exposures* coming out of a less risk-sensitive approach to calculating *exposures* as referred to in BIPRU 13.6.15G where the *FSA* considers this to be appropriate due to the complexity of the business or the nature of the risks involved.

Use of CCR internal model method

- 13.6.17 R Subject to BIPRU 13.6.10R to BIPRU 13.6.16G, a *firm* that has a *CCR internal model method permission* must not use the *CCR mark to market method* or the *CCR standardised method* for transactions within the scope of the *firm's CCR internal model method permission*.

[Note: BCD Annex III Part 6 point 4 (part)]

- 13.6.18 G A *firm* which wishes to revert to the *CCR mark to market method* or the *CCR standardised method* will need to request the *FSA* to revoke or vary its *CCR internal model method permission*.

[Note: BCD Annex III Part 6 point 4 (part)]

- 13.6.19 G The *FSA* will not agree to a *firm's* request to revoke or vary its *CCR internal model method permission* except for demonstrated good cause.

[Note: BCD Annex III Part 6 point 4 (part)]

- 13.6.20 R If a *firm* ceases to comply with the requirements set out in *BIPRU* 13.6, it must either present to the *FSA* a plan for a timely return to compliance or demonstrate that the effect of non-compliance is immaterial.

[Note: BCD Annex III Part 6 point 4 (part)]

- 13.6.21 G If a *firm* ceases to comply with the requirements set out in *BIPRU* 13.6, the *FSA* may revoke the *CCR internal model method permission* or take other appropriate supervisory action.

[Note: BCD Annex III Part 6 point 4 (part)]

Exposure value

- 13.6.22 R (1) A *firm* must measure the *exposure* value at the level of the *netting set*.
- (2) The model must specify the forecasting distribution for changes in the market value of the *netting set* attributable to changes in market variables, such as interest rates, *foreign exchange* rates.
- (3) The model must then compute the *exposure* value for the *netting set* at each future date given the changes in the market variables.
- (4) For margined counterparties, the model may also capture future collateral movements.

[Note: BCD Annex III Part 6 point 5]

- 13.6.23 R A *firm* may include eligible financial collateral as defined in *BIPRU* 5.4.8R (Eligible collateral under financial collateral comprehensive method) and *BIPRU* 14.2.15R to *BIPRU* 14.2.17R in its forecasting distributions for changes in the market value of the *netting set*, if the quantitative, qualitative and data requirements for the *CCR internal model method* are met for the collateral.

[Note: BCD Annex III Part 6 point 6]

- 13.6.24 R A *firm* must calculate the *exposure* value as the product of alpha (α), as set out in *BIPRU* 13.6.31R, times *effective EPE*:

Exposure value = $\alpha \times$ *effective EPE*

[Note: BCD Annex III Part 6 point 7 first part]

Effective EPE

- 13.6.25 R A firm must compute *effective EPE* by estimating *expected exposure (EEt)* as the average *exposure* at future date *t*, where the average is taken across possible future values of relevant *market risk* factors. The model estimates *EE* at a series of future dates *t1, t2, t3, etc.*

[Note: BCD Annex III Part 6 point 7 third part]

- 13.6.26 R A firm must compute *effective EE* recursively as:

$$\text{Effective } EE_{tk} = \max(\text{effective } EE_{tk-1}; EE_{tk})$$

where:

the current date is denoted as *t0* and *Effective EEt0* equals *current exposure*.

[Note: BCD Annex III Part 6 point 8]

- 13.6.27 R For the purposes of BIPRU 13.6.26R [above rule]:

- (1) *effective EPE* is the average *effective EE* during the first year of future *exposure*;
- (2) if all contracts in the *netting set* mature within less than one year, *EPE* is the average of *EE* until all contracts in the *netting set* mature.

[Note: BCD Annex III Part 6 point 9, first part]

- 13.6.28 R A firm must compute *effective EPE* as a weighted average of *effective EE*:

$$\text{Effective } EPE = (\sum_{k=1}^{\min(1 \text{ year}; \text{maturity})}) ((\text{Effective } EE_{tk})^* (\Delta t_k))$$

where:

the weights $\Delta t_k = t_k - t_{k-1}$ allow for the case when future *exposure* is calculated at dates that are not equally spaced over time.

[Note: BCD Annex III Part 6 point 9, second part]

- 13.6.29 R A firm must calculate *EE* or *peak exposure* measures based on a distribution of *exposures* that accounts for the possible non-normality of the distribution of *exposures*.

[Note: BCD Annex III Part 6 point 10]

- 13.6.30 R Where appropriate, volatilities and correlations of *market risk* factors used in the joint simulation of *market risk* and credit risk must be conditioned on the credit risk factor to reflect potential increases in volatility or correlation in an economic downturn.

[Note: BCD Annex III Part 6 point 14]

Alpha

- 13.6.31 R For the purposes of *BIPRU* 13.6.24R, alpha (α) is 1.4 or any higher amount specified in the *firm's CCR internal model method permission*.

[Note: BCD Annex III Part 6 point 7 second part]

- 13.6.32 G If the FSA does specify an alpha greater than 1.4, the reasons will be set out in the *firm's CCR internal model method permission*.

- 13.6.33 R If a *firm's CCR internal model method permission* permits it, the *firm* may use its own estimates of α , subject to a floor of 1.2, where α must equal the ratio of internal capital from a full simulation of *CCR exposure* across counterparties (numerator) and internal capital based on *EPE* (denominator).

[Note: BCD Annex III Part 6 point 12 (part)]

- 13.6.34 R For the purposes of *BIPRU* 13.6.33R:

- (1) in the denominator, *EPE* must be used as if it were a fixed outstanding amount;
- (2) a *firm* must be able to demonstrate that its internal estimates of α capture in the numerator material sources of stochastic dependency of *distribution of market values* of transactions or of portfolios of transactions across counterparties;
- (3) internal estimates of α must take account of the granularity of portfolios.

[Note: BCD Annex III Part 6 point 12 (part)]

- 13.6.35 R A *firm* must ensure that the numerator and denominator of α are computed in a consistent fashion with respect to the modelling methodology, parameter specifications and portfolio composition. The approach used must be based on the *firm's* internal capital approach, be well-documented and be subject to independent validation. In addition, a *firm* must review their estimates on at least a quarterly basis, and more frequently when the composition of the portfolio varies over time. A *firm* must also assess the model risk.

[Note: BCD Annex III Part 6 point 13]

- 13.6.36 G In reviewing its estimate of α , a *firm* may not need to perform a full recalculation each quarter if it can demonstrate by other means that the estimate would not be materially different. A full recalculation should however be performed at least annually. If there is a structural change in the *firm's* portfolio that is likely to have the effect that the existing estimate of α will be inappropriate, the *firm* should also recalculate it. A *firm* should have

procedures in place to identify any such structural changes.

Maturity adjustment

- 13.6.37 G A firm using the IRB approach for risk weighting of exposures arising from a CCR internal model method should also apply a different maturity adjustment as set out in BIPRU 4.4.67R-BIPRU 4.4.70R.

Margin agreement

- 13.6.38 R If the *netting set* is subject to a *margin agreement*, a firm must use one of the following *EPE* measures:

- (1) *effective EPE* without taking into account the *margin agreement*;
- (2) the *margin threshold*, if positive, under the *margin agreement* plus an add-on that reflects the potential increase in *exposure* over the *margin period of risk*:
 - (a) the add-on is computed as the expected increase in the *netting set's exposure* beginning from a *current exposure* of zero over the *margin period of risk*;
 - (b) a floor of five business days for *netting sets* consisting only of repo-style transactions subject to daily remargining and daily mark-to-market, and ten business days for all other *netting sets* is imposed on the *margin period of risk* used for this purpose.
- (4) if the model captures the effects of margining when estimating *EE*, the model's *EE* measure may be used directly in the equation in BIPRU 13.6.28R (Computation of effective *EE*), unless the *firm's CCR internal model method permission* does not apply this provision or does not permit that use.

[Note: BCD Annex III Part 6 point 15]

- 13.6.39 G Where the effects of margining are captured by the model itself, the FSA does not prescribe any floors for the *margin period of risk* but will challenge a firm that looks to use periods shorter than 5 days for *repurchase agreements* or *reverse repurchase agreements* or 10 days for *financial derivative instruments*.

Operational requirements: General

- 13.6.40 R A firm's *EPE* model must meet the operational requirements set out in BIPRU 13.6.41R to 13.6.66R.

[Note: BCD Annex III Part 6 point 16]

Operational requirements: CCR control

- 13.6.41 R (1) The *firm* must have a control unit that is responsible for the design and implementation of its *CCR* management system, including the initial and on-going validation of the model.
- (2) This unit must control input data integrity and produce and analyse reports on the output of the *firm's* risk measurement model, including an evaluation of the relationship between measures of risk *exposure* and credit and trading limits.
- (3) This unit must be:
- (a) independent from units responsible for originating, renewing or trading *exposures* and free from undue influence;
 - (b) it must be adequately staffed; and
 - (c) it must report directly to the senior management of the *firm*.
- (4) The work of this unit must be closely integrated into the day-to-day credit risk management process of the *firm*; its output must, accordingly, be an integral part of the process of planning, monitoring and controlling the *firm's* credit and overall risk profile.

[Note: *BCD* Annex III Part 6 point 17]

- 13.6.42 R (1) A *firm* must have *CCR* management policies, processes and systems that are conceptually sound and implemented with integrity.
- (2) A sound *CCR* management framework must include the identification, measurement, management, approval and internal reporting of *CCR*.

[Note: *BCD* Annex III Part 6 point 18]

- 13.6.43 R (1) A *firm's* risk management policies must take account of *market risk*, *liquidity risk*, and legal and *operational risk* that can be associated with *CCR*.
- (2) The *firm* must not undertake business with a counterparty without assessing its creditworthiness and must take due account of settlement and pre-settlement credit risk.
- (3) These risks must be managed as comprehensively as practicable at the counterparty level (aggregating *CCR exposures* with other credit *exposures*) and at the *firm-wide* level.

[Note: *BCD* Annex III Part 6 point 19]

- 13.6.44 R A *firm's governing body* and senior management must be actively involved in the *CCR* control process and must regard this as an essential aspect of the business to which significant resources need to be devoted. Senior management must be aware of the limitations and assumptions of the model

used and the impact these can have on the reliability of the output. Senior management must also consider the uncertainties of the market environment and operational issues and be aware of how these are reflected in the model.

[**Note:** *BCD Annex III Part 6 point 20*]

- 13.6.45 R A *firm* must ensure that the daily reports prepared on its *exposures* to *CCR* are reviewed by a level of management with sufficient seniority and authority to enforce both reductions of positions taken by individual credit managers or traders and reductions in the *firm's* overall *CCR exposure*.

[**Note:** *BCD Annex III Part 6 point 21*]

- 13.6.46 R (1) A *firm's* *CCR* management system must be used in conjunction with internal credit and trading limits.
- (2) A *firm* must ensure that its credit and trading limits are related to its risk measurement model in a manner that is:
- (a) consistent over time; and
 - (b) well understood by credit managers, traders and senior management.

[**Note:** *BCD Annex III Part 6 point 22*]

- 13.6.47 R (1) A *firm's* measurement of *CCR* must include measuring daily and intra-day usage of credit lines.
- (2) The *firm* must measure *current exposure* gross and net of collateral.
- (3) At portfolio and counterparty level, the *firm* must calculate and monitor *peak exposure* or potential future *exposure* (PFE) at the confidence interval chosen by the *firm*.
- (4) The *firm* must take account of large or concentrated positions, including by groups of related counterparties, by industry, by market, etc.

[**Note:** *BCD Annex III Part 6 point 23*]

- 13.6.48 R (1) A *firm* must have a routine and rigorous program of stress testing in place as a supplement to the *CCR* analysis based on the day-to-day output of the *firm's* risk measurement model.
- (2) The results of this stress testing must be reviewed periodically by senior management and must be reflected in the *CCR* policies and limits set by management and the *governing body*.
- (3) Where stress tests reveal particular vulnerability to a given set of circumstances, prompt steps must be taken to manage those risks appropriately.

[Note: BCD Annex III Part 6 point 24]

- 13.6.49 R (1) A *firm* must have a routine in place for ensuring compliance with a documented set of internal policies, controls and procedures concerning the operation of the *CCR* management system.
- (2) The *firm's CCR* management system must be well documented and must provide an explanation of the empirical techniques used to measure *CCR*.

[Note: BCD Annex III Part 6 point 25]

13.6.50 R A *firm* must conduct an independent review of the *CCR* management system regularly through its own internal auditing process. This review must include both the activities of the business units referred to in *BIPRU* 13.6.41R and of the independent *CCR* control unit. A review of the overall *CCR* management process must take place at regular intervals and must specifically address, at a minimum:

- (1) the adequacy of the documentation of the *CCR* management system and process;
- (2) the organisation of the *CCR* control unit;
- (3) the integration of *CCR* measures into daily risk management;
- (4) the approval process for risk pricing models and valuation systems used by front and back-office personnel;
- (5) the validation of any significant change in the *CCR* measurement process;
- (6) the scope of *CCR* captured by the risk measurement model;
- (7) the integrity of the management information system;
- (8) the accuracy and completeness of *CCR* data;
- (9) the verification of the consistency, timeliness and reliability of data sources used to run models, including the independence of such data sources;
- (10) the accuracy and appropriateness of volatility and correlation assumptions;
- (11) the accuracy of valuation and risk transformation calculations; and
- (12) the verification of the model's accuracy through frequent back-testing.

[Note: BCD Annex III Part 6 point 26]

Operational requirements: Use test

- 13.6.51 R The distribution of *exposures* generated by the model used to calculate *effective EPE* must be closely integrated into the day-to-day *CCR* management process of the *firm*. The model's output must accordingly play an essential role in the credit approval, *CCR* management, internal capital allocation, and corporate governance of the *firm*.

[**Note:** *BCD* Annex III Part 6 point 27]

- 13.6.52 R A *firm* must have a track record in the use of models that generate a distribution of *exposures* to *CCR*. Thus, the *firm* must be able to demonstrate that it has been using a model to calculate the distributions of *exposures* upon which the *EPE* calculation is based that meets, broadly, the minimum requirements set out in *BIPRU* 13.6 for at least one year prior to the date of its *CCR internal model method permission*.

[**Note:** *BCD* Annex III Part 6 point 28]

- 13.6.53 R (1) A *firm* must ensure that the model used to generate a distribution of *exposures* to *CCR* is part of a *CCR* management framework that includes the identification, measurement, management, approval and internal reporting of *CCR*. This framework must include the measurement of usage of credit lines (aggregating *CCR exposures* with other credit *exposures*) and internal capital allocation.
- (2) In addition to *EPE*, a *firm* must measure and manage *current exposures*.
- (3) Where appropriate, the *firm* must measure *current exposure* gross and net of collateral.
- (4) The use test is satisfied if a *firm* uses other *CCR* measures, such as *peak exposure* or *PFE* (see *BIPRU* 13.6.47R), based on the distribution of *exposures* generated by the same model to compute *EPE*.

[**Note:** *BCD* Annex III Part 6 point 29]

- 13.6.54 R A *firm* must have the systems capability to estimate *EE* daily if necessary, unless it is able to demonstrate to the *FSA* that its *exposures* to *CCR* warrant less frequent calculation. The *firm* must compute *EE* along a time profile of forecasting horizons that adequately reflects the time structure of future cash flows and maturity of the contracts and in a manner that is consistent with the materiality and composition of the *exposures*.

[**Note:** *BCD* Annex III Part 6 point 30]

- 13.6.55 R (1) *Exposure* must be measured, monitored and controlled over the life of all contracts in the *netting set* (not just to the one year horizon).

- (2) A *firm* must have procedures in place to identify and control the risks for counterparties where the *exposure* rises beyond the one-year horizon.
- (3) A *firm* must input the forecast increase in *exposure* into the *firm*'s internal capital model.

[**Note:** BCD Annex III Part 6 point 31]

Operational requirements: Stress testing

- 13.6.56 R
- (1) A *firm* must have in place sound stress testing processes for use in the assessment of capital adequacy for *CCR*.
 - (2) These stress measures must be compared with the measure of *EPE* and considered by the *firm* as part of the process set out in *GENPRU* 1.2.42R.
 - (3) Stress testing must also involve identifying possible events or future changes in economic conditions that could have unfavourable effects on a *firm*'s credit *exposures* and an assessment of the *firm*'s ability to withstand such changes.

[**Note:** BCD Annex III Part 6 point 32]

- 13.6.57 R
- (1) A *firm* must stress test its *CCR exposures*, including jointly stressing *market risk* and credit risk factors.
 - (2) In its stress tests of *CCR*, a *firm* must consider concentration risk (to a single counterparty or groups of counterparties), correlation risk across *market risk* and credit risk, and the risk that liquidating the counterparty's positions could move the market.
 - (3) In its stress tests a *firm* must also consider the impact on its own positions of such market moves and integrate that impact in its assessment of *CCR*.

[**Note:** BCD Annex III Part 6 point 33]

Operational requirements: Wrong-way risk

- 13.6.58 R
- A *firm* must give due consideration to *exposures* that give rise to a significant degree of *general wrong-way risk*.

[**Note:** BCD Annex III Part 6 point 34]

- 13.6.59 R
- A *firm* must have procedures in place to identify, monitor and control cases of *specific wrong way risk*, beginning at the inception of a transaction and continuing through the life of the transaction.

[**Note:** BCD Annex III Part 6 point 35]

Operational requirements: Integrity of modelling process

- 13.6.60 R *A firm* must ensure that:
- (1) the model reflects transaction terms and specifications in a timely, complete, and conservative fashion;
 - (2) such terms include at least:
 - (a) contract notional amounts;
 - (b) maturity;
 - (c) reference assets;
 - (d) margining arrangements; and
 - (e) netting arrangements;
 - (3) the terms and specifications are maintained in a database that is subject to formal and periodic audit;
 - (4) the process for recognising netting arrangements requires:
 - (a) signoff by legal staff to verify the legal enforceability of netting and
 - (b) input into the database by an independent unit;
 - (5) the transmission of transaction terms and specifications data to the model is also subject to internal audit; and
 - (6) formal reconciliation processes are in place between the model and source data systems to verify on an ongoing basis that transaction terms and specifications are being reflected in *EPE* correctly or at least conservatively.

[**Note:** *BCD* Annex III Part 6 point 36]

- 13.6.61 R *A firm* must ensure that:
- (1) the model employs current market data to compute *current exposures*;
 - (2) when using historical data to estimate volatility and correlations, at least three years of historical data are used and updated quarterly or more frequently if market conditions warrant;
 - (3) the data covers a full range of economic conditions, such as a full business cycle;

- (4) a unit independent from the business unit validates the price supplied by the business unit;
- (5) the data is acquired independently of the lines of business, fed into the model in a timely and complete fashion, and maintained in a database subject to formal and periodic audit;
- (6) it has a well-developed data integrity process to clean the data of erroneous and/or anomalous observations; and
- (7) to the extent that the model relies on proxy market data, including for new products where three years of historical data may not be available, internal policies identify suitable proxies and the *firm* demonstrates empirically that the proxy provides a conservative representation of the underlying risk under adverse market conditions.

[**Note:** BCD Annex III Part 6 point 37]

13.6.62 R If the model includes the effect of collateral on changes in the market value of the *netting set*, a *firm* must have adequate historical data to model the volatility of the collateral.

13.6.63 R A *firm* must ensure that the model is subject to a validation process which:

- (1) is clearly articulated in *firms'* policies and procedures;
- (2) specifies the kind of testing needed to ensure model integrity
- (3) identifies conditions under which assumptions are violated and may result in an understatement of *EPE*; and
- (4) includes a review of the comprehensiveness of the model.

[**Note:** BCD Annex III Part 6 point 38]

13.6.64 R A *firm* must monitor the appropriate risks and have processes in place to adjust its estimation of *EPE* when those risks become significant. This includes the following:

- (1) the *firm* must identify and manage its *exposures* to *specific wrong-way risk*;
- (2) for *exposures* with a rising risk profile after one year, the *firm* must compare on a regular basis the estimate of *EPE* over one year with *EPE* over the life of the *exposure*; and
- (3) for *exposures* with a residual maturity below one year, the *firm* must compare on a regular basis the replacement cost (*current exposure*) and the realised *exposure* profile, and/or store data that would allow such a comparison.

[Note: BCD Annex III Part 6 point 39]

- 13.6.65 R A *firm* must have internal procedures to verify that, prior to including a transaction in a *netting set*, the transaction is covered by a legally enforceable netting contract that meets the requirements set out in *BIPRU* 13.7.

[Note: BCD Annex III Part 6 point 40]

- 13.6.66 R A *firm* that makes use of collateral to mitigate its *CCR* must have internal procedures to verify that, prior to recognising the effect of collateral in its calculations, the collateral meets the legal certainty standards set out in *BIPRU* 5 as modified, where relevant, by *BIPRU* 4.10.

[Note: BCD Annex III Part 6 point 41]

Validation requirements

- 13.6.67 R (1) A *firm's CCR internal model method* model must meet the validation requirements in (2) to (8).
- (2) The qualitative validation requirements set out in *BIPRU* 7.10 must be met.
- (3) Interest rates, *foreign currency* rates, equity prices, *commodities*, and other *market risk* factors must be forecast over long time horizons for measuring *CCR exposure*. The performance of the forecasting model for *market risk* factors must be validated over a long time horizon.
- (4) The pricing models used to calculate *CCR exposure* for a given scenario of future shocks to *market risk* factors must be tested as part of the *CCR internal model method* model validation process. Pricing models for *options* must account for the nonlinearity of option value with respect to *market risk* factors.
- (5) The *CCR internal model method* model must capture transaction-specific information in order to aggregate *exposures* at the level of the *netting set*. A *firm* must verify that transactions are assigned to the appropriate *netting set* within the model.
- (6) The *CCR internal model method* model must also include transaction-specific information to capture the effects of margining. It must take into account both the current amount of margin and margin that would be passed between counterparties in the future. Such a model must account for the nature of *margin agreements* (unilateral or bilateral), the frequency of margin calls, the *margin period of risk*, the minimum threshold of unmarginated *exposure* the *firm* is willing to accept, and the minimum transfer amount. Such a model must either model the mark-to-market change in the value of collateral posted or apply the *rules* set out in *BIPRU* 5 as modified,

where relevant, by *BIPRU* 4.10.

- (7) Static, historical backtesting on representative counterparty portfolios must be part of the *CCR internal model method* model validation process. At regular intervals, a *firm* must conduct such backtesting on a number of representative counterparty portfolios (actual or hypothetical). These representative portfolios must be chosen based on their sensitivity to the material risk factors and correlations to which the *firm* is exposed.
- (8) If backtesting indicates that the *CCR internal model method* model is not sufficiently accurate, a *firm* must increase the *credit risk capital component* and, where *BIPRU* 13 is applied for the purposes of *BIPRU* 14, the *counterparty risk capital component* by an amount which is conservatively estimated to compensate for the inaccuracy of the model.

[**Note:** *BCD* Annex III Part 6 point 42 (part)]

- 13.6.68 G If backtesting indicates that the *CCR internal model method* model is not sufficiently accurate, the *FSA* may revoke a *firm's CCR internal model method permission* or take appropriate measures to ensure that the model is improved promptly. Measures taken by the *FSA* may include the use of its *own-initiative power* to require the *firm* to hold more *capital resources*.

[**Note:** *BCD* Annex III Part 6 point 42 (part)]

13.7 Contractual netting

Scope

13.7.1 R *BIPRU* 13.7 applies for the purpose of:

- (1) the *CCR mark to market method*;
- (2) the *CCR standardised method*;
- (3) if the *firm* has a *CCR internal model method permission*, the *CCR internal model method*.

Types of netting recognised

13.7.2 R For the purpose of *BIPRU* 13.7:

- (1) “counterparty” means any entity (including natural *persons*) that has the power to conclude a contractual netting agreement; and
- (2) “*contractual cross product netting agreement*” means a written bilateral agreement between a *firm* and a counterparty which creates a single legal obligation covering all included bilateral master agreements and transactions belonging to different product categories.

[**Note:** *BCD Annex III Part 7 point (a) (part)*]

13.7.3 R *Contractual cross product netting agreements* do not cover netting other than on a bilateral basis.

[**Note:** *BCD Annex III Part 7 point (a) (part)*]

13.7.4 R For the purposes of *cross product netting*, the following are considered different product categories:

- (1) *repurchase transactions, reverse repurchase transactions, securities or commodities lending or borrowing transactions*;
- (2) *margin lending transactions*; and
- (3) *financial derivative instruments*.

[**Note:** *BCD Annex III Part 7 point (a) (part)*]

13.7.5 R A *firm* may recognise as risk-reducing the following types of contractual netting:

- (1) bilateral contracts for novation between a *firm* and its counterparty under which mutual claims and obligations are automatically

amalgamated in such a way that this novation fixes one single net amount each time novation applies and thus creates a legally binding, single new contract extinguishing former contracts;

- (2) other bilateral agreements between a *firm* and its counterparty; and
- (3) a *firm* that has a *CCR internal model method permission* may recognise *contractual cross product netting agreements* for transactions falling within the scope of its *CCR internal model method permission*; netting across transactions entered by members of a *group* is not recognised for the purposes of calculating capital requirements.

[**Note:** *BCD Annex III Part 7 point (a) (part)*]

Conditions for recognition

13.7.6 R A *firm* may treat contractual netting as risk-reducing only under the following conditions:

- (1) the *firm* must have a contractual netting agreement with its counterparty which creates a single legal obligation, covering all included transactions, such that, in the event of a counterparty's failure to perform owing to default, bankruptcy, liquidation or any other similar circumstance, the *firm* would have a claim to receive or an obligation to pay only the net sum of the positive and negative mark-to-market values of included individual transactions;
- (2) the *firm* must be in a position to provide to the *FSA*, if requested, written and reasoned legal opinions to the effect that, in the event of a legal challenge, the relevant courts and administrative authorities would, in the cases described under (1), find that the *firm's* claims and obligations would be limited to the net sum, as described in (1), under:
 - (a) the law of the jurisdiction in which the counterparty is incorporated and, if a foreign *branch* of an *undertaking* is involved, also under the law of the jurisdiction in which the *branch* is located; or
 - (b) the law that governs the individual transactions included; or
 - (c) the law that governs any contract or agreement necessary to effect the contractual netting;
- (3) the *firm* must have procedures in place to ensure that the legal validity of its contractual netting is kept under review in the light of possible changes in the relevant laws;
- (4) the *firm* must maintain all required documentation in its files;

- (5) the effects of netting must be factored into the *firm's* measurement of each counterparty's aggregate credit risk *exposure* and the *firm* must manage its *CCR* on such a basis; and
- (7) the *firm* must aggregate credit risk to each counterparty to arrive at a single legal *exposure* across transactions; this aggregation must be factored into credit limit purposes and internal capital purposes.

[Note: BCD Annex III Part 7 point (b) (part)]

- 13.7.7 R If any of the *competent authorities* concerned is not satisfied that the contractual netting is legally valid under the law of each of the relevant jurisdictions, the *firm* must not treat the contractual netting agreement as risk-reducing.

[Note: BCD Annex III Part 7 point (b) (part)]

- 13.7.8 R A legal opinion required under *BIPRU* 13.7.6R(2) may be in the form of a reasoned legal opinion drawn up by type of contractual netting.

[Note: BCD Annex III Part 7 point (b) (part)]

- 13.7.9 R A *firm* must not recognise as risk-reducing any contract containing a provision which permits a non-defaulting counterparty to make limited payments only, or no payments at all, to the estate of the defaulter, even if the defaulter is a net creditor (a "walkaway" clause).

[Note: BCD Annex III Part 7 point (b) (part)]

- 13.7.10 R In addition to the requirements in *BIPRU* 13.7.2R to *BIPRU* 13.7.9R, for *contractual cross-product netting agreements* the following criteria must be met:

- (1) the net sum referred to in *BIPRU* 13.7.6R(1) must be the net sum of the positive and negative close out values of any included individual bilateral master agreement and of the positive and negative mark-to-market value of the individual transactions (the 'Cross-Product Net Amount');
- (3) the written and reasoned legal opinions referred to in *BIPRU* 13.7.6R(2) must address the validity and enforceability of the entire *contractual cross-product netting agreement* under its terms and the impact of the netting arrangement on the material provisions of any included individual bilateral master agreement; a legal opinion must be generally recognised as such by the legal community in the *United Kingdom* or a memorandum of law that addresses all relevant issues in a reasoned manner;
- (4) the *firm* must have procedures in place under *BIPRU* 13.7.6R(3) to verify that any transaction which is to be included in a *netting set* is covered by a legal opinion; and

- (5) taking into account the *contractual cross product netting agreement*, the *firm* must continue to comply with the requirements for the recognition of bilateral netting and the requirements of *BIPRU 4.10* and *BIPRU 5* for the recognition of *credit risk mitigation*, as applicable, with respect to each included individual bilateral master agreement and transaction.

[**Note:** *BCD Annex III Part 7 point (b) (part)*]

Effects of recognition

- 13.7.11 R For the purposes of the *CCR mark to market method*, the *CCR standardised method* and the *CCR internal model method* a *firm* must recognise netting as set out in *BIPRU 13.3* and *BIPRU 13.6*.

[**Note:** *BCD Annex III Part 7 point (b) (part)*]

13.8 Securities financing transactions

Purpose

13.8.1 G *BIPRU 13.8 summarises the treatment for securities financing transactions.*

Calculation of exposure value for SFTs

13.8.2 R Subject to *BIPRU 13.8.3R*, in respect of a *securities financing transaction*, if a *firm*:

(1) has a *CCR internal model method permission* which covers the transaction; or

(2) has a *master netting agreement internal models approach permission* which covers the transaction;

then the *firm* must use the *CCR internal model method approach* or the *master netting agreement internal models approach*, as applicable, to calculate the *exposure* value for that transaction unless an exception in *BIPRU 13* or *BIPRU 5* allows the *firm* to use another method.

[**Note:** *BCD Article 78(2)*, second sentence, in respect of *SFTs*]

13.8.3 R If a *firm* has a *CCR internal model method permission* and a *master netting agreement internal models approach permission*, and both cover a *securities financing transaction*, then the *firm* may choose which of those approaches it wishes to use to calculate the *exposure* value for that transaction.

13.8.4 R Where *BIPRU 13.8.2R* does not apply, a *firm* must use one of the following approaches to determine the *exposure* value of a *securities financing transaction*, as appropriate:

(1) if the transaction is covered by a master netting agreement which satisfies the requirements for recognition set out in *BIPRU 5.6.1R* to *BIPRU 5.6.3R*, a *firm* may calculate the *exposure* value under the master netting agreement method set out in *BIPRU 5.6.5R* to *BIPRU 5.6.11R* (Calculation of the fully adjusted exposure value: the supervisory volatility adjustments approach and the own estimates of volatility adjustments approach);

(2) otherwise, a *firm* must calculate the *exposure* value of the transaction as its on-balance sheet value.

13.8.5 G A *firm* calculating *risk weighted exposure amounts* under the *standardised approach* to credit risk will not be eligible to use the approach in *BIPRU 13.8.4R(1)* if it is using the *financial collateral simple method* to determine the effects of *credit risk mitigation*, as set out in *BIPRU 5.4.16R*.

- 13.8.6 G If a *firm* calculates the *exposure* value of a *securities financing transaction* as its on-balance sheet value, in accordance with *BIPRU* 13.8.4R(2), it may recognise the effects of financial collateral in the same way as for its other exposures, for example by using either the *financial collateral simple method* or the *financial collateral comprehensive method*. However *firms* should note that the *financial collateral simple method* is not available:
- (1) to a *firm* using the *IRB approach* (*BIPRU* 5.4.16R); or
 - (2) for *securities financing transactions* in the *trading book* (*BIPRU* 14.2.11R).

Exposure to a central counterparty

- 13.8.7 R Notwithstanding *BIPRU* 13.8.2R, a *firm* must determine the *exposure* value of a credit risk *exposure* outstanding with a *central counterparty* in accordance with *BIPRU* 13.8.10R, provided that the *central counterparty's counterparty credit risk exposures* with all participants in its arrangements are fully collateralised on a daily basis.

[**Note:** *BCD* Article 78(4) in respect of *SFTs*]

- 13.8.8 R A *firm* may attribute an *exposure* value of zero for *CCR* to a *securities financing transaction* or to any other *exposures* in respect of that transaction (but excluding an *exposure* arising from collateral held to mitigate losses in the event of the default of other participants in the *central counterparty's* arrangements) which is outstanding with a *central counterparty* and has not been rejected by the *central counterparty*.

[**Note:** *BCD* Annex III Part 2 point 6 in respect of *SFTs*]

i	Transaction type		Effective notional	Modified duration	CMV	Interest rate risk hedging sets					FX risk hedging sets		Equity risk
						USD non-gov M<1	USD non-gov M>5	EUR non-gov M<1	EUR non-gov M>5	JPY non-gov M>5	EUR/USD	JPY/USD	
1	USD	IR swap	80	8	-6		640						
1	USD	IR swap	80	-0.25									
2	USD	IR swap	300	0.125									
2	USD	IR swap	300	-6	2		-1800						
3	EUR	FX swap	100	15	0			1500			100		
3	USD	FX swap	100	-0.125									
4	EUR	cross ccy swap	60	7	1			420			60		
4	JPY	cross ccy swap	60	-7								-60	
5	DAX	Total return swap in EUR	150	0.125	4				18.75		150		
5	DAX	Total return swap in EUR	150	not applicable									-150
Sum of risk positions RPT _{ij} by hedging set _j													
Absolute amount |sum of RPT _{ij}| of risk positions by hedging set _j													
Credit conversion factors CCF _j by hedging set _j													
CCF _j x |sum of RPT _{ij}|: CCF-weighted absolute amounts of risk positions by hedging set													
						5	-1160	18.75	1920	-420	310	-60	-150
						5	1160	18.75	1920	420	310	60	150
						0.20%	0.20%	0.20%	0.20%	0.20%	2.50%	2.50%	7%
						0.0100	2.3200	0.0375	3.8400	0.8400	7.7500	1.5000	10.5000

Sum of (CCF _j x |sum of RPT _{ij}|)	26.7975
CMV: sum of <i>current market values</i> CMV _i of the transactions	1.000
Max(CMV, sum of (CCF _j x |sum of RPT _{ij}|))	26.7975
Beta:	1.4000
EAD	37.5165

- 14 Capital requirements for settlement and counterparty risk
- 14.1 Application and purpose
- Application
- 14.1.1 R *BIPRU 14 applies to a BIPRU firm.*
- 14.1.2 G (1) *BIPRU 14.2 deals with the calculation of the capital requirement for CCR for trading book positions arising from financial derivative instruments, securities financing transactions and long settlement transactions. The approaches used to calculate exposure values and risk weighted exposure amounts for these positions are largely based on the approaches applicable to non-trading book positions (BIPRU 3, BIPRU 4, BIPRU 5 and BIPRU 13). However, there are some treatments that are specific to the trading book. These are set out in BIPRU 14.2.*
- (2) *The calculation of the capital requirement for CCR for trading book positions is the first element of the counterparty risk capital component in BIPRU 14.2.1R. The second element of the counterparty risk capital component is for unsettled transactions in both the trading book and the non-trading book. It is calculated under BIPRU 14.3.*
- (4) *BIPRU 14.4 sets out the treatment for free deliveries.*
- Purpose
- 14.1.2 G *BIPRU 14 implements:*
- (1) *Article 3(1)(h), Article 17(1), and Article 40; and*
- (2) *Annex II;*
- of the Capital Adequacy Directive.*

- 14.2 Calculation of the capital requirement for CCR
- Calculation of the counterparty risk capital component
- 14.2.1 R A *firm* must calculate the *counterparty risk capital component* as the sum of:
- (1) the capital requirement calculated under *BIPRU* 14.2.13R; and
 - (2) the amount calculated under *BIPRU* 14.3.
- 14.2.2 R A *firm* must hold capital calculated in accordance with *BIPRU* 14.2.13R against the *CCR* arising from *exposures* arising in the *trading book* due to the following:
- (1) *free deliveries* (where *BIPRU* 14.4 requires it to be treated as an *exposure*);
 - (2) *financial derivative instruments* and credit derivatives;
 - (3) *repurchase agreements, reverse repurchase agreements, securities or commodities lending or borrowing transactions* based on *securities* or *commodities* included in the *trading book*;
 - (4) *margin lending transactions* based on *securities* or *commodities*; and
 - (5) *long settlement transactions*.
- [Note: *CAD* Annex II point 5]
- Credit derivatives
- 14.2.3 R For the purposes of the calculation of the *counterparty risk capital component*, a *financial derivative instrument* means:
- (1) an item falling within *BIPRU* 13.3.3R other than an item to which an *exposure* value of zero is attributed under *BIPRU* 13.3.13R or *BIPRU* 13.8.10R (*Exposure to a central counterparty*); and
 - (2) a credit derivative.
- [Note: *CAD* Article 3(1)(h) and Annex II point 7 first sentence]
- 14.2.4 R *BIPRU* 14.2.5R to *BIPRU* 14.2.8R apply for the purposes of *BIPRU* 13.4 (*CCR mark to market method*).
- 14.2.5 R In the case of total return swap credit derivatives and credit default swap credit derivatives, a *firm* must obtain a figure for potential future credit *exposure* by multiplying the nominal amount of the instrument by the following percentages:

- (1) 5% where the reference obligation is one that if it gave rise to a direct *exposure* of the *firm* would be a *qualifying debt security* for the purposes of *BIPRU 7.2*;
- (2) 10 % where the reference obligation is one that if it gave rise to a direct *exposure* of the *firm* would not be a *qualifying debt security* for the purposes of *BIPRU 7.2*.

[**Note:** *CAD Annex II point 7 (part)*]

- 14.2.6 R In the case of a credit default swap, a *firm* the *exposure* of which arising from the swap represents a long position in the underlying may use a figure of 0% for potential future credit *exposure*, unless the credit default swap is subject to closeout upon the insolvency of the entity the *exposure* of which arising from the swap represents a short position in the underlying, even though the underlying has not defaulted.
- 14.2.7 G *BIPRU 14.2.6R* permits the seller of credit protection to determine potential future credit *exposure* as 0%, unless the protection is subject to close-out on the insolvency of the buyer.
- 14.2.8 R Where the credit derivative provides protection in relation to ‘nth to default’ amongst a number of underlying obligations, a *firm* must apply the percentage figure in *BIPRU 14.2.5R* applicable to the obligation with the nth lowest credit quality determined by whether it is one that if incurred by the *firm* would be a *qualifying debt security* for the purposes of *BIPRU 7.2*.
- 14.2.9 G The operation of *BIPRU 14.2.8R* can be illustrated by an example as follows: where the credit derivative is a first to default transaction, the appropriate percentage for the potential future credit *exposure* will be determined by the lowest credit quality of the underlying obligations in the basket. If there are non-qualifying items in the basket, the percentage applicable to the non-qualifying reference obligation should be used. For second and subsequent to default transactions, underlying assets should continue to be allocated according to credit quality: i.e. for a second to default transaction, the applicable percentage figure is the percentage applicable to the second lowest credit quality.
- 14.2.10 R Where a credit derivative included in the *trading book* forms part of an internal hedge and the credit protection is recognised for the purposes of the calculation of the *credit risk capital component*, there is deemed to be no counterparty risk arising from the position in the credit derivative.

[**Note:** *CAD Annex II point 11*]

Calculation

- 14.2.11 R Subject to *BIPRU 14.2.3R* to *BIPRU 14.2.5R* and *BIPRU 14.2.14R* to *BIPRU 14.2.17R*, a *firm* must calculate *exposure* values and *risk weighted exposure amounts* for the *exposures* falling under *BIPRU 14.2.2R(1)* to (5) in accordance with:

- (1) the *standardised approach* to credit risk; or
- (2) if the *firm* has an *IRB permission*, the *IRB approach* in accordance with the terms of the *firm's IRB permission*.

[Note: CAD Annex II point 6]

14.2.12 G For the purpose of calculating counterparty *exposure* values for *financial derivative instruments*, *securities financing transactions* and *long settlement transactions*, or for *credit risk mitigation*, the effect of BIPRU 14.2.11R is to direct a *firm* to BIPRU 13 or BIPRU 5 as appropriate.

14.2.13 R A *firm* must calculate the capital requirement for the purposes of BIPRU 14.2.2R as 8% of the total *risk weighted exposure amounts*.

[Note: CAD Annex II point 12]

Collateral

14.2.14 R For the purposes of BIPRU 14.2.11R, in calculating *risk weighted exposure amounts* a *firm* must not use the *financial collateral simple method* for the recognition of the effects of financial collateral.

[Note: CAD Annex II point 8]

14.2.15 R For the purposes of BIPRU 14.2.11R:

- (1) in the case of *repurchase transactions* and *securities or commodities lending or borrowing transactions* booked in the *trading book*, all *CRD financial instruments* and *commodities* that are eligible to be included in the *trading book* may be recognised as eligible collateral;
- (2) for *exposures* due to *financial derivative instruments* and *long settlement transactions* booked in the *trading book*, *commodities* that are eligible to be included in the *trading book* may also be recognised as eligible collateral;
- (3) for the purposes of calculating volatility adjustments where such *CAD financial instruments* or *commodities* which are not eligible under BIPRU 5 and BIPRU 4.10 are lent, sold or provided, or borrowed, purchased or received by way of collateral or otherwise under such a transaction, and the *firm* is using the *supervisory volatility adjustments approach*, such instruments and *commodities* must be treated in the same way as non-main index equities listed on a *recognised investment exchange* or a *designated investment exchange*.

[Note: CAD Annex II point 9 (part)]

14.2.16 R (1) Where a *firm* is using the *own estimates of volatility adjustments approach* in respect of *CAD financial instruments* or *commodities*

which are not eligible under *BIPRU 5* and *BIPRU 4.10* it must calculate volatility adjustments for each individual item.

- (2) Where a *firm* is using the *master netting agreement internal models approach* set out in *BIPRU 5*, it may also apply this approach in the *trading book*.

[**Note:** *CAD Annex II point 9 (part)*]

14.2.17 R For the purposes of *BIPRU 14.2.11R*, in relation to the recognition of master netting agreements covering *repurchase transactions* and/or *securities or commodities lending or borrowing transactions* and/or other *capital market-driven transactions* netting across positions in the *trading book* and the *non-trading book* may only be recognised when the netted transactions fulfil the following conditions:

- (1) all transactions are marked to market daily;
- (2) any items borrowed, purchased or received under the transactions may be recognised as eligible financial collateral under *BIPRU 5* and *BIPRU 4.10* without the application of *BIPRU 14.2.14R* to *BIPRU 14.2.15R*.

[**Note:** *CAD Annex II point 9 (part)*]

Treatment of expected loss amounts under the IRB approach

14.2.18 R Where a *firm* calculates *risk weighted exposure amounts* for the purposes of *BIPRU 14* in accordance with the *IRB approach*, then for the purposes of the calculation provided for in *BIPRU 4.4.79R* (Double default), the following apply:

- (1) value adjustments made to take account of the credit quality of the counterparty may be included in the sum of value adjustments and provisions made for the *exposures* indicated in *BIPRU 14*; and
- (2) unless the *firm's IRB permission* does not permit it, if the credit risk of the counterparty is adequately taken into account in the valuation of a position included in the *trading book* the *expected loss* amount for the counterparty *risk exposure* must be zero.

[**Note:** *CAD Article 17(1)*]

14.2.19 R For the purposes of *BIPRU 14.2.18R(1)*, for such a *firm*, the value adjustments referred to in *BIPRU 14.2.18R(1)* must not be included in *capital resources* other than in accordance with *BIPRU 14.2.18R(1)*.

Exposures to recognised third-country investment firms, recognised clearing houses and designated investment exchanges

14.2.20 R For the purposes of the calculation of the *counterparty risk capital component*, without prejudice to *BIPRU 13.3.13R* and *BIPRU 13.8.10R*

(Exposure to a central counterparty) *exposures to recognised third-country investment firms* and *exposures to recognised clearing houses and designated investment exchanges* must be treated as exposures to *institutions*.

[Note: CAD Article 40]

Netting of trading book exposures against non-trading book exposures

- 14.2.21 R For the purposes of *counterparty credit risk*, a *firm* may net *exposures* arising from items in the *trading book* against *exposures* arising from items in the *non-trading book*.
- 14.2.22 R Where a *firm* carries out netting under BIPRU 14.2.21R, it must allocate the net *exposure* to:
- (1) the *trading book* for the purposes of the calculation under BIPRU 14.2.11R, if the gross *trading book exposures* exceed gross *non-trading book exposures*; and
 - (2) the *non-trading book* for the purposes of BIPRU 13, if the gross *non-trading book exposures* exceed gross *trading book exposures*.
- 14.2.23 R A *firm* may only net *exposures* under BIPRU 14.2.21R if it continues to meet other *GENPRU* and *BIPRU* requirements applicable to the *trading book* or *non-trading book* in respect of those *exposures*.
- 14.2.24 G For example, in relation to BIPRU 14.2.23R, collateral which is eligible only against *trading book exposures* will not be applicable against *non-trading book exposures*; and the large *exposures* limits on *non-trading book* positions will also remain applicable.

14.3 Unsettled transactions

Scope

14.3.1 R *BIPRU 14.3 applies in respect of items in the trading book and the non-trading book.*

14.3.2 G The capital requirement for unsettled transactions is an element of the counterparty risk capital component set out in *BIPRU 14.2.1R*.

Calculation

14.3.3 R In the case of transactions in which debt instruments, equities, *foreign currencies* and *commodities* (excluding *repurchase agreements* and *reverse repurchase agreements* and *securities or commodities lending* and *securities or commodities borrowing*) are unsettled after their due delivery dates, a *firm* must calculate the price difference to which it is exposed, being the difference between the agreed settlement price for the debt instrument, equity, *foreign currency* or *commodity* in question and its *current market value*, where the difference could involve a loss for the *firm*.

[**Note:** *CAD Annex II point 1 (part)*]

14.3.4 R A *firm* must multiply the price difference calculated under *BIPRU 14.3.2R* by the appropriate factor in column A of the Table in *BIPRU 14.3.4R* in order to calculate its capital requirement for the purposes of *BIPRU 14.3*.

[**Note:** *CAD Annex II point 1 (part)*]

Table: Factors for the multiplication of price differences

14.3.5 R This table belongs to *BIPRU 14.3.4R*

Number of working days after due settlement date	Column A (%)
5 — 15	8
16 — 30	50
31 — 45	75
46 or more	100

[Note: CAD Annex II Table 1]

- 14.3.5 G In cases of a system wide failure of a settlement or clearing system, a *firm* should refer to the emergency provisions in *GEN* 1.3. Where the requirements of *GEN* 1.3.2R are met, until the situation is rectified failure of a counterparty to settle a trade will not be deemed a default for purposes of credit risk.

[Note: CAD Annex II point 4]

14.4 Free deliveries

Scope

14.4.1 R *BIPRU* 14.4 applies in respect of items in the *trading book* and the *non-trading book*.

14.4.2 R A *firm* must hold *capital resources* with respect to a *free delivery*, as set out in the Table in *BIPRU* 14.4.3R, if:

- (1) it has paid for *securities, foreign currencies* or *commodities* before receiving them or it has delivered *securities foreign currencies* or *commodities* before receiving payment for them; and
- (2) in the case of cross-border transactions, one day or more has elapsed since it made that payment or delivery.

[**Note:** *CAD* Annex II point 2]

Exposure

Table: Capital treatment for free deliveries

14.4.3 R This table belongs to *BIPRU* 14.4.2R.

Transaction Type	Up to first contractual <i>payment leg</i> or delivery leg	From first contractual <i>payment leg</i> or delivery leg up to four days after second contractual <i>payment leg</i> or delivery leg	From 5 business days post second contractual <i>payment leg</i> or delivery leg until extinction of the transaction
<i>Free delivery</i>	No capital charge in the <i>trading book</i>	Treat as an <i>exposure</i>	Deduct value transferred plus current positive <i>exposure</i> from <i>capital resources</i>

[**Note:** *CAD* Annex II Table 2]

- 14.4.4 R (1) In the case of the *non-trading book*, a *firm* must treat an *exposure* falling into columns 2 and 3 of the table in *BIPRU* 14.4.3R in accordance with the relevant provisions of the *standardised approach* to credit risk or the *IRB approach*, as the case may be.
- (2) In the case of the *trading book*, a *firm* must apply the treatment set out in *BIPRU* 14.4.5R.

[**Note:** *CAD* Annex II point 3 (part)]

- 14.4.5 R (1) In applying a *risk weight* to *free delivery exposures* treated according to column 3 of the table in *BIPRU* 14.4.3R, a *firm* using the *IRB approach* may assign *PDs* to *counterparties*, for which they have no other *non-trading book exposure*, on the basis of the counterparty's external rating.
- (2) A *firm* using own estimates of *LGDs* may apply the *LGD* set out in *BIPRU* 4.4.34R to *BIPRU* 4.4.35R (*IRB* foundation approach: *LGDs*) to *free delivery exposures* treated according to column 3 of the table in *BIPRU* 14.4.3R, provided that it applies it to all such *exposures*.
- (3) Alternatively, a *firm* using the *IRB approach* may apply the *risk weights*, as set out in the *standardised approach* to credit risk provided that it applies them to all such *exposures* or may apply a 100% *risk weight* to all such *exposures*.

[**Note:** *CAD* Annex II point 3 (part)]

- 14.4.6 R If the amount of positive *exposure* resulting from *free delivery* transactions is not material, a *firm* may apply a *risk weight* of 100% to these *exposures*.

- 14.4.7 G In cases of a system wide failure of a settlement or clearing system, a *firm* should refer to the emergency provisions in *GEN* 1.3. Where the requirements of *GEN* 1.3.2R are met, until the situation is rectified failure of a counterparty to settle a trade will not be deemed a default for purposes of credit risk.

[**Note:** *CAD* Annex II point 4]

THE PRUDENTIAL SOURCEBOOK FOR INSURERS INSTRUMENT 2006

Powers exercised

- A. The Financial Services Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):
- (1) section 138 (General rule-making power);
 - (2) section 141 (Insurance business rules);
 - (3) section 149 (Evidential provisions);
 - (4) section 150(2) (Actions for damages);
 - (5) section 156 (General supplementary powers);
 - (6) section 157(1) (Guidance);
 - (7) section 318(1) (Exercise of powers through Council).
- B. The rule-making powers listed above are specified for the purpose of section 153(2) (Rule-making instruments) of the Act.

Commencement

- C. This instrument comes into force on 31 December 2006.

Amendments to the Handbook

- D. The Financial Services Authority creates the Prudential Sourcebook for Insurers (INSPRU) to form a new module within the Prudential Standards block of its Handbook of Rules and Guidance in accordance with the following provisions:
- (1) the provisions of the Integrated Prudential sourcebook (PRU) and the Lloyd's sourcebook (LLD) listed in column (2) of the Table in Annex A to this instrument are redesignated in accordance with the corresponding entry in column (1) of the Table in Annex A;
 - (2) the provisions in (1) are restated and amended so that they read as set out in Annex B to this instrument;
 - (3) the Financial Services Authority makes the rules and gives the guidance designated as "New text" in column (2) of the Table in Annex A; and
 - (4) all the above provisions are combined so that they appear in the appropriate numerical order.

Citation

- E. This instrument may be cited as the Prudential Sourcebook for Insurers Instrument 2006.

By order of the Board
25 October 2006

Annex A
Creation of INSPRU

- (1) The table referred to in paragraph D of this instrument is as follows.
- (2) Where a reference in the Table in this Annex A is to a chapter and section only, the whole of the section listed in column (2) is redesignated as set out in column (1). The module, chapter and section of each provision is redesignated as set out in column (1); otherwise the numbering of the paragraphs in the redesignated section remains the same, subject to the addition of those paragraphs identified in column (2) as "New text".

Table – Creation of INSPRU

INSPRU	Current designation in PRU or LLD
1.1	PRU 7.2
1.1.19AR to 1.1.19FG	New text
1.1.34AG	New text
1.1.54AG	New text
1.1.83AR	New text
1.1.84AG	New text
1.1.88AR	New text
1.1.92AR and 1.1.92BG	New text
1.1.93 R	LLD 24.3.1 R
1.1.94 R	LLD 24.3.2 R
1.1.95 R	LLD 24.3.5 R
1.1.96 R	LLD 24.3.6 R
1.2	PRU 7.3
1.2.28AG	New text
1.2.76AR	New text
1.2.92 R	LLD 24.4.1 R
1.2.93 R	LLD 24.4.2 R
1.3	PRU 7.4
1.4	PRU 7.5
1.4.49 R	LLD 24.5.1 R
1.4.50 R	LLD 24.5.2 R
1.4.51 R	LLD 24.5.3 R
1.5	PRU 7.6
1.5.13AR and 1.5.13BG	New text
1.5.58 R	LLD 24.6.1 R
1.5.59 R	LLD 24.6.2 R
1.5.60 R	LLD 24.6.3 R
1.6	New text
2.1	PRU 3.2
2.1.22AR	New text
2.1.42 R	LLD 20.3.1 R
2.1.43 R	LLD 20.3.2 R
2.1.44 G	LLD 20.3.3 G

2.1.45 R	LLD 20.3.4 R
2.1.46 R	LLD 20.3.5 R
2.1.47 R	LLD 20.3.6 R
2.1.48 R	LLD 20.3.7 R
2.1.49 R	LLD 20.3.8 R
2.2	PRU 3.3
2.2.17 R	LLD 20.4.1 R
2.2.18 G	LLD 20.4.2 G
3.1	PRU 4.2
3.1.29AG	New text
3.1.58AR	New text
3.1.61AR	New text
3.1.62 R	LLD 21.3.1 R
3.1.63 R	LLD 21.3.2 R
3.1.64 R	LLD 21.3.3 R
3.1.65 R	LLD 21.3.4 R
3.1.66 R	LLD 21.3.6 R
3.2	PRU 4.3
3.2.34 AG	New text
3.2.35 AG	New text
3.2.43 R	LLD 21.4.1 R
4.1.1 G	PRU 5.1.1 R
4.1.2 G	PRU 5.1.2 R
4.1.3 G	PRU 5.1.7 R
4.1.4 G	PRU 5.1.8 R
4.1.5 G	PRU 5.1.10 G
4.1.6 G	PRU 5.1.11 G
4.1.7 G	PRU 5.1.12 G
4.1.8 G	PRU 5.1.14 G
4.1.9 G	PRU 5.1.15 G
4.1.10 G	PRU 5.1.16 G
4.1.11 G	PRU 5.1.19 G
4.1.12 G	PRU 5.1.20 G
4.1.13 G	PRU 5.1.21 G
4.1.14 G	PRU 5.1.22 G
4.1.15 G	PRU 5.1.23 G

4.1.16 G	PRU 5.1.24 G
4.1.17 G	PRU 5.1.25 G
4.1.18 G	PRU 5.1.26 G
4.1.19 G	PRU 5.1.27 G
4.1.20 G	PRU 5.1.28 G
4.1.21 G	PRU 5.1.29 G
4.1.22 G	PRU 5.1.30 G
4.1.23 G	PRU 5.1.31 G
4.1.24 G	PRU 5.1.32 G
4.1.25 G	PRU 5.1.33 G
4.1.26 G	PRU 5.1.34 G
4.1.27 G	PRU 5.1.35 G
4.1.28 G	PRU 5.1.36 G
4.1.29 G	PRU 5.1.37 G
4.1.30 G	PRU 5.1.38 G
4.1.31 G	PRU 5.1.39 G
4.1.32 G	PRU 5.1.40 G
4.1.33 G	PRU 5.1.41 G
4.1.34 G	PRU 5.1.42 G
4.1.35 G	PRU 5.1.43 G
4.1.36 G	PRU 5.1.44 G
4.1.37 G	PRU 5.1.45 G
4.1.38 G	PRU 5.1.46 G
4.1.39 G	PRU 5.1.47 G
4.1.40 G	PRU 5.1.48 G
4.1.41 G	PRU 5.1.49 G
4.1.42 G	PRU 5.1.50 G
4.1.43 G	PRU 5.1.51 G
4.1.44 G	PRU 5.1.52 G
4.1.45 G	PRU 5.1.53 G
4.1.46 G	PRU 5.1.54 G
4.1.47 G	PRU 5.1.55 G
4.1.48 G	PRU 5.1.56 G
4.1.49 G	PRU 5.1.57 G
4.1.50 G	PRU 5.1.63 G
4.1.51 G	PRU 5.1.64 G
4.1.52 G	PRU 5.1.65 G

4.1.53 G	PRU 5.1.66 G
4.1.54 G	PRU 5.1.67 G
4.1.55 G	PRU 5.1.69 G
4.1.56 G	PRU 5.1.71 G
4.1.57 G	PRU 5.1.72 G
4.1.58 G	PRU 5.1.73 G
4.1.59 G	PRU 5.1.74 G
4.1.60 G	PRU 5.1.75 G
4.1.61 G	PRU 5.1.76 G
4.1.62 G	PRU 5.1.77 G
4.1.63 G	PRU 5.1.78 G
4.1.64 G	PRU 5.1.80 G
4.1.65 E	PRU 5.1.81 E
4.1.66 G	PRU 5.1.82 G
4.1.67 G	PRU 5.1.83 G
4.1.68 G	PRU 5.1.84 G
4.1.69 G	LLD 22.2.1 R
4.1.70 G	LLD 22.2.2 R
5.1.1 G	PRU 6.1.1 G
5.1.2 G	PRU 6.1.2 G
5.1.3 G	PRU 6.1.3 G
5.1.4 G	PRU 6.1.4 G
5.1.5 G	PRU 6.1.5 G
5.1.6 G	PRU 6.1.6 G
5.1.7 G	PRU 6.1.7 G
5.1.8 G	PRU 6.1.8 G
5.1.9 G	PRU 6.1.10 G
5.1.10 G	PRU 6.1.11 G
5.1.11 G	PRU 6.1.12 G
5.1.12 G	PRU 6.1.13 G
5.1.13 G	PRU 6.1.14 G
5.1.14 G	PRU 6.1.15 G
5.1.15 G	PRU 6.1.16 G
5.1.16 G	PRU 6.1.17 G
5.1.17 G	PRU 6.1.18 G
5.1.18 G	PRU 6.1.19 G

5.1.19 G	PRU 6.1.20 G
5.1.20 G	PRU 6.1.21 G
5.1.21 G	PRU 6.1.22 G
5.1.22 G	PRU 6.1.23 G
5.1.23 G	PRU 6.1.24 G
5.1.24 G	LLD 23.2.1 R
5.1.25 G	LLD 23.2.2 R
6.1	PRU 8.3
6.1.42AR	New text
6.1.70AR	New text
6.1.74AR	New text
7.1	PRU 2.3
7.1.57 R	LLD 19.4.1 R
7.1.58 R	LLD 19.4.2 R
7.1.59 G	LLD 19.4.5 G
7.1.60 R	LLD 19.4.6 R
7.1.61 R	LLD 19.4.7 R
7.1.62 R	LLD 19.4.8 R
7.1.63 G	LLD 19.4.9 G
7.1.64 G	LLD 19.4.11 G
7.1.65 G	LLD 19.4.12 G
7.1.66 G	LLD 19.4.13 G
7.1.67 G	LLD 19.4.14 G
7.1.68 R	LLD 19.4.15 R
7.1.69 R	LLD 19.4.16 R
7.1.70 R	LLD 19.4.17 R
7.1.71 G	LLD 19.4.18 G
7.1.72 G	LLD 19.4.19 G
7.1.73 G	LLD 19.4.21 G
7.1.74 R	LLD 19.4.23 R
7.1.75 R	LLD 19.4.24 R
7 Annex 1 G	PRU 2 Annex 3
8.1.1 R	LLD 16.2.1 R
8.1.2 R	LLD 16.3.1 R

8.1.3 G	LLD 16.3.2 G
8.1.4 R	LLD 16.3.3 R
8.1.5 G	LLD 16.3.4 G
8.1.6 G	LLD 16.3.5 G
8.1.7 G	LLD 16.3.6 G
8.1.8 G	LLD 16.4.1 G
8.2.1 R	LLD 17.2.1 R
8.2.2 R	LLD 17.3.1 R
8.2.3 R	LLD 17.4.1 R
8.2.4 R	LLD 17.4.3 R
8.2.5 R	LLD 17.4.4 R
8.2.6 R	LLD 17.4.6 R
8.2.7 G	LLD 17.4.12 G
8.2.8 R	LLD 17.4.7 R
8.2.9 R	LLD 17.4.8 R
8.2.10 G	LLD 17.4.9 G
8.2.11 R	LLD 17.4.13 R
8.2.12 R	LLD 17.4.14 R
8.2.13 R	LLD 17.4.15 R
8.2.14 G	LLD 17.5.1 G
8.2.15 G	LLD 17.5.2 G
8.2.16 R	LLD 17.5.3 R
8.2.17 R	LLD 17.6.1 R
8.2.18 R	LLD 17.6.2 R
8.2.19 R	LLD 17.7.1 R
8.2.20 R	LLD 17.7.2 R
8.2.21 R	LLD 17.7.3 R
8.2.22 R	LLD 17.7.4 R
8.2.23 R	LLD 17.8.1 R
8.2.24 R	LLD 17.8.2 R
8.2.25 R	LLD 17.8.3 R
8.2.26 R	LLD 17.8.4 R
8.2.27 G	LLD 17.8.5 G
8.2.28 R	LLD 17.8.6 R

8.2.29 G	LLD 17.8.7 G
8.3.1 R	LLD 3.1.1 R
8.3.2 G	LLD 3.1.3 G
8.3.3 D	LLD 3.1.4 D
8.3.4 D	LLD 3.1.5 D
8.3.5 G	LLD 3.2.1 G
8.3.6 G	LLD 3.2.2 G
8.3.7 D	LLD 3.2.3 D
8.4.1 R	LLD 4.1.1 R
8.4.2 G	LLD 4.1.3 G
8.4.3 R	LLD 4.2.1 R
8.4.4 G	LLD 4.2.2 G
8.4.5 G	LLD 4.2.3 G
8.4.6 G	LLD 4.2.5 G
8.4.7 G	LLD 4.2.7 G
8.5.1 R	LLD 5.1.1 R
8.5.2 G	LLD 5.1.3 G
8.5.3 R	LLD 5.2.1 R
8.5.4 R	LLD 5.2.2 R
8.6.1 R	LLD 18.4.1 R
8.6.2 R	LLD 18.4.2 R
8.6.3 R	LLD 20.2.1 R
8.6.5 R	LLD 20.2.2 R
8.6.3 R	LLD 21.2.1 R
8.6.5 R	LLD 21.2.2 R
8.6.3 R	LLD 22.2.1 R
8.6.5 R	LLD 22.2.2 R
8.6.4 R	LLD 24.2.1 R
9.1	PRU 1.8
TP 1	PRU TR 5
TP 2	PRU TR Table 10R
TP 3	New text
TP 4	New text
TP 5	New text

Annex B

Text of INSPRU

In this Annex, new text is not underlined and text that is deleted is not shown.

1.1 Capital resources requirements and technical provisions for insurance business

Application

- 1.1.1 R *INSPRU* 1.1 applies to an *insurer* unless it is:
- (1) a *non-directive friendly society*; or
 - (2) an *incoming EEA firm*; or
 - (3) an *incoming Treaty firm*.
- 1.1.2 R
- (1) This section applies to a *firm* in relation to the whole of its business, except where a particular provision provides for a narrower scope.
 - (2) Where a *firm* carries on both *long-term insurance business* and *general insurance business*, this section applies separately to each type of business.
- 1.1.3 R For a *non-EEA insurer* with a *branch* in the *United Kingdom* whose *insurance business* in the *United Kingdom* is not restricted to *reinsurance* (other than an *EEA-deposit insurer*, a *Swiss general insurer* or a *UK-deposit insurer*):
- (1) the part of this section headed "Capital requirements for insurers" (*INSPRU* 1.1.43G to *INSPRU* 1.1.92BG) applies to its world-wide activities;
 - (2) the parts of this section headed:
 - (a) "Establishing technical provisions" (*INSPRU* 1.1.12R to *INSPRU* 1.1.19G);
 - (b) "Reinsurance and analogous non-reinsurance financing agreements: risk transfer principle" (*INSPRU* 1.1.19AR to *INSPRU* 1.1.19FG);
 - (c) "Assets of a value sufficient to cover technical provisions and other liabilities" (*INSPRU* 1.1.20R to *INSPRU* 1.1.29G);
 - (d) "Matching of assets and liabilities" (*INSPRU* 1.1.34R to *INSPRU* 1.1.40G); and
 - (e) "Premiums for new business" (*INSPRU* 1.1.41R to *INSPRU* 1.1.42G);apply separately in respect of its world-wide activities and its activities carried on from a *branch* in the *United Kingdom*; and
 - (3) the part of this section headed "Localisation" (*INSPRU* 1.1.30R to *INSPRU* 1.1.33R) does not apply (see *INSPRU* 1.5 (Internal contagion risk)).

- 1.1.4 R For an *EEA-deposit insurer* or a *Swiss general insurer*:
- (1) the parts of this section headed:
 - (a) "Establishing technical provisions" (*INSPRU 1.1.12R to INSPRU 1.1.19G*);
 - (b) "Reinsurance and analogous non-reinsurance financing agreements: risk transfer principle" (*INSPRU 1.1.19AR to INSPRU 1.1.19FG*);
 - (c) "Assets of a value sufficient to cover technical provisions and other liabilities" (*INSPRU 1.1.20R to INSPRU 1.1.29G*);
 - (d) "Matching of assets and liabilities" (*INSPRU 1.1.34R to INSPRU 1.1.40G*); and
 - (e) "Premiums for new business" (*INSPRU 1.1.41R to INSPRU 1.1.42G*);

apply in respect of the activities of the *firm* carried on from a *branch* in the *United Kingdom*; and
 - (2) the parts of this section headed "Capital requirements for insurers" (*INSPRU 1.1.43G to INSPRU 1.1.92BG*) and "Localisation" (*INSPRU 1.1.30R to INSPRU 1.1.33R*) do not apply.

- 1.1.5 R For a *UK-deposit insurer*:
- (1) the part of this section headed "Capital requirements for insurers" (*INSPRU 1.1.43G to INSPRU 1.1.92BG*) applies to its world-wide activities;
 - (2) the parts of this section headed:
 - (a) "Establishing technical provisions" (*INSPRU 1.1.12R to INSPRU 1.1.19G*);
 - (b) "Reinsurance and analogous non-reinsurance financing agreements: risk transfer principle" (*INSPRU 1.1.19AR to INSPRU 1.1.19FG*);
 - (c) "Assets of a value sufficient to cover technical provisions and other liabilities" (*INSPRU 1.1.20R to INSPRU 1.1.29G*);
 - (d) "Matching of assets and liabilities" (*INSPRU 1.1.34R to INSPRU 1.1.40G*); and
 - (e) "Premiums for new business" (*INSPRU 1.1.41R to INSPRU 1.1.42G*);

apply separately in respect of its world-wide activities and its

activities carried on from *branches* in *EEA States*; and

(3) the part of this section headed "Localisation" (*INSPRU* 1.1.30R to *INSPRU* 1.1.33R) does not apply (see *INSPRU* 1.5 (Internal contagion risk)).

1.1.6 G This section may apply in cases where a *firm* has its head office in another *EEA State* but is neither an *incoming EEA firm* nor an *incoming Treaty firm*; this could arise in the case of a *non-directive mutual*.

Purpose

1.1.7 G *INSPRU* 1.1 has the aim of reducing the risk that a *firm* may fail to meet its liabilities to its *policyholders* as a result of insurance risk, that is, the risk that arises from the inherent uncertainties as to the occurrence, amount and timing of insurance liabilities.

1.1.8 G This section requires that the *technical provisions* that *firms* establish are adequate to meet their liabilities to *policyholders* under *contracts of insurance*. It also requires that *firms* hold assets of a value sufficient to cover their liabilities, including *technical provisions*, and that there is suitable matching of assets and liabilities. *Technical provisions* are the on-balance sheet provisions made by a *firm* in respect of liabilities arising under or in connection with *contracts of insurance*. There are different *rules* and *guidance* applicable to the calculation of *technical provisions* for *general insurance business* and for *long-term insurance business*.

1.1.9 G This section implements requirements of the *Insurance Directives* for both *general insurance business* and *long-term insurance business* with regard to the *technical provisions*. The relevant articles of the Directives include:
(1) article 15 of the *First Non-Life Directive*, as substituted by article 17 of the *Third Non-Life Directive*; and
(2) article 20 of the *Consolidated Life Directive* (this Directive consolidates the provisions of the previous *First, Second* and *Third Life Directives*).

1.1.10 G This section also sets out detailed *rules* and *guidance* on the calculation of the following elements of a *firm's capital resources requirement (CRR)* (see *GENPRU* 2.1):

- (1) the *general insurance capital requirement*; and
- (2) the *long-term insurance capital requirement*.

1.1.11 G These requirements are dealt with in the part of this section headed "Capital requirements for insurers" (see *INSPRU* 1.1.43G to *INSPRU* 1.1.91R). That part of this section also contains *rules* about the calculation of the *insurance-related capital requirement*, which forms part of the *enhanced capital requirement* for *firms* carrying on *general insurance business*. The *asset-related capital requirement* for *firms* carrying on *general insurance business* is set out in *INSPRU* 2.2.

Establishing technical provisions

- 1.1.12 R For *general insurance business*, a *firm* must establish adequate technical provisions:
- (1) in accordance with the *rules* in *INSPRU* 1.4 for *equalisation provisions*; and
 - (2) otherwise, in accordance with *GENPRU* 1.3.4R.
- 1.1.13 G For *general insurance business*, the *technical provisions* include outstanding *claims provisions*, *unearned premiums provisions*, unexpired risk provisions and *equalisation provisions*. These provisions take into account the expected ultimate cost of *claims*, including those not yet incurred, related expenses and include an allowance for smoothing *claims* (the *equalisation provision*).
- 1.1.14 G *Discounting* (that is discounting for the time value of money) *general insurance business technical provisions* may be carried out only in limited circumstances and on a prudent basis (see *GENPRU* 2.2.107R and paragraph 48 of the *insurance accounts rules*). The fact that the expected liabilities are generally not *discounted* helps to protect against risk from inherent uncertainty in the timing, but not necessarily the amount, of *claims*.
- 1.1.15 G For some categories of *general insurance business*, *equalisation provisions* are required. These ensure that a *firm* retains additional assets to provide some extra protection against uncertainty as to the amount of *claims*. *Equalisation provisions* are particularly suitable for volatile business, where *claims* in any future year may be subject to significant adverse deviation from recent or average expected *claims* experience, or where trends in *claims* experience may be subject to change. Such volatile *claims* experience arises in a number of types of business, for example, property, marine and aviation, nuclear, certain *non-proportional reinsurance treaty* business, and credit insurance. The *equalisation provisions* help to equalise fluctuations in loss ratios in future years (see *INSPRU* 1.4 (*Equalisation provisions*)).
- 1.1.16 R For *long-term insurance business*, a *firm* must establish adequate technical provisions in respect of its *long-term insurance contracts* as follows:
- (1) *mathematical reserves* in accordance with the *rules* and *guidance* in *INSPRU* 1.2 relating to such reserves, and with due regard to generally accepted actuarial practice; and
 - (2) for liabilities in respect of such contracts that have fallen due, in accordance with *GENPRU* 1.3.4R.
- 1.1.17 G *Rules* and *guidance* for calculating *mathematical reserves* are set out in *INSPRU* 1.2. *Firms* are advised by the *actuarial function* (see SUP 4) on the methods and assumptions to be used in calculating the *mathematical reserves*. The standards and guidance issued by the Board for Actuarial Standards to assist actuaries appointed to the *actuarial function* are important sources of evidence as to generally accepted actuarial practice, as

referred to in *INSPRU* 1.1.16R(1).

- 1.1.18 G For *long-term insurance business*, the *technical provisions* include the *mathematical reserves*. These are actuarial estimates of a *firm's* liabilities in respect of future benefits due to *policyholders*, including bonuses already declared. The *mathematical reserves* may be reduced by the actuarial value of that component of future *premiums* attributable to meeting future liabilities (see *INSPRU* 1.2 (*Mathematical reserves*)).
- 1.1.19 G For *long-term insurance business*, the *mathematical reserves* are typically valued on a discounted basis but include valuation margins intended to provide protection against adverse deviations in experience (see *INSPRU* 1.2).

Reinsurance and analogous non-reinsurance financing agreements: risk transfer principle

- 1.1.19A R (1) A *firm* may only take credit for *reinsurance* if and to the extent that there has been an effective transfer of risk from the *firm* to a third party.
- (2) In *INSPRU* 1.1.19AR to *INSPRU* 1.1.19FG, references to *reinsurance* and contracts of *reinsurance* include:
- (a) all contracts of *reinsurance* with an *ISPV*; and
- (b) analogous non-*reinsurance* financing agreements.
- 1.1.19B R For the purposes of *INSPRU* 1.1.19AR(2)(b), analogous non-*reinsurance* financing agreements include contingent loans, securitisations and any other arrangements in respect of *contracts of insurance* that are analogous to contracts of *reinsurance* in terms of the risks transferred and the finance provided.
- 1.1.19C G There are a number of ways in which a *firm* may be able to take credit for *reinsurance* under the *rules* in *GENPRU* and *INSPRU*. Examples include:
- (1) treating the *reinsurer's* share of *technical provisions* as an *admissible asset* in accordance with *GENPRU* 2 Ann 7R;
- (2) reducing its solvency requirements in accordance with the deduction for *reinsurance* allowed in the calculation of the *general insurance capital requirement* or the *long-term insurance capital requirement* under *INSPRU* 1.1; and

- (3) bringing into account amounts receivable under the contract when valuing cash flows for the purpose of a prospective valuation of *mathematical reserves* under *INSPRU* 1.2. In particular, a contingent loan or other analogous non-*reinsurance* financing agreement may then give rise to an addition to *capital resources* as a positive valuation difference in accordance with *GENPRU* 2.2.105R.

1.1.19D G The amount of credit taken by a *firm* for a risk transferred should be measured by applying the standard methods for determining the regulatory balance sheet set out in *INSPRU*. For example, where credit is being taken so as to reduce *technical provisions*, the amount of that credit should reflect the difference in *technical provisions* that arises from changing the assumptions used to reflect the risk transferred.

1.1.19E G For the purposes of *INSPRU* 1.1.19AR(1), the transfer of risk from the *firm* to the third party should be effective in all circumstances in which the *firm* may wish to rely upon the transfer. Examples of factors which the *firm* should take into account in assessing whether the transaction effectively transfers risk and the extent of that transfer include:

- (1) whether the documentation associated with the *reinsurance* reflects the economic substance of the transaction;
- (2) whether the extent of the risk transfer is clearly defined and incontrovertible;
- (3) whether the transaction contains any terms or conditions the fulfilment of which is outside the direct control of the *firm*. Such terms or conditions may include those which:
 - (a) would allow the third party unilaterally to cancel the transaction, except for the non-payment of monies due from the *firm* to the third party under the contract; or
 - (b) would increase the effective cost of the transaction to the *firm* in response to an increased likelihood of the third party experiencing losses under the transaction; or
 - (c) would oblige the *firm* to alter the risk that had been transferred with the purpose of reducing the likelihood of the third party experiencing losses under the transaction; or
 - (d) would allow for the termination of the transaction due to an increased likelihood of the third party experiencing losses under the transaction; or
 - (e) could prevent the third party from being obliged to pay out in a timely manner any monies due under the transaction; or

- (f) could allow the maturity of the transaction to be reduced;
- (4) whether the transaction is legally effective and enforceable in all relevant jurisdictions.
- 1.1.19F G A *firm* should also take into account circumstances in which the benefit to the *firm* of the transfer of risk could be undermined. For instance, where the *firm*, with a view to reducing potential or actual losses to third parties, provides support to the transaction, including support beyond its contractual obligations (implicit support). Another example of a situation where the *firm* should consider whether it should take reduced credit for a transaction is where it has invested in the bonds issued by an *ISPV* with which it has reinsured risks.
- Assets of a value sufficient to cover technical provisions and other liabilities
- 1.1.20 R A *firm* which is not a *composite firm* must hold *admissible assets* of a value at least equal to the amount of:
- (1) the *technical provisions* that it is required to establish under *INSPRU* 1.1.12R or *INSPRU* 1.1.16R; and
- (2) its other *general insurance liabilities* or *long-term insurance liabilities*; but excluding *property-linked liabilities* and *index-linked liabilities* and the assets held to cover them under *INSPRU* 3.1.57R and *INSPRU* 3.1.58R.
- 1.1.21 R A *composite firm* must ensure that:
- (1) it holds *admissible assets* separately identified in accordance with *INSPRU* 1.5.18R of a value at least equal to the amount of:
- (a) the *technical provisions* that it is required to establish under *INSPRU* 1.1.16R; and
- (b) its other *long-term insurance liabilities*;
- but excluding *property-linked liabilities* and *index-linked liabilities* and the assets held to cover them under *INSPRU* 3.1.57R and *INSPRU* 3.1.58R; and
- (2) it holds other *admissible assets* (other than those excluded under (1)) of a value at least equal to the amount of:
- (a) the *technical provisions* that it is required to establish under *INSPRU* 1.1.12R; and
- (b) its other *general insurance liabilities*.
- 1.1.22 G *INSPRU* 1.5 (Internal-contagion risk) sets out the *rules* and *guidance* on identifying and holding in a separate fund *long-term insurance assets*.
- 1.1.23 G When valuing assets for the purposes of *INSPRU* 1.1.20R and *INSPRU* 1.1.21R, a *firm* should bear in mind:
- (1) that the *technical provisions* and other *long-term insurance liabilities* or *general insurance liabilities* should be covered by *admissible assets* (see

GENPRU 2 Annex 7R); and

(2) the market and *counterparty* limits set out in *INSPRU 2.1* (Credit risk in insurance). *INSPRU 2.1* requires that a *firm* restrict to prudent levels its exposure to *reinsurer* and other *counterparties*, and, in particular, that for the purpose of its balance sheet, a *firm* must not take into account any exposure which exceeds the large exposure limits.

- 1.1.24 G *Rules and guidance* on the valuation of assets are set out in *GENPRU 1.3* (Valuation), including the treatment of *shares* in, and debts due from, *related undertakings* in *GENPRU 1.3.43R* to *GENPRU 1.3.54G*. *INSPRU 3.1* (Market risk in insurance) addresses *market risk* and sets out the matching requirements for linked assets and liabilities. *INSPRU 3.1* also sets out *rules and guidance* on the matching by currency of assets and liabilities, to reduce a *firm's* exposure to currency *market risk*.
- 1.1.25 R For the purpose of determining the value of assets available to meet *technical provisions* and other *long-term insurance liabilities* in accordance with *INSPRU 1.1.20R*, *INSPRU 1.1.21R*, *INSPRU 1.1.27R* and *INSPRU 1.1.28R*, no value is to be attributed to:
- (1) debts owed by *reinsurers*; or
 - (2) *claims*; or
 - (3) tax recoveries; or
 - (4) claims against *compensation funds*;
- to the extent already offset in the calculation of *technical provisions*.
- 1.1.26 G Certain debts and claims are excluded from *INSPRU 1.1.20R*, *INSPRU 1.1.21R*, *INSPRU 1.1.27R* and *INSPRU 1.1.28R* to avoid double-counting. The *rules and guidance* in *INSPRU 1.2* (*Mathematical reserves*) set out how a *firm* may offset debts and *claims* against liabilities in calculating the *mathematical reserves* required for *long-term insurance business*.
- 1.1.27 R A *firm* carrying on *long-term insurance business* must ensure that it has *admissible assets* in each of its *with-profits funds* of a value sufficient to cover:
- (1) the *technical provisions* in respect of all the business written in that *with-profits fund*; and
 - (2) its other *long-term insurance liabilities* in respect of that *with-profits fund*.
- 1.1.28 R In addition to complying with *INSPRU 1.1.27R*, a *realistic basis life firm* must also ensure that the *realistic value of assets* for each of its *with-profits funds* is at least equal to the *realistic value of liabilities* of that fund.
- 1.1.29 G *INSPRU 1.1.27R* and *INSPRU 1.1.28R* support the funding of *policyholder* benefits by requiring *firms* to maintain *admissible assets* in *with-profits funds* to cover the *technical provisions* and other *long-term insurance liabilities* relating to all the business in that fund and, in the case of a

realistic basis life firm, realistic assets to cover the realistic liabilities of the *with-profits insurance contracts* written in the fund.

Localisation (UK firms only)

- 1.1.30 R (1) Subject to (2), a *UK firm* must hold *admissible assets* held pursuant to *INSPRU 3.1.53R*:
- (a) (where the *admissible assets* cover *technical provisions* in pounds sterling), in any *EEA State*; and
- (b) (where the *admissible assets* cover *technical provisions* in any currency other than pounds sterling), in any *EEA State* or in the country of that currency.
- (2) In the case of a *community co-insurance operation* and a *relevant insurer*, the *admissible assets* covering *technical provisions* must be held in any *EEA State*.
- 1.1.31 G *INSPRU 1.5* (Internal contagion risk) sets out the *rules* and *guidance* on localisation for *firms* other than *UK firms*.
- 1.1.32 R *INSPRU 1.1.30R* does not apply to:
- (1) a *pure reinsurer*; or
- (2) debts owed by *reinsurers*; or
- (3) *insurance business* carried on by a *UK firm* outside the *EEA States*; or
- (4) *general insurance business class groups 3 and 4* in *IPRU(INS)*, Annex 11.2, Part II.
- 1.1.33 R For the purposes of *INSPRU 1.1.30R*:
- (1) a tangible asset is to be treated as held in the country or territory where it is situated;
- (2) an *admissible asset* consisting of a claim against a debtor is to be treated as held in any country or territory where it can be enforced by legal action;
- (3) a *listed security* is to be treated as held in any country or territory where there is a *regulated market* on which the *security* is dealt; and
- (4) a *security* which is not a *listed security* is to be treated as held in the country or territory in which the *issuer* has its head office.

Matching of assets and liabilities

- 1.1.34 R (1) Subject to (4), the assets held by a *firm* to cover its *technical provisions* and other *long-term insurance liabilities* or *general insurance liabilities* (see *INSPRU 1.1.20R* and *INSPRU 1.1.21R*) must:
- (a) have characteristics of safety, yield and marketability which are appropriate to the type of business carried on by the *firm*;
- (b) be diversified and adequately spread; and

(c) comply with (2).

(2) The assets referred to in (1) must, in addition to meeting the criteria set out in (1)(a) and (b), be of a sufficient amount, and of an appropriate currency and term, to ensure that the cash inflows from those assets will meet the expected cash outflows from the *firm's* insurance liabilities as they become due.

(3) For the purpose of (2), a *firm* must take into consideration in determining expected cash outflows any options which exist in the *firm's contracts of insurance*.

(4) (1) does not apply to:

(a) a *pure reinsurer*; or

(b) assets held to cover *index-linked liabilities* or *property-linked liabilities*, except that where the *linked long-term contract of insurance* in question includes a guarantee of investment performance or some other guaranteed benefit, (1) will nevertheless apply to assets held to cover that guaranteed element.

- 1.1.34A G *INSPRU* 1.1.34R is not applied to *pure reinsurers* because they are subject under *INSPRU* 3.1.61AR to the "prudent person" investment principles from the *Reinsurance Directive*.
- 1.1.35 G A *firm* should take account of the amount, currency and timing of its expected cash outflows in determining whether the assets it holds to cover its *technical provisions* and other *long-term insurance liabilities* or *general insurance liabilities* meet the requirements of *INSPRU* 1.1.34R(2).
- 1.1.36 G For the purpose of *INSPRU* 1.1.34R(2), the relevant cash inflows are those which the *firm* reasonably expects to receive from the *admissible assets* which it holds to cover its *technical provisions* and other *long-term insurance liabilities* or *general insurance liabilities*. A *firm* may receive cash inflows as a result of:
- (1) selling assets or closing out transactions;
 - (2) holding assets that generate dividends, interest or other income; and
 - (3) receiving future *premiums* for existing business.
- 1.1.37 G Anticipated cash inflows from future new business should not be included, for example where the *customer* has not yet contracted to pay the *premium*, and where the associated liabilities and potential cash outflows should also not be included.
- 1.1.38 G A *firm* should compare cash inflows and outflows based on current expectations of amounts and timings. Current market expectations of future asset values, interest rates and currency exchange rates should be used. Where inflows are received in a currency different from that in which outflows are to be paid, account should be taken of the cost of converting the currency received.

- 1.1.39 G In considering the value and suitability of assets required to ensure that the *firm's* liabilities are met as they become due, a *firm* should take account of the risk of default on inflows from those assets, and other risks that may mean that future inflows are reduced relative to outflows.
- 1.1.40 G *INSPRU* 1.1.20R lays down a general requirement for a *firm* that carries on *long-term insurance business* to hold *admissible assets* that are of a value sufficient to cover its *technical provisions* and other *long-term insurance liabilities*. The *INSPRU* 1.1.34R(2) requirement to match liabilities with assets that allow cash outflows to be met with suitable inflows as the outflows become due may mean that a *firm* has to hold assets of a value greater than would otherwise be required by the general *rule* in *INSPRU* 1.1.20R.

Premiums for new business

- 1.1.41 R A *firm* must not enter into a *long-term insurance contract* unless it is satisfied on reasonable actuarial assumptions that:
- (1) the *premiums* receivable and the investment income expected to be earned from those *premiums*; and
 - (2) the *reinsurance* arrangements made in respect of the risk or risks covered by that new contract are sufficient to enable it, when taken together with the *firm's* other resources, to:
 - (a) establish adequate *technical provisions* as required by *INSPRU* 1.1.16R;
 - (b) hold *admissible assets* of a value at least equal to the amount of the *technical provisions* and other *long-term insurance liabilities* as required by *INSPRU* 1.1.20R to *INSPRU* 1.1.28R; and
 - (c) maintain adequate overall financial resources as required by the *overall financial adequacy rule* .
- 1.1.42 G For the purposes of *INSPRU* 1.1.41R, the adequacy of *premiums* may be assessed in the context of a *firm's* total portfolio of business and its other resources. It thus does not prevent a *firm* writing loss leaders nor writing contracts which might incur large losses, but only if the *firm* can meet the losses that might reasonably arise, including those that would arise from an event specifically insured against.

Capital requirements for insurers

- 1.1.43 G (1) *GENPRU* 2.1.13R requires a *firm* to maintain *capital resources* equal to or in excess of its *capital resources requirement (CRR)*. *GENPRU* 2.1 sets out the overall framework of the *CRR*; in particular, *GENPRU* 2.1.17R requires that for a *firm* carrying on *general insurance business* the *CRR* is equal to the *minimum capital requirement (MCR)*. *GENPRU* 2.1.18R requires that for *realistic basis life firms* the *CRR* is the higher of the *MCR* and the *ECR*. *GENPRU* 2.1.23R requires that for *regulatory basis only life firms* the *CRR* is equal to the *MCR*.
- (2) For non-life *firms* the *MCR* represents the *minimum capital requirement*

(or margin of solvency) prescribed by the *Insurance Directives*. GENPRU 2.1.24R provides that, for a *firm* carrying on *general insurance business*, the *MCR* in respect of that business is the higher of the *base capital resources requirement* for *general insurance business* applicable to that *firm* and the *general insurance capital requirement*. GENPRU 2.1.25R provides that, for a *firm* carrying on *long-term insurance business*, the *MCR* in respect of that business is the higher of the *base capital resources requirement* for *long-term insurance business* applicable to that *firm* and the sum of the *long-term insurance capital requirement* and the *resilience capital requirement*. As specified in GENPRU 2.1.14R, a *firm* carrying on both *general insurance business* and *long-term insurance business* must apply GENPRU 2.1.13R (referred to in paragraph (1) above) separately to its *general insurance business* and its *long-term insurance business*.

(3) The calculation of the *general insurance capital requirement* is set out in INSPRU 1.1.44G to INSPRU 1.1.72R below. INSPRU 1.1.73G to INSPRU 1.1.79R set out the calculation of the *insurance-related capital requirement* for non-life *firms*. The calculation of the *long-term insurance capital requirement* is set out in INSPRU 1.1.80G to INSPRU 1.1.91R below.

General insurance capital requirement

- 1.1.44 G In relation to the *MCR* (see INSPRU 1.1.43G), GENPRU 2.1.34R requires a *firm* to calculate its *general insurance capital requirement (GICR)* as the highest of the *premiums amount*, the *claims amount*, and the *brought forward amount*. The elements for this computation are set out in INSPRU 1.1 as follows:
- (1) the *premiums amount* in INSPRU 1.1.45R;
 - (2) the *claims amount* in INSPRU 1.1.47R; and
 - (3) the *brought forward amount* in INSPRU 1.1.51R.

The premiums amount

- 1.1.45 R The *premiums amount* is:
- (1) 18% of the *gross adjusted premiums amount*; less 2% of the amount, if any, by which the *gross adjusted premiums amount* exceeds €53.1 million; multiplied by
 - (2) the reinsurance ratio set out in INSPRU 1.1.54R.

- 1.1.46 G *Rules and guidance* as to how the *gross adjusted premiums amount* is to be calculated are set out in INSPRU 1.1.56R to INSPRU 1.1.59G.

The claims amount

- 1.1.47 R The *claims amount* is:
- (1) 26% of the *gross adjusted claims amount*; less 3% of the amount, if any, by which the *gross adjusted claims amount* exceeds €37.2 million; multiplied by

(2) the reinsurance ratio set out in *INSPRU* 1.1.54R.

- 1.1.48 G *Rules and guidance* as to how the *gross adjusted claims amount* is to be calculated are set out in *INSPRU* 1.1.60R to *INSPRU* 1.1.65G.
- 1.1.49 G (1) Under the *Insurance Directives* the Euro amounts specified in *INSPRU* 1.1.45R(1) and *INSPRU* 1.1.47R(1) are subject to annual review. The relevant amounts will be increased by the percentage change in the European index of consumer prices (comprising all EU member states, as published by Eurostat) from 20 March 2002, to the relevant review date, rounded up to a multiple of €100,000, provided that where the percentage change since the last increase is less than 5%, no increase will take place.
- (2) No provision for the index-linking of these amounts is made by the *Reinsurance Directive*. However, to ensure consistency as between *pure reinsurers*, *mixed insurers* and other *insurers*, the *FSA* intends to amend the Euro amounts specified in *INSPRU* 1.1.45R(1) and *INSPRU* 1.1.47R(1) for all such *firms* when an index-linked increase is required by the *Insurance Directives*.
- 1.1.50 R For the purposes of *INSPRU* 1.1.45R(1) and *INSPRU* 1.1.47R(1), the exchange rate from the Euro to the pound sterling for each year beginning on 31 December is the rate applicable on the last day of the preceding October for which the exchange rates for the currencies of all the European Union member states were published in the Official Journal of the European Union.
- The brought forward amount
- 1.1.51 R The *brought forward amount* is the *general insurance capital requirement (GICR)* for the prior *financial year*, multiplied, if the ratio is less than one, by the ratio (expressed as a percentage) of:
- (1) the *technical provisions* (calculated net of *reinsurance*) for *claims* outstanding at the end of the prior *financial year*, determined in accordance with *INSPRU* 1.1.12R; to
- (2) the *technical provisions* (calculated net of *reinsurance*) for *claims* outstanding at the beginning of the prior *financial year*, determined in accordance with *INSPRU* 1.1.12R.
- 1.1.52 G The *brought forward amount* is the same as the *GICR* for the prior *financial year*, except where *claims* outstanding have fallen during that *financial year*. If they have fallen, the *brought forward amount* is itself reduced by the same percentage fall.
- 1.1.53 G If the *GICR* for the prior *financial year* is less than the *premiums amount* or the *claims amount*, then a *brought forward amount* is not required to be calculated.

Reinsurance ratio used in calculating the premiums amount and the claims

- amount
- 1.1.54 R The reinsurance ratio referred to in *INSPRU* 1.1.45R(2) and *INSPRU* 1.1.47R(2) is:
- (1) if the ratio lies between 50% and 100%, the ratio (expressed as a percentage) of:
- (a) the *claims* incurred (net of *reinsurance*) in the *financial year in question* and the two previous *financial years*; to
- (b) the gross *claims* incurred in that three-year period;
- (2) 50%, if the ratio calculated in (a) and (b) of (1) is 50% or less; and
- (3) 100%, if the ratio calculated in (a) and (b) of (1) is 100% or more.
- 1.1.54A G For the treatment of amounts recoverable from *ISPVs* when calculating the reinsurance ratio, see *INSPRU* 1.1.92AR and *INSPRU* 1.1.92BG.
- 1.1.55 G *Rules and guidance* as to how the net and gross *claims* are to be calculated are set out in *INSPRU* 1.1.66R to *INSPRU* 1.1.71R.
- Gross adjusted premiums amount used in calculating the premiums amount
- 1.1.56 R For the purpose of *INSPRU* 1.1.45R, the *gross adjusted premiums amount* is the higher of the *gross written premiums* and *gross earned premiums* (as adjusted in accordance with *INSPRU* 1.1.66R) for the *financial year in question*, adjusted by:
- (1) except for a *pure reinsurer* which became a *firm in run-off* before 31 December 2006 and whose *Part IV permission* has not subsequently been varied to add back the *regulated activity* of *effecting contracts of insurance*, increasing by 50% the amount included in respect of the *premiums* for *general insurance business classes* 11, 12 and 13;
- (2) deducting 66.7% of the *premiums* for *actuarial health insurance* that meets the conditions set out in *INSPRU* 1.1.72R; and
- (3) multiplying the resulting figure by 12 and dividing by the number of months in the *financial year*. For the purposes of this calculation, the number of months in the *financial year* is the number of complete calendar months in the *financial year* plus any fractions of a month at the beginning and the end of the *financial year*.
- 1.1.57 G A *firm* may use statistical methods in order to allocate *premiums* in respect of the *classes* 11, 12 and 13 for the purposes of *INSPRU* 1.1.56R.
- 1.1.58 G *General insurance business classes* 11, 12 and 13 are, respectively, the marine liability, aviation liability and general liability insurance classes.
- 1.1.59 G Where the *firm* did not carry on *insurance business* in the *financial year in question*, the *gross adjusted premiums amount*, and therefore the *premiums amount*, is nil.

- Gross adjusted claims amount used in calculating the claims amount
- 1.1.60 R For the purpose of *INSPRU* 1.1.47R and subject to *INSPRU* 1.1.62R, the *gross adjusted claims amount* is the amount of gross *claims* incurred (as determined in accordance with *INSPRU* 1.1.66R) over the reference period (as specified in *INSPRU* 1.1.63R) and adjusted by:
- (1) except for a *pure reinsurer* which became a *firm in run-off* before 31 December 2006 and whose *Part IV permission* has not subsequently been varied to add back the *regulated activity of effecting contracts of insurance*, increasing by 50% the amount included in respect of the *claims* incurred for *general insurance business classes* 11, 12 and 13;
- (2) deducting 66.7% of the *claims* for *actuarial health insurance* that meets the conditions set out in *INSPRU* 1.1.72R; and
- (3) multiplying the resulting figure by 12 and dividing by the number of months in the reference period. For the purposes of this calculation, the number of months in the reference period is the number of complete calendar months in the reference period plus any fractions of a month at the beginning and the end of the reference period.
- 1.1.61 G A *firm* may use statistical methods in order to allocate *claims* in respect of *classes* 11, 12 and 13 for the purposes of *INSPRU* 1.1.60R.
- 1.1.62 R For the purposes of *INSPRU* 1.1.47R, in relation to *general insurance business class* 18, the amount of *claims* incurred used to calculate the *gross adjusted claims amount* must be the amount of costs recorded in the *firm's* books in the reference period as borne by the *firm* (whether or not borne in the reference period) in respect of the assistance given.
- 1.1.63 R (1) Except in those cases where paragraph (2) applies, the reference period to be used in *INSPRU* 1.1.60R and *INSPRU* 1.1.62R must be:
- (a) the *financial year in question* and the two previous *financial years*; or
- (b) the period the *firm* had been in existence at the end of the *financial year in question*, if shorter.
- (2) In the case of a *firm* which underwrites only one or more of the *general insurance business* risks of credit, storm, hail or frost (including other business written in connection with such risks), the reference period to be used must be:
- (a) the *financial year in question* and the six previous *financial years*; or
- (b) the period the *firm* had been in existence at the end of the *financial year in question*, if shorter.
- 1.1.64 G The classification of the risks referred to in *INSPRU* 1.1.63R(2) is as follows: credit - as included in *general insurance business class* 14; storm - as included in *general insurance business class* 8; hail - as included in *general insurance business class* 9; and frost - as included in *general insurance business class* 9.

- 1.1.65 G Where the *firm* did not carry on *insurance business* in the reference period, the *gross adjusted claims amount*, and therefore the *claims amount*, is nil.
- Accounting for premiums and claims
- 1.1.66 R For the purposes of *INSPRU* 1.1.54R, *INSPRU* 1.1.56R, *INSPRU* 1.1.60R and *INSPRU* 1.1.62R, amounts of *premiums* and *claims* must be:
- (1) determined in accordance with the *insurance accounts rules* or the Friendly Societies (Accounts and Related Provisions) Regulations 1994, as appropriate; and
- (2) adjusted for transfers that were approved by the relevant authority (or became effective where approval by an authority was not required) before the end of the *financial year in question*:
- (a) to exclude any amount included in, or adjustment made to, *premiums* and *claims* to reflect the consideration for a transfer of *contracts of insurance* to or from the *firm*;
- (b) to exclude *premiums* and *claims* which arose from *contracts of insurance* that have been transferred by the *firm* to another body; and
- (c) to account for *premiums* and *claims* which arose from *contracts of insurance* that have been transferred to the *firm* from another body as if they were receivable by or payable to the *firm*.
- 1.1.67 G To ensure that all rights and obligations under a *contract of insurance* are transferred, a number of alternative mechanisms could be used. These are: an *insurance business transfer* under Part VII of the *Act*; under earlier *United Kingdom* insurance legislation; under equivalent foreign legislation; or by novation of contracts. The term "relevant authority" in paragraph (2) of *INSPRU* 1.1.66R may refer to whatever body has responsibility in a country, whether within or outside the *EEA*, for the approval of transfers of portfolios of *contracts of insurance*; the body may be a supervisory authority for financial services as such or it may be a judicial authority which has the necessary responsibility.
- 1.1.68 G *INSPRU* 1.1.66R(2)(b) requires a *firm*, for the purpose of calculating its *GICR*, to account for *contracts of insurance* transferred by it to another body as if it had never written those contracts. All amounts of *premiums* and *claims* arising in respect of those contracts are excluded, including amounts that arose in the *financial year in question* or previous *financial years*.
- 1.1.69 G Conversely, *INSPRU* 1.1.66R(2)(c) requires a *firm*, for the purpose of calculating its *GICR*, to account for *contracts of insurance* transferred to it by another body as if it had been responsible for those contracts from inception and not merely from the date of transfer. All amounts of *premiums* and *claims* that arose from those contracts are included even where they arose prior to the date of transfer and were, in fact, receivable by or payable to the other body.
- 1.1.70 G For both transfers to and from the *firm*, the consideration receivable or payable in respect of the transfer is excluded from *premiums* and *claims* in

order to avoid double counting.

- 1.1.71 R Where there has been a significant change in the business portfolio of the *firm* since the end of the *financial year in question*, for example, a line of business has been transferred to another *firm*, or the *firm* no longer carries on a particular *class of insurance business*, the *gross adjusted premiums amount* and the *gross adjusted claims amount* must both be recalculated to take into account the impact of this change. The recalculation must take into account the requirements of the *insurance accounts rules* or the Friendly Societies (Accounts and Related Provisions) Regulations 1994, as appropriate.

Actuarial health insurance

- 1.1.72 R The conditions referred to in *INSPRU 1.1.56R(2)* and *INSPRU 1.1.60R(2)* are that:
- (1) the health insurance is underwritten on a similar technical basis to that of life insurance;
 - (2) the *premiums* paid are calculated on the basis of sickness tables according to the mathematical method applied in insurance;
 - (3) a provision is set up for increasing age;
 - (4) an additional *premium* is collected in order to set up a safety margin of an appropriate amount;
 - (5) it is not possible for the *firm* to cancel the contract after the end of the third year of insurance; and
 - (6) the contract provides for the possibility of increasing *premiums* or reducing payments even for current contracts.

Insurance-related capital requirement (general insurance business only)

- 1.1.73 G *INSPRU 7.1.11R* requires *firms* carrying on *general insurance business*, other than a *non-directive insurer*, to calculate their *ECR* as the sum of the *asset-related capital requirement* and the *insurance-related capital requirement* less the *firm's equalisation provisions*. The *ECR* for *firms* carrying on *general insurance business* is an indicative measure of the *capital resources* that a *firm* may need to hold based on risk sensitive calculations applied to its business profile. For *firms* carrying on *general insurance business*, the *FSA* will use the *ECR* as a benchmark for *individual capital guidance* for a *firm* carrying on *general insurance business*. Details of the calculation of the *asset-related capital requirement* are set out in *INSPRU 2.2*. Details of the calculation of the *insurance-related capital requirement* are set out in *INSPRU 1.1.76R* to *INSPRU 1.1.79R*.

- 1.1.74 G The *insurance-related capital requirement* is a measure of the capital that a *firm* should hold against the risk of:
- (1) an adverse movement in the value of a *firm's* liabilities, to recognise that there may be substantial volatility in *claims* and other *technical provisions* made by the *firm*. Such variations may be due to inflationary increases,

interest rate changes, movements in the underlying provisions themselves, changes in expense costs, inadequate rate pricing or *premium* collections (or both) from intermediaries differing from projected assumptions; and

(2) the *premiums* a *firm* charges in respect of particular business not being adequate to fund future liabilities arising from that business.

- 1.1.75 G The *insurance-related capital requirement* is calculated by applying capital charge factors, expressed as a percentage, to the value of the *net written premiums* and the *technical provisions* in respect of different classes of business. *Firms* should refer to *GENPRU* 1.3.4R which sets out how a *firm* must recognise and value assets and liabilities.

Calculation of the insurance-related capital requirement

- 1.1.76 R A *firm* must calculate its *insurance-related capital requirement* in accordance with *INSPRU* 1.1.77R.

- 1.1.77 R (1) The value of:
- (a) the *net written premiums*; and
 - (b) the *technical provisions*;
- in respect of each class of business listed in the table in *INSPRU* 1.1.79R must be multiplied by the corresponding capital charge factor.
- (2) If any amount which is to be multiplied by a capital charge factor is a negative amount, that amount shall be treated as zero.
- (3) The amounts resulting from multiplying the *net written premiums* in respect of each such class of business by the corresponding capital charge factor must be aggregated.
- (4) The amounts resulting from multiplying the *technical provisions* in respect of each such class of business by the corresponding capital charge factor must be aggregated.
- (5) The *insurance-related capital requirement* is the sum of the amounts calculated in accordance with (3) and (4).

- 1.1.78 R In *INSPRU* 1.1.77R references to *technical provisions* comprise:
- (1) outstanding *claims*;
 - (2) provisions for incurred but not reported (*IBNR*) *claims*;
 - (3) provisions for incurred but not enough reported (*IBNER*) *claims*;
 - (4) *unearned premium* reserves less *deferred acquisition costs*; and
 - (5) unexpired risk reserves;
- in each case net of *reinsurance* receivables.

- 1.1.79 R Table: Insurance-related Capital Charge Factors

Class of Business	Net Written Premium	Technical provision
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	capital charge factor	capital charge factor
Reporting Group: Direct and facultative business		
Direct and facultative accident and health	5.0%	7.5%
Direct and facultative personal lines motor business	10.0%	9.0%
Direct and facultative household and domestic all risks	10.0%	10.0%
Direct and facultative personal lines financial loss	25.0%	14.0%
Direct and facultative commercial motor business	10.0%	9.0%
Direct and facultative commercial lines property	10.0%	10.0%
Direct and facultative commercial lines liability	14.0%	14.0%
Direct and facultative commercial lines financial loss	25.0%	14.0%
Direct and facultative aviation	32.0%	14.0%
Direct and facultative marine	22.0%	17.0%
Direct and facultative goods in transit	12.0%	14.0%
Direct and facultative miscellaneous	25.0%	14.0%
Reporting Group: Non-Proportional Treaty		
Non-proportional accident & health	35.0%	16.0%
Non-proportional motor	10.0%	14.0%
Non-proportional transport	16.0%	15.0%
Non-proportional aviation	61.0%	16.0%
Non-proportional marine	38.0%	17.0%
Non-proportional property	53.0%	12.0%

Non-proportional liability (non-motor)	14.0%	14.0%
Non-proportional financial lines	39.0%	14.0%
Non-proportional aggregate cover	53.0%	12.0%
Reporting Group: Proportional Treaty		
Proportional accident & health	12.0%	16.0%
Proportional motor	10.0%	12.0%
Proportional transport	12.0%	15.0%
Proportional aviation	33.0%	16.0%
Proportional marine	22.0%	17.0%
Proportional property	23.0%	12.0%
Proportional liability (non-motor)	14.0%	14.0%
Proportional financial lines	25.0%	14.0%
Proportional aggregate cover	23.0%	12.0%
Reporting Group: Miscellaneous Reinsurance		
Miscellaneous reinsurance accepted business	39.0%	14.0%

Long-term insurance capital requirement

- 1.1.80 G *GENPRU 2.1.13R* requires an insurer to maintain *capital resources* equal to or in excess of its *capital resources requirement*. *GENPRU 2.1.18R* defines the *capital resources requirement* for a firm to which that rule applies (a realistic basis life firm) as the higher of the *MCR* and the *ECR*. For other firms carrying on long-term insurance business (regulatory basis only life firms), the *capital resources requirement* is equal to the *MCR*. Except where the *base capital resources requirement* is the higher requirement, the *MCR* in respect of long-term insurance business is the sum of the long-term insurance capital requirement (*LTICR*) and the *resilience capital requirement* (see *GENPRU 2.1.25R* and *GENPRU 2.1.26R*). *GENPRU 2.1.36R* defines the *LTICR* as the sum of the *insurance death risk, health risk and life protection reinsurance, expense risk, and market risk capital components* (see *INSPRU 1.1.81R* to *INSPRU 1.1.91R*). Rules and guidance about the *resilience capital requirement* are set out in *INSPRU 3.1.9G* to *INSPRU 3.1.26R*.

Insurance death risk capital component

- 1.1.81 R The *insurance death risk capital component* is the aggregate of the amounts which represent the fractions specified by *INSPRU* 1.1.82R of the capital at risk, defined in *INSPRU* 1.1.83R, for each category of *contracts of insurance* (as specified in *INSPRU* 1.1.81AR), in respect of those contracts where the capital at risk is not a negative figure, multiplied by the higher of:
- (1) 50%; and
 - (2) the ratio as at the end of the *financial year in question* of:
 - (a) the aggregate capital at risk in respect of that category of contracts net of *reinsurance* cessions; to
 - (b) the aggregate capital at risk in respect of that category of contracts gross of *reinsurance* cessions.
- 1.1.81A R For the purpose of *INSPRU* 1.1.81R, the categories of *contracts of insurance* are as follows:
- (1) contracts which fall in *long-term insurance business classes* I, II or IX; and
 - (2) contracts which fall in *long-term insurance business classes* III, VII or VIII.
- 1.1.82 R For the purpose of *INSPRU* 1.1.81R, the fraction is:
- (1) for *long-term insurance business classes* I, II and IX, except for a *pure reinsurer*:
 - (a) 0.1% for temporary insurance on death where the original term of the contract is three years or less;
 - (b) 0.15% for temporary insurance on death where the original term of the contract is five years or less but more than three years; and
 - (c) 0.3% in any other case;
 - (2) 0.3% for *long-term insurance business classes* III, VII and VIII, except for a *pure reinsurer*; and
 - (3) 0.1% for a *pure reinsurer*.
- 1.1.83 R For the purpose of *INSPRU* 1.1.81R, the capital at risk is:
- (1) where the benefit under a *contract of insurance* payable as a result of death includes periodic or deferred payments, the present value of the benefits payable; and
 - (2) in any other case, the amount payable as a result of death; less, in either case, the *mathematical reserves* for the contract.
- 1.1.83A R *INSPRU* 1.1.81R does not apply to:
- (1) a *pure reinsurer*; or
 - (2) a *mixed insurer*;

in respect of *life protection reinsurance business*.

1.1.84 G The *insurance death risk capital component* only relates to the risk of death. There is a separate risk component for insured health risks (*class IV*) which also applies to the risk of death covered in the *life protection reinsurance business* of *pure reinsurers* and *mixed insurers*. *Tontines (class V)* and *capital redemption operations (class VI)* also have separate risk components. There is no specified risk margin for other insured risks.

1.1.84A G For the treatment of amounts recoverable from *ISPVs* when calculating the *insurance death risk capital component* in accordance with *INSPRU 1.1.81R*, see *INSPRU 1.1.92AR* and *INSPRU 1.1.92BG*.

Insurance health risk and life protection reinsurance capital component

1.1.85 R The *insurance health risk and life protection reinsurance capital component* is the highest of:

(1) the *premiums amount* (determined in accordance with *INSPRU 1.1.45R*);

(2) the *claims amount* (determined in accordance with *INSPRU 1.1.47R*);
and

(3) the *brought forward amount* (determined in accordance with *INSPRU 1.1.51R*);
in respect of:

(a) *contracts of insurance* falling in *long-term insurance business class IV* (see *INSPRU 1.1.86R*);

(b) risks falling in *general insurance business classes 1 or 2* that are written as part of a *long-term insurance contract*; and

(c) in the case of a *pure reinsurer* or a *mixed insurer*, *life protection reinsurance business*.

1.1.86 R For the purposes of *INSPRU 1.1.85R*, in the case of *contracts of insurance* falling in *long-term insurance business class IV*, condition (3) as set out in *INSPRU 1.1.72R (Actuarial health insurance)* is modified to: "either the reserves include a provision for increasing age, or the business is conducted on a group basis."

1.1.87 G The *insurance health risk and life protection reinsurance capital component* only applies to *permanent health insurance (long-term insurance business class IV)*, *accident and sickness insurance (general insurance business classes 1 and 2)* and the *life protection reinsurance business* of *pure reinsurers* and *mixed insurers*.

Insurance expense risk capital component

1.1.88 R The *insurance expense risk capital component* is:

(1) in respect of *long-term insurance business classes III, VII and VIII*, an amount equivalent to 25% of the net *administrative expenses* in the *financial*

year in question relevant to the business of each of those *classes*, in so far as the *firm* bears no investment risk and the allocation to cover *management expenses* in the *contract of insurance* does not have a fixed upper limit which is effective as a limit for a period exceeding 5 years from the commencement of the contract;

(2) in respect of any *tontine* (*long-term insurance business class V*), 1% of the assets of the *tontine*;

(3) in the case of any other *long-term insurance business*, 1% of the "adjusted *mathematical reserves*" (as defined in *INSPRU 1.1.89AR*).

1.1.88A R *INSPRU 1.1.88R* does not apply to:

(1) a *pure reinsurer*; or

(2) a *mixed insurer*;

in respect of:

(a) *life protection reinsurance business*; or

(b) *permanent health reinsurance business*.

Insurance market risk capital component

1.1.89 R The *insurance market risk capital component* is 3% of the "adjusted *mathematical reserves*" (as defined in *INSPRU 1.1.89AR*) for all insurance liabilities except those of a kind which:

(1) arise from *contracts of insurance* falling in *long-term insurance business classes III, VII or VIII* to the extent that the *firm* does not bear any investment risk; or

(2) arise from *contracts of insurance* falling in *long-term insurance business class V*; or

(3) for a *pure reinsurer* or a *mixed insurer*, arise from *contracts of insurance* falling within:

(a) its *life protection reinsurance business*; or

(b) its *permanent health reinsurance business*.

Adjusted mathematical reserves

1.1.89A R (1) For the purpose of *INSPRU 1.1.88R* and *INSPRU 1.1.89R*, the "adjusted *mathematical reserves*" is the aggregate of the amounts which result from the performance of the calculation in *INSPRU 1.1.90R* for each category of insurance liability specified in (2).

(2) The categories of insurance liability referred to in (1) are:

(a) for the purpose of *INSPRU 1.1.88R*, those categories described in

INSPRU 1.1.91R (1), (2), (3), (4) and (5); and

(b) for the purpose of *INSPRU* 1.1.89R, those categories described in *INSPRU* 1.1.91R (1), (2), (4) and (5).

- 1.1.90 R The calculation referred to in *INSPRU* 1.1.89AR (1) is the multiplication of the amount of the *mathematical reserves* (gross of *reinsurance* cessions) in respect of a category of insurance liability by the higher of:
- (1) 85% or, in the case of a *pure reinsurer*, 50%; and
 - (2) the ratio as at the end of the *financial year in question* of:
 - (a) the *mathematical reserves* in respect of that category of insurance liability net of *reinsurance* cessions; to
 - (b) the *mathematical reserves* in respect of that category of insurance liability gross of *reinsurance* cessions.
- 1.1.91 R For the purpose of *INSPRU* 1.1.89AR and *INSPRU* 1.1.90R, the categories of insurance liability are as follows:
- (1) liabilities of a kind which arise from *contracts of insurance* falling in *long-term insurance business classes* I, II or IX;
 - (2) liabilities of a kind which arise from *contracts of insurance* falling in *long-term insurance business classes* III, VII or VIII to the extent that the *firm* bears an investment risk;
 - (3) liabilities of a kind which arise from *contracts of insurance* falling in *long-term insurance business classes* III, VII or VIII to the extent that the *firm* bears no investment risk and where the allocation to cover *management expenses* in the *contract of insurance* has a fixed upper limit which is effective as a limit for a period exceeding 5 years from the commencement of the contract;
 - (4) liabilities of a kind which arise from *contracts of insurance* falling in *long-term insurance business class* IV; and
 - (5) liabilities of a kind which arise from *contracts of insurance* falling in *long-term insurance business class* VI.
- 1.1.92 G Where a *firm* has written a unit-linked contract, the *firm's* liability under the contract may consist of a unit liability, where the *firm* bears no investment risk, and other liabilities for which the *firm* bears an investment risk, and for which a separate reserve is held. *INSPRU* 1.1.91R(2) and (3) require a *firm* to analyse its liabilities under unit-linked contracts between those for which it bears an investment risk and those for which it does not. *INSPRU* 1.1.88R and *INSPRU* 1.1.89R taken together result in a capital requirement for any liabilities for which the *firm* bears an investment risk of 4% of "adjusted *mathematical reserves*" (1% for expense risk and 3% for market risk).
- Insurance special purpose vehicles
- 1.1.92A R A *firm* must not treat any amounts recoverable from an *ISPV* as *reinsurance* for the purposes of the calculation of:

- (1) the reinsurance ratio in accordance with *INSPRU* 1.1.54R; or
- (2) the *insurance death risk capital component* in accordance with *INSPRU* 1.1.81R; or
- (3) the "adjusted *mathematical reserves*" in accordance with *INSPRU* 1.1.90R.

1.1.92B G A *firm* may treat amounts recoverable from an *ISPV* as *reinsurance* for these purposes if it obtains a *waiver* of *INSPRU* 1.1.92AR under section 148 of the *Act*. The conditions that will need to be met, in addition to the statutory tests under section 148(4) of the *Act*, before the *FSA* will consider granting such a *waiver* are set out in *INSPRU* 1.6.13G to *INSPRU* 1.6.18G.

Application of *INSPRU* 1.1 to Lloyd's

1.1.93 R *INSPRU* 1.1 applies to the *Society* in accordance with *INSPRU* 8.1.2R.

1.1.94 R The following *rules* and *guidance* apply to *managing agents* in accordance with *INSPRU* 8.1.4R:

- (1) *INSPRU* 1.1.13G to *INSPRU* 1.1.20R (except *INSPRU* 1.1.13R(1));
- (2) *INSPRU* 1.1.42G to *INSPRU* 1.1.43G; and
- (3) *INSPRU* 1.1.74G to *INSPRU* 1.1.80G.

1.1.95 R The *Society* must calculate the *brought forward amount* for the *members* in aggregate in accordance with *INSPRU* 1.1.51R, using the result of *GENPRU* 2.3.6R for the prior *financial year* and the aggregate of all *members' technical provisions* for the relevant periods.

1.1.96 R For the purposes of *INSPRU* 1.1.66R and further to that *rule*, in the case of Lloyd's *members*, amounts of *premiums* and *claims* must be adjusted for *approved reinsurance to close* to exclude any amount included in, or adjustment made to, *premiums* and *claims* to reflect the consideration for an *approved reinsurance to close*.

1.2 Mathematical reserves

Application

- 1.2.1 R *INSPRU* 1.2 applies to a *long-term insurer* unless it is:
- (1) a *non-directive friendly society*; or
 - (2) an *incoming EEA firm*; or
 - (3) an *incoming Treaty firm*.

Purpose

- 1.2.2 G This section follows on from the overall requirement on *firms* to establish adequate *technical provisions* (see *INSPRU* 1.1.16R). The *mathematical reserves* form the main component of *technical provisions* for *long-term insurance business*. *INSPRU* 1.2 sets out *rules* and *guidance* as to the methods and assumptions to be used in calculating the *mathematical reserves*. The *rules* and *guidance* set out the minimum basis for *mathematical reserves*. Methods and assumptions that produce reserves that are demonstrably equal to or greater than the minimum basis may also be used, though they must meet the basic requirements for methods and assumptions set out in *INSPRU* 1.2.7R to *INSPRU* 1.2.27G.
- 1.2.3 G This section applies to all *firms* carrying on *long-term insurance business* and implements some of the requirements contained in article 20 of the *Consolidated Life Directive*. The implementation is designed to ensure that a *firm's mathematical reserves* in respect of *long-term insurance contracts* meet the minimum requirements set by the *Consolidated Life Directive*. A *firm* may use a prospective or a retrospective method to value its *mathematical reserves* (see *INSPRU* 1.2.7R).
- 1.2.4 G The required procedures are summarised in the flowchart in *INSPRU* 1 Annex 1G.
- 1.2.5 G *Firms* to which *GENPRU* 2.1.18R applies are required to calculate a *with-profits insurance capital component* (see *GENPRU* 2.1.38R). In order to calculate its *with-profits insurance capital component*, such a *firm* is required to carry out additional calculations of its liabilities on a realistic basis (see *INSPRU* 1.3), which it is required to report to the *FSA* (see Forms 18,19). A *firm* that reports its liabilities on a realistic basis is referred to in *PRU* as a *realistic basis life firm*. Such *firms* are subject to different *rules* relating to the calculation of *mathematical reserves* (see *INSPRU* 1.2.46R and *INSPRU* 1.2.76R) compared with those that apply to *firms* that report on a regulatory basis only (*regulatory basis only life firms*).
- 1.2.6 G A number of the *rules* in this section require a *firm* to take into account its regulatory duty to treat *customers* fairly. In this section, references to such a duty are to a *firm's* duty to pay due regard to the interests of its *customers* and to treat them fairly (see *Principle 6* in *PRIN*). This duty is owed to both

policyholders and potential *policyholders*.

Basic valuation method

- 1.2.7 R (1) Subject to (2), a *firm* must establish its *mathematical reserves* using a prospective actuarial valuation on prudent assumptions of all future cash flows expected to arise under, or in respect of, each of its *long-term insurance contracts*.
(2) But a *firm* may use a retrospective actuarial valuation where:
(a) a prospective method cannot be applied to a particular type of contract;
or
(b) the *firm* can demonstrate that the resulting amount of the *mathematical reserves* would be no lower than would be required by a prudent prospective actuarial valuation.
- 1.2.8 G A prospective valuation sets the *mathematical reserves* at the present value of future net cash flows. A retrospective method typically sets the *mathematical reserves* at the level of *premiums* received (and accumulated with investment return), less *claims* and expenses paid. A prospective valuation is preferred because it takes account of circumstances that might have arisen since the *premium* rate was set and of changes in the perception of future experience. Circumstances in which a retrospective valuation might be appropriate include:
(1) where the assumptions initially made in determining the *premium* rate were sufficiently prudent at inception and have not been overtaken by subsequent events; and
(2) where the liability depends on the emerging experience.
- 1.2.9 R Except in *INSPRU* 1.2.71R(1), *INSPRU* 1.2 does not apply to *final bonuses*. In addition, for *realistic basis life firms* only, *INSPRU* 1.2 does not apply to other discretionary benefits, including future *annual bonuses*.

Methods and assumptions

- 1.2.10 R In the actuarial valuation under *INSPRU* 1.2.7R, a *firm* must use methods and prudent assumptions which:
(1) are appropriate to the business of the *firm*;
(2) are consistent from year to year without arbitrary changes (see *INSPRU* 1.2.11G);
(3) are consistent with the method of valuing assets (see *GENPRU* 1.3);
(4) include appropriate margins for adverse deviation of relevant factors (see *INSPRU* 1.2.12G);
(5) recognise the distribution of profits (that is, emerging surplus) in an appropriate way over the duration of each *contract of insurance*;
(6) take into account its regulatory duty to treat its *customers* fairly (see *Principle* 6); and
(7) are in accordance with generally accepted actuarial practice.
- 1.2.11 G *INSPRU* 1.2.10R(2) prohibits only arbitrary changes in methods and

assumptions, that is, changes made without adequate reasons. Any such changes would hinder comparisons over time as to the amount of the *mathematical reserves* and so obscure trends in solvency and the emergence of surplus.

- 1.2.12 G The relevant factors referred to in *INSPRU* 1.2.10R(4) may include, but are not limited to, factors such as future investment returns, expenses, mortality, morbidity, options, persistency and *reinsurance* (see also *INSPRU* 1.2.13R to *INSPRU* 1.2.19G).
- Margins for adverse deviation
- 1.2.13 R The appropriate margins for adverse deviation required by *INSPRU* 1.2.10R (4) must be sufficiently prudent to ensure that there is no significant foreseeable risk that liabilities to *policyholders* in respect of *long-term insurance contracts* will not be met as they fall due.
- 1.2.14 G The margins for adverse deviation are a prudential margin in respect of the risks that arise under a *long-term insurance contract*.
- 1.2.15 G *INSPRU* 1.2.13R sets the normal standard of prudence required for margins. *INSPRU* 1.2.16G suggests benchmarks against which a *firm* should compare the margins it has set in accordance with *INSPRU* 1.2.10R(4) and *INSPRU* 1.2.13R. *INSPRU* 1.2.17G gives *guidance* where a market risk premium is not readily obtainable.
- 1.2.16 G When setting the margins for adverse deviation required by *INSPRU* 1.2.10R(4) in relation to a particular contract, a *firm* should consider, where appropriate:
(1) the margin for adverse deviation included in the *premium* for similar *long-term insurance contracts*, if any, newly issued by the *firm*; and
(2) where a sufficiently developed and diversified market for transferring a risk exists, the risk premium that would be required by an unconnected party to assume the risk in respect of the contract.
The margin for adverse deviation of a risk should generally be greater than or equal to the relevant market price for that risk.
- 1.2.17 G Where a risk premium is not readily available, or cannot be determined, an external proxy for the risk should be used, such as adjusted industry mortality tables. Where there is a considerable range of possible outcomes, the *FSA* expects *firms* to use stochastic techniques to evaluate these risks. In time, for example, longevity risk, where this constitutes a significant risk for the *firm*, may fall into this category.
- 1.2.18 G The margins for adverse deviation should be recognised as profit only as the *firm* itself is released from risk over the duration of the contract.
- 1.2.19 G Further detailed *rules* and *guidance* on margins for adverse deviation are included in *INSPRU* 1.2.32G to *INSPRU* 1.2.89G. In particular, the cross-references for the different assumptions used in calculating the

mathematical reserves are as follows:

- (1) expenses (*INSPRU* 1.2.50R to *INSPRU* 1.2.58G);
- (2) mortality and morbidity (*INSPRU* 1.2.59R to *INSPRU* 1.2.61G);
- (3) options (*INSPRU* 1.2.62R to *INSPRU* 1.2.72G);
- (4) persistency (*INSPRU* 1.2.73G to *INSPRU* 1.2.77G); and
- (5) *reinsurance* (*INSPRU* 1.2.77AR to *INSPRU* 1.2.89G).

The *rules* and *guidance* on margins for adverse deviation in respect of future investment returns, which are also required in the calculation of *mathematical reserves*, are set out in *INSPRU* 3.1.28R to *INSPRU* 3.1.48G.

Record keeping

- 1.2.20 R A *firm* must make, and retain for an appropriate period, a record of:
- (1) the methods and assumptions used in establishing its *mathematical reserves*, including the margins for adverse deviation, and the reasons for their use; and
 - (2) the nature of, reasons for, and effect of, any change in approach, including the amount by which the change in approach increases or decreases its *mathematical reserves*.
- 1.2.21 G *SYSC* 14.1.53 R requires *firms* to maintain accounting and other records for a minimum of three years, or longer as appropriate. For the purposes of *INSPRU* 1.2.20R, a period of longer than three years will be appropriate for a *firm's long-term insurance business*. In determining an appropriate period, a *firm* should have regard to:
- (1) the detailed *rules* and *guidance* on record keeping in *SYSC* 14.1.51G - *SYSC* 14.1.64G;
 - (2) the nature and term of the *firm's long-term insurance business*; and
 - (3) any additional provisions or statutory requirements applicable to the *firm* or its records.

Valuation of individual contracts

- 1.2.22 R (1) Subject to (2) and (3), a *firm* must determine the amount of the *mathematical reserves* separately for each *long-term insurance contract*.
- (2) Approximations or generalisations may be made where they are likely to provide the same, or a higher, result.
- (3) A *firm* must set up additional *mathematical reserves* on an aggregated basis for general risks that are not specific to individual contracts.
- 1.2.23 G *INSPRU* 1.2.22R to *INSPRU* 1.2.89G set out *rules* and *guidance* for the separate prospective valuation of each contract. These may be applied instead to groups of contracts where the conditions set out in *INSPRU* 1.2.22R(2) are satisfied.

Contracts not to be treated as assets

- 1.2.24 R (1) A *firm* must not treat a *long-term insurance contract* as an asset.

- (2) (1) does not apply to a *pure reinsurer* in respect of a *contract of insurance* which does not have a guaranteed *surrender value* and falls within:
- (a) its *life protection reinsurance business*; or
 - (b) its *permanent health reinsurance business*.
- (3) Notwithstanding (2), the total *mathematical reserves* established by a *pure reinsurer* must have a minimum value of at least zero.

1.2.25 G A separate prospective valuation for each contract may identify contracts for which the value of future cash inflows exceeds that of outflows, that is, the contracts have an asset value, rather than liability value. However, the *Consolidated Life Directive* requires that no contract should be valued at less than its guaranteed *surrender value*. As a result, no contract with a guaranteed *surrender value* to which the *Consolidated Life Directive* applies should be treated as an asset. Although the *Reinsurance Directive* does not require this treatment of contracts with guaranteed *surrender values* to be applied to *pure reinsurers*, the *FSA's* policy is that there should be equal treatment in this respect. *Pure reinsurers* may therefore treat as an asset a contract written as part of carrying on *life protection reinsurance business* or *permanent health reinsurance business* provided that this is based on assumptions which meet the general requirements for prudent assumptions as set out in *INSPRU* 1.2.10R and *INSPRU* 1.2.13R and it is not written on terms that provide for a guaranteed *surrender value*. This does not, however, allow a *pure reinsurer* to establish total *mathematical reserves* which are negative.

Avoidance of future valuation strain

1.2.26 R (1) A *firm* must establish *mathematical reserves* for a *contract of insurance* which are sufficient to ensure that, at any subsequent date, the *mathematical reserves* then required are covered solely by:

- (a) the assets covering the current *mathematical reserves*; and
- (b) the resources arising from those assets and from the contract itself.

(2) For the purposes of (1), the *firm* must assume that:

- (a) the assumptions adopted for the current valuation of liabilities remain unaltered and are met; and
- (b) discretionary benefits and charges will be set so as to fulfil its regulatory duty to treat its *customers* fairly.

(3) (1) may be applied to a group of similar contracts instead of to the individual contracts within that group.

1.2.27 G The valuation of each contract, or group of similar contracts, should allow for the possibility, where it exists, that contracts may be surrendered (wholly or in part), lapsed or made paid-up at any time. The valuation assumptions include margins for adverse deviation (see *INSPRU* 1.2.13R). *INSPRU* 1.2.26R requires *mathematical reserves* to be established such that, if future experience is in line with the valuation assumptions, there would be no

future valuation strain.

Cash flows to be valued

- 1.2.28 R In a prospective valuation, a *firm* must:
- (1) include in the cash flows to be valued the following:
 - (a) future *premiums* (see *INSPRU* 1.2.35G to *INSPRU* 1.2.47G);
 - (b) expenses, including *commissions* (see *INSPRU* 1.2.50 R to *INSPRU* 1.2.58G);
 - (c) benefits payable (see *INSPRU* 1.2.29R); and
 - (d) subject to (2), amounts to be received or paid in respect of the *long-term insurance contracts* under contracts of *reinsurance* or analogous non-*reinsurance* financing agreements (see *INSPRU* 1.2.77AR to *INSPRU* 1.2.89G); but
 - (2) exclude from those cash flows amounts recoverable from an *ISPV*.
- 1.2.28A G A *firm* may include amounts recoverable from an *ISPV* in the cash flows to be valued in a prospective valuation if it obtains a *waiver* of *INSPRU* 1.2.28R under section 148 of the *Act*. The conditions that will need to be met, in addition to the statutory tests under section 148(4) of the *Act*, before the *FSA* will consider granting such a *waiver* are set out in *INSPRU* 1.6.13G to *INSPRU* 1.6.18G.
- 1.2.29 R For the purpose of *INSPRU* 1.2.28R(3), benefits payable include:
- (1) all guaranteed benefits including guaranteed *surrender values* and paid-up values;
 - (2) vested, declared and allotted bonuses to which the *policyholder* is entitled;
 - (3) all options available to the *policyholder* under the terms of the contract; and
 - (4) discretionary benefits payable in accordance with the *firm's* regulatory duty to treat its *customers* fairly.
- 1.2.30 G All cash flows are to be valued using prudent assumptions in accordance with generally accepted actuarial practice. Cash flows may be omitted from the valuation calculations provided the reserves obtained as a result of leaving those cash flows out of the calculation are not less than would have resulted had all cash flows been included (see *INSPRU* 1.2.22R(2)). Provision for future expenses in respect of *with-profits insurance contracts* (excluding *accumulating with-profits policies*) may be made implicitly, using the *net premium* method of valuation (see *INSPRU* 1.2.43R below). For the purposes of *INSPRU* 1.2.28R(2), any charges included in expenses should be determined in accordance with the *firm's* regulatory duty to treat its *customers* fairly.
- 1.2.31 G *INSPRU* 1.2.29R(4) requires *regulatory basis only life firms* to make allowance for any future *annual bonus* that a *firm* would expect to grant, assuming future experience is in line with the assumptions used in the calculation of the *mathematical reserves*. *Final bonuses* do not have to be

taken into consideration in these calculations except in relation to *accumulating with-profits policies* (see *INSPRU 1.2.9R*). The calculations required for *accumulating with-profits policies* are set out in *INSPRU 1.2.71R(1)*. For *realistic basis life firms*, except for *accumulating with-profits policies*, the *mathematical reserves* may be calculated without taking into account discretionary benefits, including both *annual bonuses* and *final bonuses*. For such *firms* full allowance for discretionary benefits is made in the calculation of the *realistic value of liabilities* (see *INSPRU 1.3.105R(5)*).

Valuation assumptions: detailed rules and guidance

- 1.2.32 G More detailed *rules* and *guidance* about the valuation of cash flows are set out in *INSPRU 1.2.33R* to *INSPRU 1.2.89G*.

Valuation rates of interest

- 1.2.33 R In calculating the present value of future net cash flows, a *firm* must determine the rates of interest to be used in accordance with *INSPRU 3.1.28R* to *INSPRU 3.1.47R*.
- 1.2.34 G The *rules* in *INSPRU 3.1.28R* to *INSPRU 3.1.47R* set out the approach *firms* must take in setting margins for adverse deviation in the interest rates assumed in calculating the *mathematical reserves*. This includes a margin to allow for adverse deviation in *market risk* and, where relevant, credit risk. The requirements set out in *INSPRU 3.1.28R* to *INSPRU 3.1.47R* protect against the *market risk* that the return actually achieved on assets may fall below the market yields on assets at the *actuarial valuation date*.

Future premiums

- 1.2.35 G *INSPRU 1.2.46R* and *INSPRU 1.2.47G* apply to the valuation of *with-profits insurance liabilities* for a *realistic basis life firm*. *INSPRU 1.2.38R* to *INSPRU 1.2.45G* apply to a *regulatory basis only life firm*.
- 1.2.36 G For *non-profit insurance contracts* no specific method of valuation for future *premiums* is required by *INSPRU*. However, the method of valuation used should be sufficiently prudent taking into account, in particular, the risk of voluntary discontinuance by the *policyholder*.

Future premiums: firms reporting only on a regulatory basis

- 1.2.37 R *INSPRU 1.2.38R* to *INSPRU 1.2.43R* apply to a *regulatory basis only life firm*.
- 1.2.38 R (1) This *rule* applies to with-profits insurance contracts except accumulating with-profits policies written on a recurring single premium basis.
(2) The value attributed to a *premium* due in any future *financial year* (a future *premium*) must not exceed the lower of the value of:
(a) the actual *premium* payable under the contract; and
(b) the *net premium*.

(3) The *net premium* may be increased for *deferred acquisition costs* in accordance with *INSPRU 1.2.43R*.

- 1.2.39 G The valuation method for future *premiums* in *INSPRU 1.2.38R* retains the difference, if any, between the gross *premium* and the *net premium* as an implicit margin available to finance future bonuses, expenses and other costs. It thus helps to protect against the risk that adequate resources may not be available in the future to meet those costs.
- 1.2.40 R Where the terms of a *contract of insurance* have changed since it was first entered into, a *firm* must apply one of the methods in *INSPRU 1.2.41R* in determining the *net premium* for the purpose of *INSPRU 1.2.38R(2)(b)*.
- 1.2.41 R A *firm* must treat the change referred to in *INSPRU 1.2.40R* as if either:
- (1) it had been included in the original contract but came into effect from the time the change became effective; or
 - (2) the original contract were cancelled and replaced by a new contract (with an initial *premium* paid on the new contract equal to the liability under the original contract immediately prior to the change); or
 - (3) it gave rise to two separate contracts where:
 - (a) all *premiums* are payable under the first contract and that contract provides only for such benefits as those *premiums* could have purchased from the *firm* at the date the change became effective; and
 - (b) no *premiums* are payable under the second contract and that contract provides for all the other benefits.
- 1.2.42 G *INSPRU 1.2.41R* permits three alternative methods. However, the third method is only possible where a meaningful comparison can be made between the terms of the contract (as changed) and the terms upon which the *firm* was *effecting* its new *contracts of insurance* at the time the contract was changed.

Future net premiums: adjustment for deferred acquisition costs

1.2.43 R (1) The amount of any increase to the *net premium* for *deferred acquisition costs* must not exceed the equivalent of the recoverable acquisition expenses spread over the period of *premium* payments and calculated in accordance with the rates of interest, mortality and morbidity assumed in calculating the *mathematical reserves*.
(2) For the purpose of (1), recoverable acquisition expenses means the amount of expenses, after allowing for the effects of taxation, which it is reasonable to expect will be recovered from future *premiums* payable under the contract.
(3) The recoverable acquisition expenses in (1) must not exceed the lower of:
(a) the value of the excess of actual *premiums* over *net premiums*; and
(b) 3.5% of the *relevant capital sum*.
(4) Recoverable acquisition expenses may be calculated as the average for a group of similar contracts weighted by the *relevant capital sum* for each contract.

1.2.44 G *INSPRU* 1.2.43R allows a *firm* to spread acquisition costs over the lifetime of a *contract of insurance*, but only if it is reasonable to expect those costs to be recoverable from future *premium* income from that contract. Further prudence is provided by the limitation of recoverable acquisition expenses to 3.5% of the *relevant capital sum*. This adjustment for acquisition costs is sometimes termed a Zillmer adjustment.

1.2.45 G In determining the extent, if any, to which it is reasonable to expect acquisition costs to be recoverable from future *premium* income, the *firm* should make prudent assumptions as to levels of voluntary discontinuance by *policyholders*.

Future premiums: firms also reporting with-profits insurance liabilities on a realistic basis

1.2.46 R (1) Subject to (2), for a *realistic basis life firm*, the future *premiums* to be valued in the calculation of the *mathematical reserves* for its *with-profits insurance contracts* must not be greater than the gross *premiums* payable by the *policyholder*.
(2) This *rule* does not apply to *accumulating with-profits policies* written on a recurring single *premium* basis (see *INSPRU* 1.2.48R).

1.2.47 G The gross *premium* is the full amount of *premium* payable by the *policyholder* to the *firm*. The gross *premium* method contrasts with the *net premium* method which is required from *regulatory basis only life firms* (see *INSPRU* 1.2.37R to *INSPRU* 1.2.45G).

Future premiums: accumulating with-profits policies

- 1.2.48 R (1) This *rule* applies to *accumulating with-profits policies* written on a recurring single *premium* basis.
(2) A *firm* must not attribute any value to a future *premium* under the contract.
(3) Any liability arising only upon the payment of that *premium* may be ignored except to the extent that the value of that liability upon payment would exceed the amount of that *premium*.

- 1.2.49 G *INSPRU* 1.2.48R prohibits a *firm* from taking credit for recurring single *premiums* under *accumulating with-profits policies*. As there is no contractual commitment to pay any future *premiums* the amount and timing of which are uncertain, the recognition of any potential margins would not be prudent. Where the payment of a future *premium* would give rise to a liability in excess of the *premium* a provision should be established.

Expenses

- 1.2.50 R (1) A *firm* must make provision for expenses, either implicitly or explicitly, in its *mathematical reserves* of an amount which is not less than the amount expected, on prudent assumptions, to be incurred in fulfilling its *long-term insurance contracts*.
(2) For the purpose of (1), expenses must be valued:
(a) after taking account of the effect of taxation;
(b) having regard to the *firm's* actual expenses in the last 12 months before the *actuarial valuation date* and any increases in expenses expected to occur in the future;
(c) after making prudent assumptions as to the effects of inflation on future increases in prices and earnings; and
(d) at no less than the level that would be incurred if the *firm* were to cease to transact new business 12 months after the *actuarial valuation date*.
(3) A *firm* must not rely upon an implicit provision arising from the method of valuing future *premiums* except to the extent that:
(a) it is reasonable to assume that expenses will be recoverable from future *premiums*; and
(b) the expenses would only arise if the future *premiums* were received.
- 1.2.51 G For *with-profits insurance contracts* where the *net premium* valuation method applies, an implicit provision arises because the future *premiums* valued are limited to the *net premium* adjusted as permitted by *INSPRU* 1.2.43R. This excludes the allowance within the gross *premium* for expenses (other than recoverable acquisition expenses). It also excludes other margins within the actual *premium* that are a prudential margin in respect of the risks that arise under the contract or that are needed to provide for future discretionary benefits. To the extent that these other margins are not needed for the purpose for which they were originally established, they may also constitute an implicit provision for expenses.
- 1.2.52 G An implicit provision may also arise for other types of *long-term insurance contract* where, for example, no value is attributed to future *premiums*, but

the *firm* is entitled to make deductions from future regular *premiums* before allocating them to secure *policyholder* benefits.

- 1.2.53 G A *firm* should only reduce the provision for future expenses to take account of expected taxation recoveries related to those expenses where recovery is reasonably certain, and after taking into account the assumption that the *firm* ceases to transact new business 12 months after the *actuarial valuation date*. An appropriate adjustment for discounting should be made where receipt of the taxation recoveries is not expected until significantly after the expenses are incurred.
- 1.2.54 G The *firm's* actual expenses in the 12 months prior to the *actuarial valuation date* may serve as a guide to the assumptions for future expenses, taking into consideration the mix of acquisition and renewal expenses. The expense assumptions should not be reduced to account for expected future improvements in efficiency until such efficiency improvements result in a reduced level of actual expenditure. However, the assumptions should take account of all factors which might increase costs including earnings and price inflation.
- 1.2.55 R The provisions for expenses (whether implicit or explicit) required by *INSPRU* 1.2.50R must be sufficient to cover all the expenses of running off the *firm's* existing *long-term insurance business* including:
- (1) all discontinuance costs (for example, redundancy costs and closure costs) that would arise if the *firm* were to cease transacting new business 12 months after the *actuarial valuation date* in circumstances where (and to the extent that) the discontinuance costs exceed the projected surplus available to meet such costs;
 - (2) all costs of continuing to service the existing business taking into account the loss of economies of scale from, and any other likely consequences of, ceasing to transact new business at that time; and
 - (3) the lower of:
 - (a) any projected valuation strain from writing new business for the 12 months following the *actuarial valuation date* to the extent the actual amount of that strain exceeds the projected surplus on prudent assumptions from existing business in the 12 months following the *actuarial valuation date*; and
 - (b) any projected new business expense overrun from writing new business for the 12 months following the *actuarial valuation date* to the extent the projected expenses exceed the expenses that the new business can support on a prudent basis.
- 1.2.56 G The provision for future expenses, whether implicit or explicit, should include a prudent margin for adverse deviation in the level and timing of expenses (see *INSPRU* 1.2.13R to *INSPRU* 1.2.19G). The margin should cover the risk of underestimating expenses whether due to, for example, initial under-calculation or subsequent increases in the amount of expenses. In setting the amount of the margin, the *firm* should take into account the

extent to which:

- (1) an appropriately validated method based on reliable data is used to allocate expenses by product type, by distribution channel and as between acquisition and non-acquisition expenses;
- (2) the volume of existing and new business and its distribution by product type or distribution channel is stable or predictable;
- (3) costs vary in the short, medium or long term dependent upon the volume of existing or new business and its distribution by product type or distribution channel; and
- (4) cost control is well-managed.

1.2.57 G In setting the margin, the *firm* should also take into account:

- (1) the length of the period over which it is necessary to project costs;
- (2) the extent to which it is reasonable to expect inflation to be stable or predictable over that period; and
- (3) whether, if inflation is higher than expected, it is reasonable to expect that the excess would be offset by increases in investment returns.

1.2.58 G Where a *firm* has entered into an agreement with any other person for the sharing or reimbursement of costs, in setting the margin it should take into account the potential impact of that agreement and of its discontinuance.

Mortality and Morbidity

1.2.59 R A *firm* must set the assumptions for mortality and morbidity using prudent rates of mortality and morbidity that are appropriate to the country or territory of residence of the person whose life or health is insured.

1.2.60 G The rates of mortality or morbidity should contain prudent margins for adverse deviation (see *INSPRU* 1.2.13R to *INSPRU* 1.2.19G). In setting those rates, a *firm* should take account of:

(1) the systems and controls applied in underwriting *long-term insurance contracts* and whether they provide adequate protection against anti-selection (that is, selection against the *firm*) including:

- (a) adequately defining and identifying non-standard risks; and
- (b) where such risks are underwritten, allocating to them an appropriate weighting;

(2) the nature of the contractual exposure to mortality or morbidity risk including:

- (a) whether lower mortality increases or decreases the *firm's* liability;
- (b) the period of cover and whether risk charges can be varied during that period and, if so, how quickly; and
- (c) whether the options in the contract give rise to a significant risk of anti-selection (for example, opportunities for voluntary discontinuance, guaranteed renewal at the option of the *policyholder* and rights for conversion of benefits);

(3) the credibility of the *firm's* actual experience as a basis for projecting future experience including:

- (a) whether there is sufficient data (especially for medical or financial risks and for new types of benefit or new methods of distribution); and
- (b) whether the data is reliable and has been appropriately validated;

(4) the availability and reliability of:

- (a) any published tables of mortality or morbidity for the country or territory of residence of the person whose life or health is insured; and
- (b) any other information as to the industry-wide insurance experience for that country or territory;

(5) anticipated or possible future trends in experience including, but only where they increase the liability:

- (a) anticipated improvements in mortality;
- (b) changes arising from improved detection of morbidity (including critical illnesses);
- (c) diseases the impact of which may not yet be reflected fully in current experience; and
- (d) changes in market segmentation (such as impaired life annuities) which, in the light of developing experience, may require different assumptions for different parts of the policy class.

- 1.2.61 G An additional provision for diseases covered by *INSPRU* 1.2.60G(5)(c) may be needed, in particular for unit-linked policies. In determining whether such a provision is needed a *firm* may take into consideration any ability to increase product charges commensurately (provided that such increase does not infringe on its regulatory duty to treat its *customers* fairly), but a provision would still be required for the period until such an increase could be brought into effect.

Options

- 1.2.62 R When a *firm* establishes its *mathematical reserves* in respect of a *long-term insurance contract*, the *firm* must include an amount to cover any increase in

liabilities which might be the direct result of its *policyholder* exercising an option under, or by virtue of, that *contract of insurance*. Where the *surrender value* of a contract is guaranteed, the amount of the *mathematical reserves* for that contract at any time must be at least as great as the value guaranteed at that time.

- 1.2.63 G An option exists where a *policyholder* is given a choice between alternative forms of benefit, for example, a choice between receiving a cash benefit upon maturity or an annuity at a guaranteed rate. In some cases, the contract may designate one or other of these alternatives as the principal benefit and any other as an option. This designation, in itself, is not one of substance in the context of reserving since it does not affect the *policyholder's* choices. Other forms of option include:
- (1) the right to convert to a different contract on guaranteed terms;
 - (2) the right to increase cover on guaranteed terms;
 - (3) the right to a specified amount on surrender; and
 - (4) the right to a paid up value.
- 1.2.64 G The *firm* should provide for the benefit which the *firm* anticipates the *policyholder* is most likely to choose. Except for the "option" of voluntary discontinuance in the case of *regulatory basis only life firms* (see *INSPRU* 1.2.74R), past experience may be used as a guide, but only if this is likely to give a reasonable estimate of future experience. For example, past experience of the take-up of a cash payment option instead of an annuity would not be a reliable guide, if, in the past, market rates exceeded those guaranteed in the annuity but no longer do so. Similarly, past experience on the take-up of options may not be relevant in the light of the assumptions made in respect of future interest rates and mortality rates in the valuation of the benefits.
- 1.2.65 G Many options are long-term and need careful consideration. Improving longevity, for example, can increase the value of guaranteed annuity options vesting further in the future. *Firms* also need to have regard to the fact that *policyholder* behaviour can change in the future as *policyholders* become more aware of the value of their options. The impact on *policyholder* behaviour of possible changes in taxation should also be considered.
- 1.2.66 G In accordance with *INSPRU* 1.2.7R and *INSPRU* 1.2.13R, take-up rates for guaranteed annuity options should be assessed on a prudent basis with assumptions that include margins for adverse deviation (see *INSPRU* 1.2.13R to *INSPRU* 1.2.19G) that take account of current experience and the potential for future change. The *firm* should reserve for option take-up at least at a prudent margin over current experience for options shortly to vest. For longer term options where the option becomes increasingly valuable in the future due to projected mortality improvements, increased take-up rates should be assumed. In view of the growing uncertainty over take-up rates for projections further in the future, for guaranteed annuity option dates 20 years or more ahead at least a 95% take-up rate assumption should be made.

- 1.2.67 G Where there is considerable variation in the cost of the option depending on conditions at the time the option is exercised, and where that variation constitutes a material risk for the *firm*, it will generally be appropriate to use stochastic modelling. In this case prices from the asset model used in the stochastic approach should be benchmarked to relevant market asset prices before determining the value of the option. Where stochastic modelling is not undertaken, market option prices should be used to determine suitable assumptions for the valuation of the option. If no market exists for a particular option, a *firm* should take the value of the nearest equivalent benefit or right for which a market exists and document the way in which it has adjusted that valuation to reflect the original option.
- 1.2.68 G Where the option offers a choice between two non-discretionary financial benefits (such as between a guaranteed cash sum or a guaranteed annuity value, or between a unit value and a maturity guarantee) and where there is a wide range of possible outcomes, the *firm* should normally model such liabilities stochastically. In carrying out such modelling *firms* should take into account the likely choices to be made by *policyholders* in each scenario. *Firms* should make and retain a record of the development and application of the model.
- 1.2.69 G The value of a contract with an option is greater than the value of a similar contract without the option, that is, the option has value whether it is expected to be exercised or not. Although in theory a *firm* can rebalance its investments to match the expected cost of the option to the *firm* (including the time value of the option), this takes time to achieve and the market may move more quickly than the *firm* is able to respond. Also, there are likely to be transaction costs. *Firms* should take these aspects into consideration in setting up *mathematical reserves*.
- 1.2.70 R (1) Where a *policyholder* may opt to be paid a cash amount, or a series of cash payments, the *mathematical reserves* for the *contract of insurance* established under *INSPRU* 1.2.7R must be sufficient to ensure that the payment or payments could be made solely from:
- (a) the assets covering those *mathematical reserves*; and
 - (b) the resources arising from those assets and from the contract itself.
- (2) In (1) references to a cash amount or a series of cash payments include the amount or amounts likely to be paid on a voluntary discontinuance.
- (3) For the purposes of (1), the *firm* must assume that:
- (a) the assumptions adopted for the current valuation remain unaltered and are met; and
 - (b) discretionary benefits and charges will be set so as to fulfil the *firm's* regulatory duty to treat its *customers* fairly.
- (4) (1) may be applied to a group of similar contracts instead of to the individual contracts within that group except where the cash amount or series of cash payments is the amount or amounts likely to be paid on a voluntary discontinuance.

- 1.2.71 R For the purposes of *INSPRU* 1.2.70R, a *firm* must assume that the amount of a cash payment secured by the exercise of an option is:
- (1) in the case of an *accumulating with-profits policy*, the lower of:
- (a) the amount which the *policyholder* would reasonably expect to be paid if the option were exercised, having regard to the representations made by the *firm* and including any expectations of a *final bonus*; and
- (b) that amount, disregarding all discretionary adjustments;
- (2) in the case of any other *policy*, the amount which the *policyholder* would reasonably expect to be paid if the option were exercised, having regard to the representations made by the *firm*, without taking into account any expectations regarding future distributions of profits or the granting of discretionary additions in respect of an *established surplus*.
- 1.2.72 G *INSPRU* 1.2.71R(1) applies only to *accumulating with-profits policies*; *INSPRU* 1.2.71R(2) applies to any other type of *policy*, including *non-profit insurance contracts*. In *INSPRU* 1.2.71R(1)(a) a *firm* must take into consideration, for example, a market value adjustment where such an adjustment has been described in representations made to *policyholders* by the *firm*. However, any discretionary adjustment, such as a market value adjustment, must not be included in the amount calculated in *INSPRU* 1.2.71R(1)(b).
- Persistency assumptions
- 1.2.73 G *INSPRU* 1.2.76R and *INSPRU* 1.2.77G apply to the valuation of the *with-profits insurance liabilities* of *realistic basis life firms*. *INSPRU* 1.2.76AR and *INSPRU* 1.2.77G apply to the valuation of liabilities arising from the *life protection reinsurance business* and *permanent health reinsurance business* of *pure reinsurers*. *INSPRU* 1.2.74R and *INSPRU* 1.2.75G apply to the valuation of all other liabilities.
- 1.2.74 R Except as permitted by *INSPRU* 1.2.76R and *INSPRU* 1.2.76AR, a *firm* must not make any allowance in the calculation of the *mathematical reserves* for the voluntary discontinuance of any *contract of insurance* if the amount of the *mathematical reserves* so determined would, as a result, be reduced.
- 1.2.75 G The rate of voluntary discontinuance (that is, lapse, surrender or paying up) is often difficult to predict and may be volatile especially in the short term during stressful economic conditions. Depending upon the circumstances and contract terms, voluntary discontinuance may increase or decrease the *firm's* liability. In effect, *INSPRU* 1.2.74R requires a *firm* to assume that there will be no voluntary discontinuance if assuming voluntary discontinuance would reduce the liability. This protects against the risk that arises from volatility in the rate of voluntary discontinuance. In addition, there is the risk of assets not being realisable when needed due to the rates of discontinuance exceeding expected levels.
- 1.2.76 R A *realistic basis life firm* may make assumptions about voluntary

discontinuance rates in the calculation of the *mathematical reserves* for its *with-profits insurance business* provided that those assumptions meet the general requirements for prudent assumptions as set out in *INSPRU 1.2.10R* and *INSPRU 1.2.13R*.

1.2.76A R A *pure reinsurer* may make assumptions about voluntary discontinuance rates in the calculation of the *mathematical reserves* in respect of *contracts of insurance* falling within:

- (1) its *life protection reinsurance business*; or
- (2) its *permanent health reinsurance business*;

provided that those assumptions meet the general requirements for prudent assumptions as set out in *INSPRU 1.2.10R* and *INSPRU 1.2.13R*.

1.2.77 G The prudential margin in respect of assumptions of voluntary discontinuance should be validated both in relation to recent experience and to variations in future experience that might arise as a result of reasonably foreseeable changes in conditions. In particular, where estimates of experience are being made well into the future, the assumptions should contain margins that take into account the increased risk of adverse experience arising from changed circumstances. *Firms* should also consider the possibility of anti-selection by *policyholders* and of variations in persistency experience for different classes and cohorts of business.

Reinsurance

1.2.77A R In *INSPRU 1.2.78G* to *INSPRU 1.2.89G* references to:

- (1) *reinsurance* and contracts of *reinsurance* include analogous non-*reinsurance* financing agreements, including contingent loans, securitisations and any other arrangements in respect of *contracts of insurance* that are analogous to contracts of *reinsurance* in terms of the risks transferred and the finance provided;
- (2) reinsured risks, in relation to a contract of *reinsurance* entered into by a *firm*, means that part of:
 - (a) the risks insured by the *firm* under *long-term insurance contracts* entered into by it; and
 - (b) the other risks arising directly from the *firm's long-term insurance business*; that have been transferred to the *reinsurer* under that contract of *reinsurance*; and
- (3) *reinsurance* cash outflows include any reduction in *policy* liabilities recognised as covered under a contract of *reinsurance* or any reduction of any debt to the *firm* under or in respect of a contract of *reinsurance*.

1.2.78 G The prospective valuation of future cash flows to determine the amount of the *mathematical reserves* includes amounts to be received or paid under contracts of *reinsurance* in respect of *long-term insurance business* (see *INSPRU 1.2.28R(4)*). This applies even where those cash flows cannot be

identified as related to particular *long-term insurance contracts* (see *INSPRU 1.2.22R(3)*).

- 1.2.79 R A *firm* must value *reinsurance* cash flows using methods and assumptions which are at least as prudent as the methods and assumptions used to value the underlying *contracts of insurance* which have been reinsured. In particular:
- (1) *reinsurance* recoveries must not be recognised unless the underlying liabilities to which they relate have also been recognised;
 - (2) *reinsurance* cash outflows that are unambiguously linked to the emergence as surplus of margins included in the valuation of existing *contracts of insurance* or to the exercise by a *reinsurer* of its rights under a termination clause need not be valued (see *INSPRU 1.2.85R*); and
 - (3) *reinsurance* cash inflows that are contingent on factors or conditions other than the reinsured risks must not be valued.
- 1.2.80 G In valuing *reinsurance* cash flows, a *firm* should establish prudent margins for adverse deviation (see *INSPRU 1.2.13R* to *INSPRU 1.2.19G*) including margins in respect of:
- (1) any uncertainty as to the amount or timing of amounts to be paid or received; and
 - (2) the risk of credit default by the *reinsurer*.
- 1.2.81 G In assessing the risk of credit default, the *firm* should take into account the *rules* and *guidance* in *INSPRU 2.1* (Credit risk in insurance).
- 1.2.82 G It will not necessarily be appropriate to use the same assumptions in *INSPRU 1.2.79R* as for the underlying contracts. For example, if only a subgroup of the original contracts is reinsured, it may be appropriate to use different mortality rates.
- 1.2.83 G Only *reinsurance* cash inflows that are triggered unambiguously by the reinsured risks may be valued. *Reinsurance* cash inflows that depend on other contingencies where the outcome does not form part of the valuation basis should not be given credit.
- 1.2.84 G *Firms* should assess the extent of margins in the valuation of the existing *contracts of insurance* where these provide implicit provision for the *reinsurance* cash outflows in *INSPRU 1.2.79R*. Where the *reinsurance* asset exceeds the estimated value of the future surplus under reinsured contracts *firms* should assess their credit risk exposure to the *reinsurer*.
- 1.2.85 R For the purposes of *INSPRU 1.2.79R(2)*, the "link" must be such that a contingent liability to pay or repay the amount to the *reinsurer* could not arise except when, and to the extent that, the margins in the valuation of the existing *contracts of insurance* emerge as surplus, or the *reinsurer* exercises its rights under a termination clause in the contract of *reinsurance* as a result of:

- (1) fraudulent conduct by the *firm* under or in relation to the contract of *reinsurance*; or
- (2) a representation as to the existence, at or before the time the contract of *reinsurance* is entered into, of a state of affairs which is within the knowledge or control of the *firm* and which is material to the *reinsurer's* decision to enter into the contract being discovered to be false; or
- (3) the non-payment of *reinsurance premiums* by the *firm*; or
- (4) a transfer by the *firm* of the whole or a specified part of its business without the agreement of the *reinsurer*, except where that agreement has been unreasonably withheld.

- 1.2.86 R For the purposes of *INSPRU* 1.2.79R(2) and *INSPRU* 1.2.85R, future surplus may only be offset against future *reinsurance* cash outflow in respect of surplus on *non-profit insurance contracts* and the charges or shareholder transfers arising as surplus from *with-profits insurance contracts*. Such charges and transfers may only be allowed for to the extent consistent with the regulatory duty of the *firm* to treat its *customers* fairly.
- 1.2.87 G For the purposes of *INSPRU* 1.2.85R, a contingent liability means a liability that would only arise upon the happening of a particular contingency, even where that contingency is not expected to occur. For example, if the *firm* has a *reinsurance* arrangement in force that in the event the *firm* were wound up would give rise to repayments other than out of surplus emerging, the *reinsurance* cash outflows should be valued as a liability.
- 1.2.88 G *INSPRU* 1.2.85R allows a *firm* not to value *reinsurance* cash outflows provided the contingencies in which the *reinsurance* would require repayment other than out of future surpluses are limited to termination clauses concerning fraud, material misrepresentation, non-payment of *reinsurance premiums* by the *firm* or a transfer of business by the *firm* without the agreement of the *reinsurer*, except if unreasonably withheld.
- 1.2.89 G Where the *reinsurance* cash outflow is payable by a fund or sub-fund that generates such profits, charges or transfers, the *firm* need make no provision for such payments provided that repayment to the *reinsurer* is linked unambiguously (as defined in *INSPRU* 1.2.85R) to the emergence of future surplus. Where the profits, charges or transfers arising under a block of business are payable by a fund or sub-fund to another part of the *firm* then only where the *firm* has committed to remit such profits, charges or transfers directly to the *reinsurer* would it be acceptable for no provision for payments to the *reinsurer* to be made.
- 1.2.90 R [deleted]
- 1.2.91 G [deleted]
- Application of *INSPRU* 1.2 to Lloyd's
- 1.2.92 R *INSPRU* 1.2 applies to *managing agents* in accordance with *INSPRU* 8.1.4R.

Approved reinsurance to close

- 1.2.93 R In respect of business that has been subject to an *approved reinsurance to close*, *managing agents* must calculate *mathematical reserves* (before and after deduction of reinsurance cessions) for the reinsuring and not for the reinsured *member*.

1.3 With-profits insurance capital component

Application

- 1.3.1 R *INSPRU 1.3 applies to a realistic basis life firm.*
- 1.3.2 G *A realistic basis life firm means a firm to which GENPRU 2.1.18R applies. The application of GENPRU 2.1.18R is set out in GENPRU 2.1.19R and GENPRU 2.1.20R. GENPRU 2.1.13R requires that a firm must maintain at all times capital resources equal to or in excess of its capital resources requirement. The enhanced capital requirement forms part of the capital resources requirement for a realistic basis life firm. The with-profits insurance capital component forms part of the enhanced capital requirement which a realistic basis life firm is required to calculate in accordance with GENPRU 2.1.38R.*

Purpose

- 1.3.3 G *This section sets out rules and guidance as to the methods and assumptions to be used in calculating the with-profits insurance capital component.*
- 1.3.4 G *The purpose of the with-profits insurance capital component is to supplement the mathematical reserves so as to ensure that a firm holds adequate financial resources for the conduct of its with-profits insurance business. In particular, capital in excess of the mathematical reserves may be needed to ensure that adequate final bonuses can be awarded to policyholders. That is, adequate in the sense that in setting bonuses payable to policyholders the firm pays due regard to the interests of its policyholders and treats them fairly. The mathematical reserves for a realistic basis life firm are not required to include provision for future annual bonuses or final bonuses (INSPRU 1.2.9R).*
- 1.3.5 G *The required procedures are summarised in the flowchart in INSPRU 1 Annex 1G.*

Main requirements

- 1.3.6 R *A firm must calculate the with-profits insurance capital component in accordance with INSPRU 1.3.7R.*
- 1.3.7 R *(1) The with-profits insurance capital component for a firm is the aggregate of any amounts that:*

- (a) result from the calculations specified in (2) and (3); and
 - (b) are greater than zero.
- (2) Subject to (3), in relation to each *with-profits fund* within the *firm*, the *firm* must deduct B from A, where:
- (a) A is the amount of the *regulatory excess capital* for that fund (see *INSPRU* 1.3.23R); and
 - (b) B is the amount of the *realistic excess capital* for that fund (see *INSPRU* 1.3.32R).
- (3) Where a capital instrument that can be included in the *firm's capital resources* in accordance with *GENPRU* 2.2 has been attributed wholly or partly to a *with-profits fund* and that instrument meets the requirements of *GENPRU* 2.2.271R, the *firm* must add to the amount calculated under (2) for that fund the result, subject to a minimum of zero, of deducting D from C where:
- (a) C is the outstanding face amount of the instrument to the extent attributed to the fund; and
 - (b) D is the realistic value of the instrument to the extent attributed to the fund in the single event that determines the *risk capital margin* under *INSPRU* 1.3.43R.

- 1.3.8 G Subordinated debt which is subordinated to *policyholder* interests (see *GENPRU* 2.2.271R) is an example of the sort of capital instrument that may give rise to a component of the *WPICC* under *INSPRU* 1.3.7R(3). Such instruments are treated as capital under *GENPRU* 2.2, subject to the requirements of *GENPRU* 2.2.271R. Under realistic reserving the capital instrument is valued as a realistic liability (*INSPRU* 1.3.40R) and in calculating the *risk capital margin* such an instrument would be valued at its realistic value in the single event outlined in *INSPRU* 1.3.43R (see also *INSPRU* 1.3.162R). Overall, the effect of *GENPRU* 2.2, *INSPRU* 1.3.7R(3) and *INSPRU* 1.3.43R is to enable a *firm* that obtains subordinated debt to benefit from additional *capital resources* equal to the face amount of that debt.
- 1.3.9 G *SUP* 4 (Actuaries) sets out the role and responsibilities of the *actuarial function* and of the *with-profits actuary*.

(1) As part of his duties under SUP 4.3.13R, the *actuary* appointed by the *firm* to perform the *actuarial function* must calculate the *firm's mathematical reserves* and, in the context of the calculation of the *with-profits insurance capital component*, must also:

(a) advise the *firm's governing body* on the methods and assumptions to be used in the calculation of the *firm's with-profits insurance capital component*;

(b) perform that calculation in accordance with the methods and assumptions determined by the *firm's governing body*; and

(c) report to the *firm's governing body* on the results of that calculation.

(2) As part of his duties under SUP 4.3.16G, the *with-profits actuary* must advise the *firm's governing body* on the discretion exercised by the *firm*. In the context of the calculation of the *with-profits insurance capital component*, the *with-profits actuary* must also advise the *firm's governing body* as to whether the methods and assumptions (including the allowance for management actions) used for that calculation are consistent with the *firm's Principles and Practices of Financial Management (PPFM - see COB 6.10)* and with its regulatory duty to treat its *customers* fairly.

General

Definitions

- 1.3.10 R In this section, real estate means an interest in land, buildings or other immovable property.
- 1.3.11 R In this section, the long-term gilt yield is the annualised equivalent of the yield on the 15-year index for United Kingdom Government fixed-interest securities jointly compiled by the Financial Times, the Institute of Actuaries and the Faculty of Actuaries.
- 1.3.12 R For the purposes of this section, a *firm* has an exposure to an asset or liability where the *firm's* valuation of its assets or liabilities changes when the value of the asset or liability changes.
- 1.3.13 R Unless the context otherwise requires, all references (however expressed) in this section to realistic liabilities, or to liabilities which are included in the calculation of realistic liabilities, include discretionary benefits payable by the *firm* in accordance with the *firm's* regulatory duty to treat its *customers* fairly.
- 1.3.14 G In this section, any reference to a *firm's* regulatory duty to treat its *customers* fairly is a reference to the *firm's* duty under *Principle 6 (Customers' interests)*. This states that a *firm* must pay due regard to the interests of its *customers* and treat them fairly.
- 1.3.15 G In this section, any reference to the *Principles and Practices of Financial Management (PPFM)* is a reference to the requirements in *COB 6.10 (Principles and Practices of Financial Management)* for *firms* to establish,

maintain and record the principles and practices of financial management according to which the business of its *with-profits funds* is conducted.

- 1.3.16 G The extent to which a *firm* requires a separate *PPFM* for each of its *with-profits funds* will depend on the *firm's* circumstances and any relevant representations made by the *firm* to its *with-profits policyholders*. In this section, any reference to a *firm's PPFM* refers to the *PPFM* which relate to the *with-profits fund* or the *with-profits insurance contracts* in question.

Record keeping

- 1.3.17 R A *firm* must make, and retain for an appropriate period of time, a record of:
(1) the methods and assumptions used in making any calculation required for the purposes of this section (and any subsequent changes) and the reasons for their use; and
(2) any change in practice and the nature of, reasons for, and effect of, any change in approach with respect to those methods and assumptions.

- 1.3.18 G *SYSC 14.1.53R* requires *firms* to maintain accounting and other records for a minimum of three years, or longer as appropriate. For the purposes of *INSPRU 1.3.17R*, a period of longer than three years will be appropriate for a *firm's long-term insurance business*. In determining an appropriate time period, a *firm* should have regard to:

- (1) the detailed *guidance* on record keeping in *SYSC 14.1.51G* to *SYSC 14.1.64G*;
(2) the nature and term of the *firm's long-term insurance contracts*; and
(3) any additional provisions or statutory requirements applicable to the *firm* or its records.

- 1.3.19 R A *firm* must also identify in the record required to be kept by *INSPRU 1.3.17R* changes in practice, in particular changes in those items which will or may be significant in relation to the eventual *claim* values.

- 1.3.20 G Some of the changes identified in accordance with *INSPRU 1.3.19R* may have to be notified to the *firm's policyholders* in accordance with the *firm's PPFM*.

General principles for allocating aggregate amounts

- 1.3.21 R Where any calculation is required under this section which:
(1) is to be made in respect of any *with-profits fund* of a *firm*; and
(2) covers an amount that is otherwise calculated in relation to the *firm* as a whole;
the *firm* must make an allocation of that amount as between all of its funds (including funds which are not *with-profits funds*).

- 1.3.22 R In any case where:

- (1) *non-profit insurance contracts* are written in any *with-profits fund* of a *firm*; and
- (2) any calculation is required under this section which:
- (a) is to be made in respect of the *regulatory excess capital* or *realistic excess capital* for the fund; and
- (b) covers an amount that is otherwise calculated or allocated in relation to the fund as a whole;
- the *firm* must make an allocation of the amount in (2)(b) as between the *with-profits insurance contracts* and *non-profit insurance contracts* written in the fund.

Calculation of regulatory excess capital

- 1.3.23 R A *firm* must calculate the *regulatory excess capital* for each of its *with-profits funds* by deducting B from A, where:
- (1) A is the *regulatory value of assets* of the fund (*INSPRU* 1.3.24R); and
- (2) B is the sum of:
- (a) the *regulatory value of liabilities* of the fund (*INSPRU* 1.3.29R);
- (b) the *long-term insurance capital requirement* in respect of the fund's *with-profits insurance contracts*; and
- (c) the *resilience capital requirement* in respect of the fund's *with-profits insurance contracts*.

Regulatory value of assets

- 1.3.24 R (1) For the purposes of *INSPRU* 1.3.23R(1), the *regulatory value of assets* of a *with-profits fund* is equal to the sum of:
- (a) the amount of the fund's *long-term admissible assets*; and
- (b) the amount of any *implicit items* allocated to that fund;
- less an amount, representing any *non-profit insurance contracts* written in that fund, determined in accordance with (2).
- (2) Where *non-profit insurance contracts* are written in a *with-profits fund*, the amount representing those contracts is the sum of:
- (a) the *mathematical reserves* in respect of the *non-profit insurance contract* written in the fund; and
- (b) the following amounts, to the extent that each of them is covered by the fund's *long-term admissible assets*:
- (i) an amount in respect of the *non-profit insurance contracts* written in the fund which represents an appropriate allocation of the *firm's long-term insurance capital requirement*; and
- (ii) an amount in respect of the *non-profit insurance contracts* written in the fund which represents an appropriate allocation of the *firm's resilience capital requirement*.
- 1.3.25 R For the purpose of determining the value of a fund's *long-term admissible assets* in accordance with *INSPRU* 1.3.24R(1)(a), no value is to be attributed to:

(1) debts owed by *reinsurers*; or
(2) *claims*; or
(3) tax recoveries; or
(4) claims against *compensation funds*;
to the extent already offset in the calculation of *technical provisions*.

1.3.26 R In making a determination in accordance with *INSPRU* 1.3.24R(2), a *firm* must allocate *long-term admissible assets* of an appropriate nature and term to any *non-profit insurance contracts* written in the *with-profits fund*.

1.3.27 G In calculating the amount of a *firm's resilience capital requirement* allocated to the *non-profit insurance contracts* in the *with-profits fund*, the *firm* should calculate the amount of resilience capital that would be required if that business were in a stand-alone company owning the assets allocated. The *resilience capital requirement* for the *with-profits insurance business* should also be calculated as if it were a stand-alone company. An allocation of the *firm's total resilience capital requirement* should then be made in a manner that would produce a result materially consistent with an allocation in proportion to the amounts calculated for each part of the business as stand-alone entities.

1.3.28 G A *firm* needs to obtain an *implicit item waiver* from the *FSA* in order to bring in an amount under *INSPRU* 1.3.24R(1)(b). For *guidance* on applying for an *implicit item waiver* in respect of future surpluses relating to *with-profits funds* see *GENPRU* 2 Annex 8G. The amount of any *implicit item* allocated to a *with-profits fund* may be defined in the terms of any *waiver* granted.

Regulatory value of liabilities

1.3.29 R For the purposes of *INSPRU* 1.3.23R(2)(a), the *regulatory value of liabilities* of a *with-profits fund* is equal to the sum of:
(1) the *mathematical reserves*, in respect of the fund's *with-profits insurance contracts*, including the value of any provisions reflecting bonuses allocated at the *actuarial valuation date*; and
(2) the *regulatory current liabilities* of the fund (see *INSPRU* 1.3.30R).

1.3.30 R For the purposes of *INSPRU* 1.3.29R(2), the *regulatory current liabilities* of a *with-profits fund* are equal to the sum of the following amounts to the extent that they relate to that fund:

(1) accounting liabilities (including *long-term insurance liabilities* which have fallen due before the end of the *financial year*);
(2) liabilities from *deposit back arrangements*; and
(3) any provision for adverse variations (determined in accordance with *INPSRU* 3.2.17R).

1.3.31 G The amount of *regulatory current liabilities* for a *with-profits fund* refers to the sum of the amounts in (1) and (2) in respect of the fund:

(1) the amount of 'Total other insurance and non-insurance liabilities'; and
(2) the amount of 'Cash bonuses which had not been paid to *policyholders* prior to the end of the financial year';
as disclosed at lines 49 and 12 respectively of the appropriate Form 14 ('Long-term business liabilities and margins') for that fund as part of the Annual Returns required to be deposited with the *FSA* under *IPRU(INS)* rule 9.6R(1).

Calculation of realistic excess capital

- 1.3.32 R *A firm* must calculate the *realistic excess capital* for each of its *with-profits funds* by deducting B from A, where:
- (1) A is the *realistic value of assets* of the fund (see *INSPRU* 1.3.33R); and
 - (2) B is the sum of:
 - (a) the *realistic value of liabilities* of the fund (see *INSPRU* 1.3.40R); and
 - (b) the *risk capital margin* for the fund (see *INSPRU* 1.3.43R).

Realistic value of assets

- 1.3.33 R (1) For the purposes of *INSPRU* 1.3.32R(1), the *realistic value of assets* of a *with-profits fund* is the sum of:
- (a) the amount of the fund's *regulatory value of assets* determined in accordance with *INSPRU* 1.3.24R, but with no value given to any *implicit items* and excluding the regulatory value of any *shares* in a *related undertaking* which carries on *long-term insurance business*;
 - (b) the amount of the fund's excess *admissible assets* (see *INSPRU* 1.3.36R);
 - (c) the present value of future profits (or losses) on any *non-profit insurance contracts* written in the *with-profits fund* (see *INSPRU* 1.3.37R);
 - (d) the value of any *derivative* or *quasi-derivative* held in the fund (see *GENPRU* 1.3.41R) to the extent its value is not reflected in (a), (b) or (c);
 - (e) any amount determined under (2); and
 - (f) the amount of any prepayments made from the fund.
- (2) Where any equity *shares* held (directly or indirectly) by a *firm* (A):
- (a) are *shares* in a *related undertaking* (B) which carries on *long-term insurance business*; and
 - (b) have been identified by A under *INSPRU* 1.3.21R as *long-term insurance assets* which are held in the *with-profits fund* for which the realistic value is to be determined under (1);
- the amount required under (1)(e) is the relevant proportion of the value of all B's equity *shares* as determined in (3).
- (3) For the purposes of (2):
- (a) the relevant proportion is the proportion of the total number of equity *shares* issued by B which are held (directly or indirectly) by A;
 - (b) the value of all B's equity *shares* must be taken as D deducted from C, where C is equal to the sum of:
 - (i) the shareholder net assets of B;
 - (ii) any surplus assets in the *non-profit funds* of B;
 - (iii) any additional amount arising from the present value of future profits (or losses) on any *non-profit insurance contracts* written by B (calculated on a basis consistent with *INSPRU* 1.3.37R), excluding any amount arising from business that is written in a *with-profits fund*; and
 - (iv) where B has any *with-profits funds*, the present value of projected future transfers out of those funds to shareholder funds of B;and D is equal to the sum of:
 - (v) the *long-term insurance capital requirement* in respect of any *non-profit insurance contracts* written in a *non-profit fund* of B;
 - (vi) the amount of the *resilience capital requirement* in respect of any *non-profit insurance contracts* written in a *non-profit fund* of B;
 - (vii) any part of the *with-profits insurance capital component* of B, or of B's *long-term insurance capital requirement* or *resilience capital requirement* in respect of B's *with-profits insurance contracts*, that is not covered from the assets of the *with-profits fund* from which it arises after deducting from those assets the amount calculated under (iv); and
 - (viii) any assets of B that back its regulatory capital requirements and that are valued in (iii) in the calculation of the present value of future profits of *non-profit insurance business* written by B.
- (4) The methods and assumptions used in the calculations under (3)(b)(iii) and (iv) must follow a consistent approach to that set out in *INSPRU* 1.3.37R.

- 1.3.34 G In *INSPRU* 1.3.33R(1)(d), where a *derivative* or *quasi-derivative* has a positive asset value, credit should be given within the *realistic value of assets*. If the *derivative* or *quasi-derivative* has a negative asset value it should be valued within realistic liabilities as an element of *realistic current liabilities* (see *INSPRU* 1.3.40R(3)).
- 1.3.35 G Where a *firm* identifies *shares* in a *related undertaking* which carries on *long-term insurance business* as *shares* held in one of its *with-profits funds*, *INSPRU* 1.3.33R(1)(e), *INSPRU* 1.3.33R(2) and *INSPRU* 1.3.33R(3) bring in a realistic valuation of the *related undertaking* equal to its net assets plus the present value of future profits, less its regulatory capital requirements (see *INSPRU* 1.3.33R(3)(v), (vi) and (vii)). Where the *related undertaking* has taken the present value of future profits arising from its contracts into consideration in covering its regulatory capital requirements (for example, its *risk capital margin*, under *INSPRU* 1.3.45R(2)(c)), *INSPRU* 1.3.33R(3)(b)(iii) requires a *firm* to exclude those future profits in valuing the *related undertaking*. The subtraction of the capital requirements in the calculation provides a straightforward method of allowing for the change in the *related undertaking's* value in stress conditions, as the value of the *related undertaking* is not subject to the realistic stress tests of the *risk capital margin*. In calculating the present value of future profits on *non-profit insurance business* written in the *related undertaking* under *INSPRU* 1.3.33R(3)(b)(iii), a *firm* may value the release of capital requirements as the business runs off (see *INSPRU* 1.3.38G). *INSPRU* 1.3.33R(3)(b)(viii) ensures that any such capital is not double-counted.
- 1.3.36 R Excess *admissible assets* of a *with-profits fund* means *admissible assets* which exceed any of the percentage limits referred to in *INSPRU* 2.1.22R.
- 1.3.37 R A *firm* must calculate the present value of future profits (or losses) on *non-profit insurance contracts* written in the *with-profits fund* using methodology and assumptions which:

- (1) are based on current estimates of future experience;
- (2) involve reasonable (but not excessively prudent) adjustments to reflect risk and uncertainty;
- (3) allow for a market-consistent valuation of any guarantees or options within the contracts valued;
- (4) are derived from current market yields, having regard to International Financial Reporting Standard 4: Insurance Contracts, as if it were being applied to determine the value under that standard for the first time;
- (5) have regard to generally accepted actuarial practice and generally accepted industry standards appropriate for *firms* carrying on *long-term insurance business*;
- (6) are consistent with the allocation, made in accordance with *INSPRU* 1.3.22 R, of any aggregate amounts as between the *with-profits insurance contracts* and the *non-profit insurance contracts* written in the fund;
- (7) allow for any tax that would be payable out of the *with-profits fund* in respect of the contracts valued; and
- (8) are consistent with the allocation, made in accordance with *INSPRU* 1.3.26R, of *long-term admissible assets* as between the *with-profits insurance contracts* and any *non-profit insurance contracts* written in the fund.

- 1.3.38 G In calculating the present value of future profits (or losses) for *non-profit insurance business* required by *INSPRU* 1.3.33R(1)(c), to the extent that the *long-term insurance capital requirement* and the *resilience capital requirement* are covered by the *with-profits fund's long-term admissible assets*, a *firm* may take into consideration any release of these items as the relevant *policies* go off the books.
- 1.3.39 G Annuities do not typically fall to be valued on a market-consistent basis under *INSPRU* 1.3.37R(3) as they are not "options and guarantees" as defined for accounting purposes. This is because they do not have "time value" in the option-pricing meaning of that term. However where, atypically, annuities do fall to be valued on a market-consistent basis under *INSPRU* 1.3.37(3), the discount rate used should be appropriate to the characteristics of the liability, including its illiquidity. The appropriate interest rate, therefore, would not typically be the risk-free rate. Where illiquid assets are used to closely match similar illiquid liabilities, as could be the case in annuities business, it would be appropriate to look at the liquidity premium that is implicit in the market value of the assets as a proxy for the liquidity premium that should be included in a market consistent valuation of the liabilities. However, care should be exercised in doing this. Assets and liabilities are rarely perfectly matched and an appropriate margin needs to be included in the valuation to cover the risk of unexpected mismatch.
- 1.3.39A G In view of *INSPRU* 1.3.39G, it is likely that the discount rate to be applied to the market-consistent valuation of those annuities that fall within the scope of *INSPRU* 1.3.37 R(3) would not be significantly different from that which applies to other annuities (to which a discount rate based on the return on the matching assets less an allowance for risk which is reasonable but not

excessively prudent, in accordance with *INSPRU* 1.3.37 R(2), might be applied).

- 1.3.39B G In determining current market yields for the purpose of *INSPRU* 1.3.3 R (4), a *firm* is required to have regard to IFRS 4 as if it were being applied to determine the value under that standard for the first time, that is, without reference to existing practices. Paragraph 27 of the standard is likely to be of particular relevance. A *firm* should not include an allowance for future investment margins until they are earned. In particular, a *firm* should not include an allowance for capital growth in determining current market yields for equities and real estate investments.

Realistic value of liabilities: general

- 1.3.40 R For the purposes of *INSPRU* 1.3.32R(2)(a), the *realistic value of liabilities* of a *with-profits fund* is the sum of:
(1) the *with-profits benefits reserve* of the fund;
(2) the *future policy related liabilities* of the fund; and
(3) the *realistic current liabilities* of the fund.

- 1.3.41 G All liabilities arising under, or in connection with, *with-profits insurance contracts* written in the fund should be included in the *realistic value of liabilities* referred to in *INSPRU* 1.3.40R, including those in respect of guarantees and the value of options.

- 1.3.42 G Detailed *rules* and *guidance* for the calculation of the three elements referred to in *INSPRU* 1.3.40R are contained below in this section:
(1) *INSPRU* 1.3.116R to *INSPRU* 1.3.135G refer to the *with-profits benefits reserve*;
(2) *INSPRU* 1.3.136G to *INSPRU* 1.3.189G refer to the *future policy related liabilities*; and
(3) *INSPRU* 1.3.190R and *INSPRU* 1.3.191R refer to the *realistic current liabilities*.

Risk capital margin

- 1.3.43 R (1) A *firm* must calculate a *risk capital margin* for each of its *with-profits funds* in accordance with (2) to (6).
(2) The *firm* must identify relevant assets (*INSPRU* 1.3.45R) which, in the most adverse scenario, will have a value (*INSPRU* 1.3.46R) which is equal to the *realistic value of liabilities* of the fund under that scenario.
(3) The most adverse scenario means the single event comprising that combination of the scenarios in *INSPRU* 1.3.44R which gives rise to the largest positive value that results from deducting B from A, where:
(a) A is the value of relevant assets which will produce the result described in (2); and
(b) B is the *realistic value of liabilities* of the fund.
(4) The *risk capital margin* for the fund is the result of deducting C from A, where C is the sum of:
(a) B; and
(b) any amount included within relevant assets under *INSPRU* 1.3.45R(2)(c).
(5) In calculating the value of relevant assets for the purpose of determining the most adverse scenario in (3), a *firm* must not adjust the valuation of any asset taken into consideration under *INSPRU* 1.3.33R(1)(e) (*related undertakings* carrying on *long-term insurance business*) or *INSPRU* 1.3.45R(2)(c) (present value of future profits arising from *insurance contracts* written outside the *with-profits fund*).
(6) In calculating the *realistic value of liabilities* of a fund under any scenario, a *firm* is not required to adjust the best estimate provision made under *INSPRU* 1.3.190R(1) in respect of a *defined benefits pension scheme* in accordance with *INSPRU* 1.3.191R .
- 1.3.44 R For the purposes of *INSPRU* 1.3.43R(3), the scenarios are one scenario selected from each of the following:

- (1) in respect of *UK* and other assets within *INSPRU* 1.3.62R(1)(a):
 - (a) the range of *market risk* scenarios identified in accordance with *INSPRU* 1.3.68R(1) (equities);
 - (b) the range of *market risk* scenarios identified in accordance with *INSPRU* 1.3.68R(2) (real estate); and
 - (c) the range of *market risk* scenarios identified in accordance with *INSPRU* 1.3.68R(3) (fixed interest securities);
- (2) in respect of non-*UK* assets within *INSPRU* 1.3.62R(1)(b):
 - (a) the range of *market risk* scenarios identified in accordance with *INSPRU* 1.3.73R(1) (equities);
 - (b) the range of *market risk* scenarios identified in accordance with *INSPRU* 1.3.73R(2) (real estate); and
 - (c) the range of *market risk* scenarios identified in accordance with *INSPRU* 1.3.73R(3) (fixed interest securities);
- (3) the range of credit risk scenarios identified in accordance with *INSPRU* 1.3.78R(1) (bond or debt items);
- (4) the range of credit risk scenarios identified in accordance with *INSPRU* 1.3.78R(2) (*reinsurance* items or analogous non-*reinsurance* financing agreements);
- (5) the range of credit risk scenarios identified in accordance with *INSPRU* 1.3.78R(3) (other items including *derivatives* and *quasi-derivatives*); and
- (6) the persistency risk scenario identified in accordance with *INSPRU* 1.3.100R.

1.3.45 R (1) In *INSPRU* 1.3.43R, in relation to a *with-profits fund*, the relevant assets means a range of assets which meets the following conditions:

- (a) the range is selected on a basis which is consistent with the *firm's* regulatory duty to treat its *customers* fairly;
 - (b) the range must include assets from within the *with-profits fund* the value of which is greater than or equal to the *realistic value of liabilities* of the fund;
 - (c) the range is selected in accordance with (2); and
 - (d) no asset of the *firm* may be allocated to the range of assets identified in respect of more than one *with-profits fund*.
- (2) The range of assets must be selected from the assets specified in (a) to (c), in the order specified:
- (a) assets that have a realistic value under *INSPRU* 1.3.33R;
 - (b) where a *firm* has selected all the assets within (a), any *admissible assets* that are not identified as held within the *with-profits fund*; and
 - (c) where a *firm* has selected all the assets within (a) and (b), any additional assets.
- (3) But a *firm* must not bring any amounts into account under (2)(b) or (2)(c) in respect of any *with-profits fund* if that would result in the *firm* exceeding its overall maximum limit (determined according to whether the *firm* has only one *with-profits fund* or more than one such fund).
- (4) A *firm* exceeds its overall maximum limit for amounts brought into account under (2)(b) where:
- (a) in the case of a *firm* with a single *with-profits fund*, the amount the *firm* brings into account in respect of that fund;
 - (b) in the case of a *firm* with two or more *with-profits funds*, the aggregate of the amounts the *firm* brings into account in respect of each of those funds; exceeds the sum of the *firm's* shareholder net assets and the surplus assets in the *firm's non-profits funds*, less any regulatory capital requirements in respect of business written outside its *with-profits funds*.
- (5) A *firm* exceeds its overall maximum limit for amounts brought into account under (2)(c) where:
- (a) in the case of a *firm* with a single *with-profits fund*, the amount the *firm* brings into account in respect of that fund;
 - (b) in the case of a *firm* with two or more *with-profits funds*, the aggregate of the amounts the *firm* brings into account in respect of each of those funds; exceeds 50% of the present value of future profits arising from *insurance contracts* written by the *firm* outside its *with-profits funds*.

- 1.3.46 R In valuing the relevant assets identified under *INSPRU* 1.3.43R(2), a *firm* must use the same methods of valuation as in *INSPRU* 1.3.33R, except that:
- (1) the value of any *admissible assets* not identified as held within the *with-profits fund* (*INSPRU* 1.3.45R(2)(b)) must be as determined under *GENPRU* 1.3; and
 - (2) the value of any asset which forms part of the range of assets as a result of *INSPRU* 1.3.45R(2)(c) must be determined on a basis consistent with that described in *INSPRU* 1.3.37R.
- 1.3.47 G The purpose of the *risk capital margin* for a *with-profits fund* is to cover

adverse deviation from:

(1) the fund's *realistic value of liabilities*;
(2) the value of assets identified, in accordance with *INSPRU* 1.3.43R(2), to cover the amount in (1) and the fund's *risk capital margin*; arising from the effects of *market risk*, credit risk and persistency risk. Other risks are not explicitly addressed by the *risk capital margin*.

- 1.3.48 G The amount of the *risk capital margin* calculated by the *firm* for a *with-profits fund* will depend on the *firm's* choice of assets held to cover the fund's *realistic value of liabilities* and the margin. *INSPRU* 1.3.43R requires the relevant assets to be sufficient, in the most adverse scenario, to cover the *realistic value of liabilities* in the event that scenario was to arise.
- 1.3.49 G *INSPRU* 1.3.45R(2)(c) allows *firms* to bring the economic value of *non-profit insurance business* written outside a *with-profits fund* into the assets available to cover the *risk capital margin*. To place a prudent limit on the amount of future profits taken into consideration a maximum of 50% of the present value of *non-profit insurance business* can be taken into the calculation (*INSPRU* 1.3.45R(5)). Where a contract is written in a *non-profit fund* but the assets arising from that contract are invested in a *with-profits fund* which is subject to charges for investment management or other services which benefit the *non-profit fund*, such charges can be taken into consideration in calculating the present value of future profits of the *non-profit insurance business*. Where a proportion of the present value of future profits on *non-profit insurance business* written outside a *with-profits fund* is brought in as an asset, no stress tests apply to this asset (see *INSPRU* 1.3.43R(5)) as the amount taken into consideration is limited to 50% of the total present value.
- 1.3.50 G A *firm* using a stochastic approach in *INSPRU* 1.3.169R(1) should keep recalibration in the post-stress scenarios to the minimum required to reflect any change in the underlying risk-free yields. A *firm* using the market costs of hedging approach, as in *INSPRU* 1.3.169R(2), may assume in estimating the market cost of hedging in the post-stress scenarios that market volatilities are unchanged.
- 1.3.51 G In the scenario tests set out in *INSPRU* 1.3.62R to *INSPRU* 1.3.103G, *firms* are required to test for worst case scenarios across a range of assumptions. The tests are, with the exception of the credit risk test, two-sided, requiring both increases and decreases in the assumptions. The *FSA* does not expect a *firm* to investigate every possible stress, but a *firm* should be able to demonstrate that it is reasonable to assume that it has successfully identified the single event that determines the *risk capital margin* for the *firm's* business, as required by *INSPRU* 1.3.43R(3).
- 1.3.51A G In the scenario tests set out in *INSPRU* 1.3.62R to *INSPRU* 1.3.103G, a *firm* is required to assess the changed value of its assets and liabilities in the economic conditions of the most adverse scenario. A *firm* is required to assess the changed value of each relevant asset (as defined in *INSPRU*

1.3.45R), notwithstanding any uncertainty about the appropriate valuation basis for that asset. In valuing an asset in the most adverse scenario, a *firm* should have regard to the economic substance of the asset, rather than its legal form, and assess its value accordingly. Consider, for example, a convertible bond that is close to its conversion date and where the conversion option has value. The value of the convertible bond in the most adverse scenario is likely to be sensitive primarily to equity market scenarios and to a lesser extent to interest rate scenarios. The *firm* should value the asset according to its expected market value in the economic conditions underlying the most adverse scenario.

Management actions

- 1.3.52 R In calculating the *risk capital margin* for a *with-profits fund*, a *firm* may reflect, in its projections of the value of assets and liabilities under the scenarios in *INSPRU* 1.3.44R, the *firm's* prospective management actions (*INSPRU* 1.3.53R).
- 1.3.53 R Prospective management actions refer to the foreseeable actions that would be taken by the *firm's* management, taking into account:
- (1) an appropriately realistic period of time for the management actions to take effect; and
- (2) the *firm's* *PPFM* and its regulatory duty to treat its *customers* fairly.
- 1.3.54 G The management actions in *INSPRU* 1.3.53R may include, but are not limited to, changes in future bonus rates, reductions in *surrender values*, changes in asset dispositions (taking into account the associated selling costs) and changes in the amount of charges deducted from asset shares for *with-profits insurance contracts*.
- 1.3.55 G A *firm* should use reasonable assumptions in incorporating management actions into its projections of *claims* such that the mitigating effects of the management actions are not overstated. In modelling management actions, a *firm* should ensure consistency with its *PPFM* and take into account its regulatory duty to treat its *customers* fairly.
- 1.3.56 G In accordance with *INSPRU* 1.3.17R, a *firm* should make and retain a record of the approach used, in particular the nature and effect of anticipated management actions (including, where practicable, the amount by which the actions would serve to reduce the projected values of assets and liabilities).
- 1.3.57 G A *firm* which deducts charges in respect of any adverse experience or cost of capital to *with-profits insurance contracts* should keep a record under *INSPRU* 1.3.17R of the amount of any such charges to its *customers* and of how it has ensured their fair treatment.

Policyholder actions

- 1.3.58 R In calculating the *risk capital margin* for a *with-profits fund*, a *firm* must

reflect, in its projections of the value of assets and liabilities under the scenarios in *INSPRU* 1.3.44R, a realistic assessment of the actions of its *policyholders* (see *INSPRU* 1.3.59R).

- 1.3.59 R *Policyholder* actions refer to the foreseeable actions that would be taken by the *firm's policyholders*, taking into account:
- (1) the experience of the *firm* in the past; and
 - (2) the changes that may occur in the future if options and guarantees become more valuable to *policyholders* than in the past.
- 1.3.60 G A *firm* should use realistic assumptions in incorporating *policyholder* actions into its projections of *claims* such that any mitigating effects of *policyholder* actions are not overstated and any exacerbating effects of *policyholder* actions are not understated. In modelling *policyholder* actions, a *firm* should ensure consistency with its *PPFM* and take into account its regulatory duty to treat its *customers* fairly in determining the options and information that would be available to *policyholders*.
- 1.3.61 G In calculating the persistency scenario in *INSPRU* 1.3.100R, a *firm* needs to make assumptions regarding the future termination rates exhibited by *policies*, at points described in particular in *INSPRU* 1.3.101R. Such assumptions should be realistic. However, the *firm* must have regard to the economic scenarios being projected. For example, if the value of an option became significantly greater in a future scenario than in the recent past, then the behaviour of *policyholders* in taking up the option is likely to differ in this future scenario compared with the recent past.
- Market risk scenario
- 1.3.62 R (1) For the purposes of *INSPRU* 1.3.44R, the ranges of *market risk* scenarios that a *firm* must assume are:
- (a) for exposures to *UK* assets and for exposures to non-*UK* assets within (2), the ranges of scenarios set out in *INSPRU* 1.3.68R; and
 - (b) for exposures to other non-*UK* assets, the ranges of scenarios set out in *INSPRU* 1.3.73R.
- (2) The exposures to non-*UK* assets within this paragraph are:
- (a) exposures which do not arise from a significant territory outside the *United Kingdom* (*INSPRU* 1.3.63R); or
 - (b) exposures which do arise from a significant territory outside the *United Kingdom* but which represent less than 0.5% of the *realistic value of assets* of the *with-profits fund*, measured by *market value*.
- 1.3.63 R For the purposes of this section in relation to a *with-profits fund*, a significant territory is any country or territory in which more than 2.5% of the fund's *realistic value of assets* (by *market value*) are invested.
- 1.3.63A G *Guidance* on how a *firm* should determine where particular assets are invested is provided in *INSPRU* 3.1.13BG.

- 1.3.64 G In determining its most adverse scenario, a *firm* applying *INSPRU* 1.3.68R and *INSPRU* 1.3.73R should consider separately possible movements in *UK* and non-*UK* markets. It should not assume that market prices in different markets move in a similar way at the same time. A *firm* should also allow for the effect of the other components of the single event comprising the combination of scenarios applicable under *INSPRU* 1.3.43R.
- 1.3.65 G In relation to the *market risk* scenarios in *INSPRU* 1.3.68R and *INSPRU* 1.3.73R, the effect of *INSPRU* 1.3.52R and *INSPRU* 1.3.58R is that a *firm* may reflect management actions and must make a realistic assessment of *policyholder* actions in projecting the assets and liabilities in its calculation of the *risk capital margin* for a *with-profits fund* within the *firm*. This contrasts with the position for calculating the *resilience capital requirement* for the *firm* (*INSPRU* 3.1.9 G to *INSPRU* 3.1.26R).

1.3.66 G [deleted]

- 1.3.67 G The relevant assets identified under *INSPRU* 1.3.43R(2) to calculate the *risk capital margin* may, in certain circumstances, include up to 50% of the present value of future profits arising from *insurance contracts* written by the *firm* outside its *with-profits funds*. *INSPRU* 1.3.43R(5) exempts such an asset from the *market risk* stress tests.

Market risk scenario for exposures to UK assets and certain non-UK assets

- 1.3.68 R The range of *market risk* scenarios referred to in *INSPRU* 1.3.62R(1)(a) is:
(1) a rise or fall in the *market value* of equities of up to the greater of:
(a) 10%; and
(b) 20%, less the *equity market adjustment ratio* (see *INSPRU* 1.3.71R);
(2) a rise or fall in real estate values of up to 12.5%; and
(3) a rise or fall in yields on all fixed interest securities of up to 17.5% of the long-term gilt yield.
- 1.3.69 R For the purposes of *INSPRU* 1.3.68R, a *firm* must:
(1) assume that yields on equities and real estate remain unchanged from those applicable at market levels before applying each scenario; and
(2) model a rise or fall in equity, real estate and fixed interest markets as if the movement occurred instantaneously.
- 1.3.70 G For example, where the long-term gilt yield is 6%, a change of 17.5% in that yield would amount to a change of 1.05 percentage points. For the purpose of the scenarios in *INSPRU* 1.3.68R(3), the *firm* would assume a fall or rise of up to 1.05 percentage points in yields on all fixed interest securities.

Equity market adjustment ratio

1.3.71 R The equity market adjustment ratio referred to in *INSPRU* 1.3.68R(1)(b) is:
(1) if the ratio calculated in (a) and (b) lies between 80% and 100%, the result of 100% less the ratio (expressed as a percentage) of:
(a) the current value of the FTSE Actuaries All Share Index; to
(b) the average value of the FTSE Actuaries All Share Index over the preceding 90 calendar days;
(2) 0%, if the ratio calculated in (1)(a) and (b) is more than 100%; and
(3) 20%, if the ratio calculated in (1)(a) and (b) is less than 80%.

1.3.72 R In *INSPRU* 1.3.71(1)(b), the average value of the FTSE Actuaries All Share Index over any period of 90 calendar days means the arithmetic mean based on levels at the close of business on each of the days in that period on which the London Stock Exchange was open for trading.

Market risk scenario for exposures to other non-UK assets

1.3.73 R The range of *market risk* scenarios referred to in *INSPRU* 1.3.62R(1)(b) is:
(1) an appropriate rise or fall in the *market value* of equities listed in that territory (*INSPRU* 1.3.75G), which must be at least equal to the percentage determined in *INSPRU* 1.3.68R(1);
(2) a rise or fall in real estate values in that territory of up to 12.5%; and
(3) a rise or fall in yields on all fixed interest securities of up to 17.5% of the nearest equivalent (in respect of the method of calculation) of the long-term gilt yield.

1.3.74 R For the purposes of *INSPRU* 1.3.73R, a *firm* must:

(1) assume that yields on equities and real estate remain unchanged from those applicable at market levels before applying each scenario; and
(2) model a rise or fall in equity, real estate and fixed interest markets as if the movement occurred instantaneously.

1.3.75 G For the purposes of *INSPRU* 1.3.73R(1), an appropriate rise or fall in the *market value* of equities to which a *firm* has exposure in a significant territory must be determined having regard to:

(1) an appropriate equity market index (or indices) for that territory; and
(2) the historical volatility of the equity market index (or indices) selected in (1).

1.3.76 G For the purpose of *INSPRU* 1.3.75G(1), an appropriate equity market index (or indices) for a territory should be such that:

- (1) the constituents of the index (or indices) are reasonably representative of the nature of the equities to which the *firm* is exposed in that territory which are included in the relevant assets identified in accordance with *INSPRU* 1.3.43R(2); and
- (2) the frequency of, and historical data relating to, published values of the index (or indices) are sufficient to enable an average value(s) and historical volatility of the index (or indices) to be calculated over at least the three preceding *financial years*.

Credit risk scenarios

General

- 1.3.77 G (1) The purpose of the credit risk scenarios in *INSPRU* 1.3.78R to *INSPRU* 1.3.99G is to show the financial effect of specified changes in the general credit risk environment on a *firm's* direct (*counterparty*) and indirect credit risk exposures. The scenarios apply in relation to corporate bonds, debt, *reinsurance* and other exposures, including *derivatives* and *quasi-derivatives*. This is thus quite separate from any reference to allowance for credit risk in *INSPRU* 3.1.
- (2) In the case of bonds and debts, the scenarios are described in terms of an assumed credit rating dependent on the widening of credit spreads - changes in bond and debt credit spreads will have a direct impact on the value of bond and debt assets. Credit ratings are intended to give an indication of the security of the income and capital payments for a bond - the higher the credit rating, the more secure the payments. The reaction of credit spreads to developments in markets for credit risk varies by credit rating and so the scenarios to be assumed for bonds and debts depend on their ratings. The credit spreads on bonds and debt represent compensation to the investor for the risk of default and downgrade, but also for illiquidity, price volatility and the uncertainty of recovery rates relative to government bonds. Credit spreads on bonds tend to widen during an economic recession to reflect the increased expectations that corporate borrowers may default on their obligations or be subject to rating downgrades.
- (3) Changes in bond and debt credit spreads will also be indicative of a change in direct *counterparty* exposure in relation to *reinsurance* and other exposures including *derivatives* and *quasi-derivatives*.
- (4) In addition, changes in bond and debt credit spreads may indirectly impact on credit exposures, for example by affecting the payments anticipated under credit *derivative* instruments.
- (5) A *firm* will also need to allow for the effect of other components of the single event comprising the combination of scenarios applicable under *INSPRU* 1.3.43R in assessing exposure to credit risk. For example, in the case of an equity put *option* and a fall in equity market values, the resulting increase in the level of exposure to the *firm's counterparty* for the *option* combined with a change in the quality of the *counterparty* should be allowed for.
- 1.3.78 R For the purposes of *INSPRU* 1.3.44R, the range of credit risk scenarios that

a *firm* must assume is:

- (1) changes in value resulting from an increase in credit spreads by an amount of up to the spread stress determined according to *INSPRU* 1.3.84R in respect of any bond or debt item;
- (2) changes in value determined according to *INSPRU* 1.3.94R in respect of any *reinsurance* item or any analogous non-*reinsurance* financing agreement item; and
- (3) changes in value determined according to *INSPRU* 1.3.98R for any other item (including any *derivative* or *quasi-derivative*).

- 1.3.79 R For the purposes of *INSPRU* 1.3.78R, a *firm* must make appropriate allowance for any loss mitigation techniques to the extent that they are loss mitigation techniques relied on for the purpose of *INSPRU* 2.1.8R in accordance with *INSPRU* 2.1.16R and *INSPRU* 2.1.18R.
- 1.3.80 G The change in asset or liability values to be determined in relation to a credit risk scenario for the purposes of *INSPRU* 1.3.43R and *INSPRU* 1.3.44R is the change in value which would arise on the occurrence of the relevant credit risk scenario as a result of bond, debt, *reinsurance* or other exposures whether or not there is a direct *counterparty* exposure.
- 1.3.81 R Where a bond or a debt item or *reinsurance* asset is currently in default, it may be ignored by a *firm* for the purpose of applying *INSPRU* 1.3.78R.
- 1.3.82 G Where a bond or a debt item or a *reinsurance* asset is currently in default and has been specifically provisioned, in accordance with relevant accounting standards, a *firm* is not required to increase the existing default provisions to reflect a worsening of recovery rates.
- 1.3.83 R Where the credit risk scenarios in *INSPRU* 1.3.78R to *INSPRU* 1.3.99G require a *firm* to assume a change in current credit spread, or a direct change in market value, the *firm* must not change the risk-free yields used to discount future cash flows in calculating the revised *realistic value of liabilities* and *realistic value of assets* (*INSPRU* 1.3.43R(2)) resulting from those credit risk scenarios.

Spread stresses to be assumed for bonds and debt

- 1.3.84 R (1) In *INSPRU* 1.3.78R(1) the spread stress which a *firm* must assume for any bond or debt item is:
- (a) for any bond or debt item issued or guaranteed by an organisation which is in accordance with *INSPRU* 1.3.87R a credit risk scenario exempt organisation in respect of that item, zero basis points; and
 - (b) for any other bond or debt item:
 - (i) Y if the credit rating description of that other bond or debt item determined by reference to *INSPRU* 1.3.89R is not "Highly speculative or very vulnerable"; and
 - (ii) otherwise the larger of Y and Z.
- (2) For the purpose of (1)(b):
- (a) Y is the product of the spread factor for that bond or debt item and the square root of S, where:
 - (i) the spread factor for a bond or debt item is the spread factor shown in the final column of Table *INSPRU* 1.3.90R, in the row of that Table corresponding to the credit rating description of the bond or debt item determined for the purpose of this *rule* by reference to *INSPRU* 1.3.89R; and
 - (ii) subject to (3), S is the current credit spread for a bond or debt item, expressed as a number of basis points, which the *firm* must determine as the current yield on that bond or debt item in excess of the current gross redemption yield on the government bond most similar to that bond or debt item in terms of currency of denomination and equivalent term; and
 - (b) Z is the change in credit spread expressed as a number of basis points that would result in the current market value of the bond or debt falling by 5%.
- (3) Where, for the purposes of (2)(a)(ii), there is no suitable government bond, the *firm* must use its best estimate of the gross redemption yield that would apply for a notional government bond similar to the bond or debt item in terms of currency of denomination and equivalent term.
- 1.3.85 R For the purpose of *INSPRU* 1.3.84R(1)(a), a guarantee must be direct, explicit, unconditional and irrevocable.
- 1.3.86 G (1) As an example, a bond item has the credit rating description "exceptional or extremely strong" and currently yields 49 basis points in excess of the most similar government bond. The spread factor for that bond item is 3.00 by reference to Table *INSPRU* 1.3.90R. Since S is 49, the square root of S is 7 and the spread stress for that item is 3 times 7, that is, 21 basis points. The *firm* must consider the impact of an increase in spreads by up to 21 basis points for that item.

(2) As a further example, a bond item has the credit rating description "highly speculative or very vulnerable". For this bond, S is 400, being the current spread for that bond expressed as a number of basis points. The spread factor for the bond is 24.00. So the *firm* must consider the impact of an increase in spreads by up to 24.00 times 20 i.e. 480 basis points for that item. The bond is however of short duration and the reduction in market value resulting from an additional spread of 480 basis points is less than 5 per cent of its current market value. A 5 per cent reduction in its market value would result from a spread widening of 525 basis points. The *firm* must consider the impact of an increase in spreads by up to 525 basis points for that item by virtue of its credit rating description.

(3) The calculation of the credit spread on commercial floating rate notes warrants particular consideration. Suppose, for example, that a notional floating rate note guaranteed by the *UK* government would have a market consistent price of X. This price can be estimated based on an assumed distribution of future payments under the floating rate note, and the current forward gilt curve. Suppose further that the market price of the commercial floating rate note is Y, where Y is less than X. A *firm* could calculate what parallel upward shift in the forward gilt curve would result in the notional government-backed floating rate note having a market price of Y for an unchanged assumed distribution of future payments. The size of the resulting shift could then be taken as the credit spread on the commercial floating rate note.

(4) In arriving at the estimated gross redemption yield in *INSPRU* 1.3.84R(3), the *firm* may have regard to any appropriate swap rates for the currency of denomination of the bond or debt item, adjusted to take appropriate account of observed differences between swap rates and the yields on government bonds.

1.3.87 R For the purposes of this section:

(1) an organisation is a credit risk scenario exempt organisation in respect of an item if the organisation is:

(a) the European Central Bank; or
(b) any central government or central bank which, in relation to that item, satisfies the conditions in (2); or

(c) a multilateral development bank which is listed in (3); or

(d) an international organisation which is listed in (4);

(2) the conditions in (1)(b) are that, for any claim against the central government or central bank denominated in the currency in which the item is denominated:

(a) a credit rating is available from at least one listed rating agency nominated in accordance with *INSPRU* 1.3.92R; and

(b) the credit rating description in the first column of Table *INSPRU* 1.3.90R corresponding to the lowest such credit rating is either "exceptionally or extremely strong" or "very strong";

(3) for the purposes of (1)(c) the listed multilateral development banks are:

(a) the International Bank for Reconstruction and Development;

(b) the International Finance Corporation;

(c) the Inter-American Development Bank;

(d) the Asian Development Bank;

(e) the African Development Bank;

(f) the Council of Europe Development Bank;

(g) the Nordic Investment Bank;

(h) the Caribbean Development Bank;

(i) the European Bank for Reconstruction and Development;

(j) the European Investment Bank;

(k) the European Investment Fund; and

(l) the Multilateral Investment Guarantee Agency;

(4) for the purposes of (1)(d) the listed international organisations are:

(a) the European Community;

(b) the International Monetary Fund; and

(c) the Bank for International Settlements.

- 1.3.88 G Under *INSPRU* 1.3.87R(2), a *firm* needs to take account of the currency in which the claim is denominated when it is considering claims on or guaranteed by a central government or central bank. It is possible, for example, that a given central bank would be a credit risk scenario exempt organisation in respect of claims on it denominated in its domestic currency, while not being a credit risk scenario exempt organisation in respect of claims on it denominated in a currency other than its domestic currency - the central government or central bank may have been assigned different credit assessments depending on the currency in which the claim on it is denominated.
- 1.3.89 R (1) For the purposes of this section, the credit rating description of a bond or debt item is to be determined in accordance with (2) and (3).

- (2) If the item has at least one credit rating nominated in accordance with *INSPRU* 1.3.92R ("a rated item"), its credit rating description is:
- (a) where it has only one nominated credit rating, the general description given in the first column of Table *INSPRU* 1.3.90R corresponding to that rating; or
 - (b) where it has two or more nominated credit ratings and the two highest nominated ratings fall within the same general description given in the first column of that Table, that description; or
 - (c) where it has two or more nominated credit ratings and the two highest nominated ratings do not fall within the same general description given in the first column of that Table, the second highest of those two descriptions.
- (3) If the item is not a rated item, its credit rating description is the general description given in the first column of Table *INSPRU* 1.3.90R that most closely corresponds to the *firm's* own assessment of the item's credit quality.
- (4) An assessment under (3) must be made by the *firm* for the purposes of the credit risk scenario having due regard to the seniority of the bond or debt and the credit quality of the bond or debt issuer.

1.3.90 R Table : Listed rating agencies, credit rating descriptions, spread factors

Credit Rating Description	Listed rating agencies				Spread Factor
	A.M. Best Company	Fitch Ratings	Moody's Investors Service	Standard & Poor's Corporation	
Exceptional or extremely strong	aaa	AAA	Aaa	AAA	3.00
Very strong	aa	AA	Aa	AA	5.25
Strong	a	A	A	A	6.75
Adequate	bbb	BBB	Baa	BBB	9.25
Speculative or less vulnerable	bb	BB	Ba	BB	15.00
Very speculative or more vulnerable	B	B	B	B	24.00
Highly speculative or very vulnerable	Below B	Below B	Below B	Below B	24.00

- 1.3.91 G Where listed rating agencies provide ratings by sub-category then all ratings should be allocated to the main ratings category (e.g. ratings sub-category A+ or A- would be allocated to the assigned ratings category "Strong").
- 1.3.92 R For the purposes of *INSPRU* 1.3.87R and *INSPRU* 1.3.89R, a *firm* may, subject to (1) to (5), nominate for use credit ratings produced by one or more of the rating agencies listed in *INSPRU* 1.3.93R:

- (1) if the *firm* decides to nominate for use for an item the credit rating produced by one or more rating agencies, it must do so consistently for all similar items;
- (2) the *firm* must use credit ratings in a continuous and consistent way over time;
- (3) the *firm* must nominate for use only credit ratings that take into account both principal and interest;
- (4) if the *firm* nominates for use credit ratings produced by one of the listed rating agencies then the *firm* must use solicited credit ratings produced by that listed rating agency; and
- (5) the *firm* may nominate for use unsolicited credit ratings produced by one or more of the listed rating agencies except where there are reasonable grounds for believing that any unsolicited credit ratings produced by the agency are used so as to obtain inappropriate advantages in the relationship with rated parties.

1.3.93 R In this section, a listed rating agency is:

- (1) A.M. Best Company; or
- (2) Fitch Ratings; or
- (3) Moody's Investors Service; or
- (4) Standard & Poor's Corporation.

Credit risk scenario for reinsurance

- 1.3.94 R (1) The contracts of *reinsurance* or analogous non-*reinsurance* financing agreements to which *INSPRU* 1.3.78R(2) applies are those:
- (a) into which the *firm* has entered;
 - (b) which represent an economic asset under the single event applicable under *INSPRU* 1.3.43R(3); and
 - (c) which are material (individually or in aggregate).
- (2) For the purposes of (1), no account is to be taken of *reinsurance* or analogous non-*reinsurance* financing arrangements between *undertakings* in the same *group* where:
- (a) the ceding and accepting *undertakings* are regulated by the *FSA* or a regulatory body in a *designated State or territory* for insurance (including *reinsurance*);
 - (b) no subsequent cessions of the ceded risk which are material (individually or in aggregate) are made to subsequent accepting *undertakings* by accepting *undertakings* (including subsequent accepting *undertakings*) other than to subsequent accepting *undertakings* which are in the same *group*; and
 - (c) for any subsequent cession or cessions of the ceded risk which are material (individually or in aggregate) each of the ceding and accepting *undertakings* (including subsequent accepting *undertakings*) is regulated by the *FSA* or a regulatory body in a *designated State or territory* for insurance (including *reinsurance*).
- (3) The change in value which a *firm* must determine for a contract of *reinsurance* or an analogous non-*reinsurance* financing agreement is the *firm's* best estimate of the change in realistic value which would result from changes in credit risk market conditions consistent, subject to (4), with the changes in credit spreads determined in accordance with *INSPRU* 1.3.78R(1).
- (4) For the purpose of (3), 5% should be replaced by 10% in *INSPRU* 1.3.84R(2)(b).
- 1.3.95 G (1) *Reinsurance* and analogous non-*reinsurance* financing agreements entered into by the *firm*, either with or acting as a *reinsurer*, must be included within the scope of the scenario. The combined rights and obligations under a contract of *reinsurance* or an analogous non-*reinsurance* financing agreement may represent an economic asset or liability. The value placed by the *firm* on the *reinsurance* item or non-*reinsurance* financing item should allow for a realistic assessment of the risks transferred and the risks of *counterparty* default associated with the item. In the case of analogous non-*reinsurance* financing agreements, references to terms such as "*reinsurer*", "*ceding undertakings*" and "*accepting undertakings*" include *undertakings* which by analogy are *reinsurers*, ceding or accepting *undertakings*. Analogous non-*reinsurance* financing agreements include contingent loans, securitisations and any other arrangements in respect of *contracts of insurance* that are analogous to contracts of *reinsurance* in terms of the risks transferred and the finance provided.

(2) In assessing values in accordance with *INSPRU* 1.3.94R, a *firm* may consider it appropriate to determine values by drawing an analogy with the approach in respect of bond and debt items set out in *INSPRU* 1.3.84R. (This might be the case if, in economic terms, the item being valued sufficiently resembles a bond or debt item - an alternative approach might otherwise be preferred). If the *firm* does consider it appropriate to draw an analogy, the "credit spread" assumed should be consistent with the assumed default probabilities and the values placed on the *reinsurance* asset for the purposes of determining the *realistic values of assets and liabilities*. A *firm* may regard it as appropriate to have regard to any financial strength ratings applicable to the *reinsurer*, but if so should apply the same principles set out in *INSPRU* 1.3.92R for the nomination of financial strength ratings. Table *INSPRU* 1.3.97G provides *guidance* as to the allocation of spread factors which a *firm* may, by analogy, deem appropriate to apply. Appropriate allowance should be made for any change in the extent of the *counterparty* exposure under the assumed scenario.

(3) The changes in credit risk spreads determined for bond and debt items in accordance with *INSPRU* 1.3.78R(1) are required to result in a reduction in market value for some items of 5% of their current value through the operation of *INSPRU* 1.3.84R(2)(b). For *reinsurance* contracts and analogous non-*reinsurance* financing agreements, determining the change in value by reference to *INSPRU* 1.3.94R(3) requires a *firm* to consider the possibility of *counterparty* default in changed credit risk market conditions. Where in the changed credit risk market conditions assumed to apply the *firm's* assessment of the *counterparty* risk would result in the asset being considered equivalent to "Highly speculative or very vulnerable", the reduction in value required is at least 10% of its current value. *INSPRU* 1.3.94R(4) relates to this requirement.

- 1.3.96 G A financial strength rating of a *reinsurer* refers to a current assessment of the financial security characteristics of the *reinsurer* with respect to its ability to pay *claims* under its *reinsurance* contracts and treaties in accordance with their terms.
- 1.3.97 G Table: Listed rating agencies, financial strength descriptions and spread factors

Financial Strength Description	A.M. Best Company	Fitch Ratings	Moody's Investors Service	Standard & Poor's Corporation	Spread Factor
Superior, extremely strong	A++	AAA	Aaa	AAA	3.00
Superior, very strong	A+	AA	Aa	AA	5.25
Excellent or strong	A, A-	A	A	A	6.75
Good	B++,B+	BBB	Baa	BBB	9.25
Fair, marginal	B, B-	BB	Ba	BB	15.00
Marginal, weak	C++,C+	B	B	B	24.00
Unrated or very weak	Unrated or below C++,C+	Unrated or below B	Unrated or below B	Unrated or below B	24.00

Credit risk scenario for other exposures (including any derivative or quasi-derivative)

- 1.3.98 R For the purposes of *INSPRU* 1.3.78R(3), the change in value which must be determined for any other item (including any *derivative* or *quasi-derivative*) which represents an economic asset under the single event applicable under *INSPRU* 1.3.43R(3) is the *firm's* best estimate of the change in the realistic value of that item which would result from changes in credit risk market conditions consistent with the changes in credit spreads determined in accordance with *INSPRU* 1.3.78R(1) and the changes in value determined in accordance with *INSPRU* 1.3.78R(2).
- 1.3.99 G In applying *INSPRU* 1.3.98R, a *firm* should assess the total impact on the value of the item resulting from the assumed changed credit risk market conditions. The total change in value may result from the interaction of a number of separate influences. For example, a widening of credit spreads may imply an impact on the amount exposed to *counterparty* default as well as on the likelihood of that default. Each factor influencing the change in value needs separate consideration. It should be assumed, both for determining amounts exposed to *counterparty* default and the likelihood of such default that there will be no change in the likelihood of default in relation to an item issued by or guaranteed by an organisation which is in respect of that item a credit risk scenario exempt organisation (*INSPRU* 1.3.87R). *INSPRU* 1.3.77(5) is also relevant in this context.

Persistency risk scenario

- 1.3.100 R For the purposes of the persistency risk scenario in *INSPRU* 1.3.44R(6), a *firm* must allow for the effects of an increase or a decrease in persistency experience of its *with-profits insurance contract* by adjusting the termination rates in each year of projection by 32.5% of the termination rates assumed in the calculation of the *realistic value of liabilities* in

INSPRU 1.3.40R.

- 1.3.101 R The termination rates referred to in *INSPRU 1.3.100R* are the rates of termination (including the paying-up of *policies*, but excluding deaths, maturities and retirements) other than on dates specified by the *firm* where:
- (1) a guaranteed amount applies as the minimum amount which will be paid on *claim*; or
 - (2) any payments to the *policyholder* cannot be reduced at the discretion of the *firm* by its applying a market value adjustment.
- 1.3.102 R For the purposes of *INSPRU 1.3.100R*, the increase or decrease in termination rates must be applied to the projection of terminations up to *policy* guarantee dates and between *policy* guarantee dates, but not to the assumptions as to the proportion of *policyholders* taking up the guarantees at *policy* guarantee dates.
- 1.3.103 G *INSPRU 1.3.100R* to *INSPRU 1.3.102R* require *firms* to apply a persistency stress test to the *realistic value of liabilities*. Where a *firm* brings the present value of *non-profit insurance business* in a *with-profits fund* into the calculation of the *realistic value of assets* (see *INSPRU 1.3.33R*) there is no requirement to stress this asset for changes in persistency assumptions.

Realistic value of liabilities: detailed provisions

- 1.3.104 G *INSPRU 1.3.40R* sets out the three elements comprising the *realistic value of liabilities* for a *with-profits fund*. The remainder of this section contains general *rules* and *guidance* on determining the *realistic value of liabilities* plus further detail relating to each of those elements separately, as follows:
- (1) general *rules* and *guidance* in *INSPRU 1.3.105R* to *INSPRU 1.3.115G*;
 - (2) *with-profits benefits reserve* in *INSPRU 1.3.116R* to *INSPRU 1.3.135G*;
 - (3) *future policy related liabilities* in *INSPRU 1.3.136G* to *INSPRU 1.3.189G*; and
 - (4) *realistic current liabilities* in *INSPRU 1.3.190R* and *INSPRU 1.3.191R*.

Methods and assumptions: general

- 1.3.105 R In calculating the *realistic value of liabilities* for a *with-profits fund*, a *firm* must use methods and assumptions which:
- (1) are appropriate to the business of the *firm*;
 - (2) are consistent from year to year without arbitrary changes (that is, changes without adequate reasons);
 - (3) are consistent with the method of valuing assets (*GENPRU 1.3*);
 - (4) make full provision for tax payable out of the *with-profits fund*, based on current legislation and practice, together with any known future changes, and on a consistent basis with the other methods and assumptions used;
 - (5) take into account discretionary benefits which are at least equal to, and charges which are no more than, the levels required for the *firm* to fulfil its regulatory duty to treat its *customers* fairly;
 - (6) take into account prospective management actions (*INSPRU 1.3.53R*) and *policyholder* actions (*INSPRU 1.3.59R*);
 - (7) provide for shareholder transfers out of the *with-profits fund* as a liability of the fund;
 - (8) have regard to generally accepted actuarial practice; and
 - (9) are consistent with the *firm's PPFM*.
- 1.3.106 G More specific *rules* and *guidance* are set out below on some aspects of the methods and assumptions to be used in calculating the *realistic value of liabilities* for a *with-profits fund*. In contrast to the *mathematical reserves* requirements in *INSPRU 1.2.10R(4)* and *INSPRU 1.2.13R*, there is no requirement to include margins for adverse deviation of relevant factors in calculating the *realistic value of liabilities*. Assumptions need be no more prudent than is necessary to achieve a best estimate, taking into account the *firm's PPFM* and its regulatory duty to treat its *customers* fairly. Where there is no requirement for a *PPFM*, for example non-UK business, a *firm* should use assumptions that are consistent with the *firm's* documented approach to treating its *customers* fairly. A *firm* may judge that a margin should be included in its calculations to avoid an understatement of the *realistic value of liabilities* as a result of uncertainty, for example, either in its method or in its data.
- 1.3.107 G The amount and timing of tax charges affect the amount of assets available to meet *policyholder* liabilities. *INSPRU 1.3.105R(4)* requires *firms* to provide fully for all tax payable out of the *with-profits fund* on a basis consistent with the other assumptions and methods used in deriving the realistic balance sheet. So, for example, all projections which underlie the realistic valuation of assets or liabilities must allow for taxation. The approach adopted should not give any credit for any reduction in tax deriving from future expenses or deficits which is attributable to future new business. For assets backing capital requirements it is not necessary to take into consideration future tax charges on investment income generated by those assets. However, *firms* should consider this aspect in their capital planning.
- 1.3.108 G *INSPRU 1.3.105R(7)* requires *firms* to provide fully for shareholder transfers. Such transfers do not therefore count as capital in the *with-profits*

fund. However, a *firm* may apply under section 148 of the *Act* for a *waiver* from this requirement. In exercising its discretion under section 148 of the *Act*, the *FSA* will have regard (among other factors) to whether a *firm* has put in place undertakings satisfactory to the *FSA*, including that future transfers will not be paid out of the *firm* by way of dividend.

Valuation of contracts: General

- 1.3.109 R (1) A *firm* must determine the amount of the *with-profits benefits reserve* or the *future policy related liabilities* for a *with-profits fund* by carrying out a separate calculation in relation to each *with-profits insurance contract* or for each group of similar contracts.
(2) Appropriate approximations or generalisations may be made where they are likely to provide the same, or a higher, result than a separate calculation for each contract.
(3) A *firm* must set up additional reserves on an aggregated basis for general risks which are not specific to individual contracts or a group of similar contacts where the *firm* considers the *realistic value of liabilities* may otherwise be understated.
- 1.3.110 R For the purpose of *INSPRU* 1.3.109R(1), a group of similar contracts is such that the conditions in *INSPRU* 1.3.109R(2) are satisfied.
- 1.3.111 G Where a *firm* has grouped individual contracts for the purpose of calculating the *mathematical reserves* for a *with-profits fund* (in accordance with *INSPRU* 1.2.22R), the *firm* is not required to use the same grouping of contracts in calculating the *with-profits benefits reserve* or *future policy related liabilities* for that fund.
- 1.3.112 G In contrast to *INSPRU* 1.2.24R for the *mathematical reserves*, treating individual contracts as an asset is not prohibited if, and to the extent that, this treatment does not conflict with a *firm's* regulatory duty to treat its *customers* fairly.
- 1.3.113 G In calculating the *with-profits benefits reserve*, an overall (grouped or pooled) approach may be appropriate under either of the two methods set out in *INSPRU* 1.3.116R. In particular, the calculation of aggregate retrospective reserves (see *INSPRU* 1.3.118R) and the projection of future cash flows (see *INSPRU* 1.3.128R) based on suitable specimen *policies* is permitted.
- 1.3.114 G In calculating the *future policy related liabilities*, the grouping of *policies* for valuing the costs of guarantees, options or smoothing, and their representation by representative *policies*, is acceptable provided the *firm* can demonstrate that the grouping of *policies* does not materially misrepresent the underlying exposure and does not significantly misstate the costs. A *firm* should exercise care in grouping *policies* in order to ensure that the risk exposure is not inappropriately distorted by, for example, forming groups containing *policies* with guarantees that are "in the money" and *policies* with guarantees well "out of the money". A *firm* should also have regard to the

effects of *policyholder* behaviour over time on the spread of the outstanding guarantees or options.

- 1.3.115 G Where a *firm* groups similar *policies* for the purpose of calculating the *with-profits benefits reserve* or the *future policy related liabilities*, the *firm* should carry out sufficient validation to be reasonably sure that the grouping of *policies* has not resulted in the loss of any significant attributes of the portfolio being valued.

With-profits benefits reserve

- 1.3.116 R A *firm* must calculate a with-profits benefits reserve for a with-profits fund using either:
(1) a retrospective calculation under *INSPRU* 1.3.118R (the retrospective method); or
(2) a prospective calculation under *INSPRU* 1.3.128R of all future cash flows expected to arise under, or in respect of, each of the *with-profits insurance contracts* written in that fund (the prospective method).

- 1.3.117 R Subject to *INSPRU* 1.3.105R(2), a *firm* may use different methods under *INSPRU* 1.3.116R for different types or generations of *with-profits insurance contracts*.

Retrospective method

- 1.3.118 R In the retrospective method of calculating a *with-profits benefits reserve*, a *firm* must calculate either the aggregate of the retrospective reserves in respect of each *with-profits insurance contract* or, to the extent permitted by *INSPRU* 1.3.109R and *INSPRU* 1.3.110R, the total retrospective reserve in respect of each group of *with-profits insurance contracts*.

- 1.3.119 R In calculating the retrospective reserve for a *with-profits insurance contract*, or the total retrospective reserve in respect of a group of *with-profits insurance contracts*, a *firm* must take account of at least the following:

- (1) *premiums* received from the *policyholder*;
- (2) any expenses incurred or charges made (including *commissions*);
- (3) any partial benefits paid or due;
- (4) any investment income on, and any increases (or decreases) in, asset values;
- (5) any tax paid or payable;
- (6) any amounts received (or paid) under contracts of *reinsurance* or analogous non-*reinsurance* financing agreements, where relevant to retrospective reserves;
- (7) any shareholder transfers and any associated tax paid or payable; and
- (8) any permanent enhancements to (or deductions from) the retrospective reserves made by the *firm*.

- 1.3.120 G In taking account of amounts in *INSPRU* 1.3.119R(6), due regard should be had to the specific details of each relevant contract of *reinsurance* or

analogous non-*reinsurance* financing agreement and the relationship between the amounts received (or paid) and the value of the benefit granted (or received) under the arrangement. This should take into consideration, for example, the risk of default and differences in the *firm's* realistic assessment of the risks transferred and the contractual terms for such transfer of risk. Analogous non-*reinsurance* financing agreements include contingent loans, securitisations and any other arrangements in respect of *contracts of insurance* that are analogous to contracts of *reinsurance* in terms of the risks transferred and the finance provided.

- 1.3.121 G Where allowance is made for shareholder transfers, this should be in respect of the accrued bonus entitlement reflected in the retrospective reserve. This would include both *annual bonuses* already declared and accrued *final bonus*. However, shareholder transfers in respect of surplus yet to be credited to retrospective reserves should not be charged to those reserves until the corresponding surplus is credited.
- 1.3.122 R In calculating retrospective reserves, a *firm* must have regard to its regulatory duty to treat its *customers* fairly and must ensure that its approach is consistent with its *Principles and Practices of Financial Management*.
- 1.3.123 R In calculating retrospective reserves, a *firm* must ensure its treatment of past cash flows, and of any future cash flows, is consistent with those cash flows valued in its prospective calculation of the *future policy related liabilities* for that fund in accordance with the *rules* in *INSPRU* 1.3.136G to *INSPRU* 1.3.189G.
- 1.3.124 G An example of *INSPRU* 1.3.123R concerns future shareholder transfers. A *firm* must make adequate provision for future shareholder transfers within the *future policy related liabilities* (see *INSPRU* 1.3.165R). The basis of provisioning needs to be consistent with the amounts accrued within retrospective reserves and the amounts already transferred out of the *with-profits fund*.
- 1.3.125 G Another example of the application of *INSPRU* 1.3.123R relates to the reference in *INSPRU* 1.3.119R(8) to past permanent enhancements to (or deductions from) retrospective reserves made by *firms*. This item may include past miscellaneous surplus (or losses) which have been credited to (or debited from) retrospective reserves. Any other enhancements (or deductions) made on a temporary basis and any future surplus (or losses) that *firms* intend to credit to (or debit from) retrospective reserves should be included under the *future policy related liabilities* (see *INSPRU* 1.3.137R).
- 1.3.126 G *Firms* characteristically use a range of calculation methods to determine retrospective reserves. A *firm's* definition and calculation of retrospective reserves will depend on a number of factors. These include: the *firm's* practice; its administration and accounting systems; the extent of its historical records; and the composition of its with-profits portfolio. The *rules* and *guidance* for the retrospective method are drawn up to be sufficiently flexible to accommodate the diversity of calculation methods

used by *firms*, rather than to enforce any particular method of calculation of retrospective reserves. *INSPRU* 1.3.119R simply sets minimum standards that all retrospective methods must meet.

- 1.3.127 G For the purposes of *INSPRU* 1.3.119R(2) and *INSPRU* 1.3.128R(2), the phrases 'charges made' or 'charges to be made' refer to circumstances where types of risk (such as mortality risk, longevity risk and investment risk) are met by the *firm* or *with-profits fund* in return for a charge deducted by the *firm* from the *with-profits benefits reserve*.
- Prospective method
- 1.3.128 R In the prospective method of calculating a *with-profits benefits reserve*, a *firm* must take account of at least the following cash flows:
- (1) future *premiums*;
 - (2) expenses to be incurred or charges to be made, including *commissions*;
 - (3) benefits payable (*INSPRU* 1.3.129R);
 - (4) tax payable;
 - (5) any amounts to be received (or paid) under contracts of *reinsurance* or analogous non-*reinsurance* financing agreements, where relevant to *with-profits insurance contracts* being valued; and
 - (6) shareholder transfers.
- 1.3.129 R For the purposes of *INSPRU* 1.3.128R(3), benefits payable include:
- (1) all guaranteed benefits, including guaranteed amounts payable on death and maturity, guaranteed *surrender values* and paid-up values;
 - (2) vested, declared and allotted bonuses to which *policyholders* are entitled; and
 - (3) future *annual* and *final bonuses* at least equal to the levels required for the *firm* to fulfil its regulatory duty to treat its *customers* fairly.
- 1.3.130 R A *firm* must value the cash flows listed in *INSPRU* 1.3.128R using best estimate assumptions of future experience, having regard to generally accepted actuarial practice and taking into account the *firm's PPFM* and its regulatory duty to treat its *customers* fairly.
- 1.3.131 G The prospective method sets the *with-profits benefits reserve* at the net present value of future cash flows listed in *INSPRU* 1.3.128R.
- 1.3.132 G In contrast to *INSPRU* 1.2.10R(4) and *INSPRU* 1.2.13R relating to the methods and assumptions used to value the *mathematical reserves*, there is no requirement to value future cash flows using assumptions that include margins for adverse deviation. Also there are no detailed *rules* as to the future yields on assets, discount rates, *premium* levels, expenses, tax, mortality, morbidity, persistency and *reinsurance*. A *firm* should make its own assessment as to the amount of these future cash flows including bonuses and discretionary surrender or transfer values. A *firm* should make a realistic assessment of longevity risk and asset default risk (including default risk arising under contracts of *reinsurance* or analogous non-

reinsurance financing agreements) within the best estimate assumptions of future experience required by *INSPRU* 1.3.130R.

- 1.3.133 G In valuing the future cash flows listed in *INSPRU* 1.3.128R, the *firm* should use a projection term which is long enough to capture all material cash flows arising from the contract or groups of contracts being valued. If the projection term does not extend to the term of the last *policy*, the *firm* should check that the shorter projection term does not significantly affect the results.
- 1.3.134 R Where a *firm* expects to pay additional benefits that are not included in the cash flows listed in *INSPRU* 1.3.128R, it must make adequate provision for these benefits in calculating the *future policy related liabilities* in accordance with the *rules* in *INSPRU* 1.3.136G to *INSPRU* 1.3.189G.
- 1.3.135 G The prospective assessment of the *with-profits benefits reserve* will usually be on a deterministic basis. A *firm* will have to make further provision in the *future policy-related liabilities* for, for example, the costs of potential asset fluctuations or *policy* options.

Future policy related liabilities

Overview of liabilities

- 1.3.136 G *INSPRU* 1.3.137R lists the *future policy related liabilities* for a *with-profits fund* that form part of a *firm's realistic value of liabilities* in *INSPRU* 1.3.40R. Detailed *rules* and *guidance* relating to particular types of liability and asset are set out in *INSPRU* 1.3.139R to *INSPRU* 1.3.168G. These are followed by *rules* and *guidance* that deal with certain aspects of several liabilities (that is, liabilities relating to guarantees, options and smoothing): (1) *INSPRU* 1.3.169R to *INSPRU* 1.3.186G refer to valuing the costs of guarantees, options and smoothing; and (2) *INSPRU* 1.3.187R to *INSPRU* 1.3.189G refer to the treatment of surplus on guarantees, options and smoothing.
- 1.3.137 R The *future policy related liabilities* for a *with-profits fund* are equal to the sum of amounts, as they relate to that fund, in respect of (1) to (11) to the extent each is valued as a liability less the sum of amounts, as they relate to that fund, in respect of (1) to (11) to the extent each is valued as an asset:

- (1) past miscellaneous surplus (or deficit) planned to be attributed to the *with-profits benefits reserve* (see *INSPRU* 1.3.139R);
- (2) planned enhancements to the *with-profits benefits reserve* (see *INSPRU* 1.3.141R);
- (3) planned deductions for the costs of guarantees, options and smoothing from the *with-profits benefits reserve* (see *INSPRU* 1.3.144R);
- (4) planned deductions for other costs deemed chargeable to the *with-profits benefits reserve* (see *INSPRU* 1.3.146R);
- (5) future costs of contractual guarantees (other than financial options) (see *INSPRU* 1.3.148R);
- (6) future costs of non-contractual commitments (see *INSPRU* 1.3.154R);
- (7) future costs of financial options (see *INSPRU* 1.3.156G);
- (8) future costs of smoothing (see *INSPRU* 1.3.158R);
- (9) financing costs (see *INSPRU* 1.3.162R);
- (10) any other further liabilities required for the *firm* to fulfil its regulatory duty to treat its *customers* fairly; and
- (11) other *long-term insurance liabilities* (see *INSPRU* 1.3.165R).

- 1.3.138 G Some of the elements of the calculation set out in *INSPRU* 1.3.137R may have already been taken into consideration in the calculation of the *with-profits benefits reserve*, either under the retrospective method (see *INSPRU* 1.3.118R onwards) or the prospective method (see *INSPRU* 1.3.128R onwards). Where this is the case, the adjustments made under *INSPRU* 1.3.137R should be such that no double-counting arises.

Past miscellaneous surplus (or deficit) planned to be attributed to the with-profits benefits reserve

- 1.3.139 R In calculating the *future policy related liabilities* for a *with-profits fund*, a *firm* must allow for past miscellaneous surplus (or deficit) which it intends to attribute to the *with-profits benefits reserve* for that fund but which has not yet been permanently credited to (or debited from) the *with-profits benefits reserve* for that fund.

- 1.3.140 G Past miscellaneous surplus (or deficit) already permanently credited to (or debited from) the *with-profits benefits reserve* will have been included in the calculation of the *with-profits benefits reserve* in accordance with *INSPRU* 1.3.119R(8).

Planned enhancements to the with-profits benefits reserve

- 1.3.141 R In calculating the *future policy related liabilities* for a *with-profits fund*, a *firm* must make provision for any future planned enhancements to the *with-profits benefits reserve* for that fund that cannot be financed out of the resources of the *with-profits benefits reserve* and future *premiums*.

- 1.3.142 G For the purposes of *INSPRU* 1.3.141R, planned enhancements to the *with-profits benefits reserve* will arise when a *firm* has a contractual obligation, or a non-contractual commitment (arising from its regulatory duty to treat *customers* fairly), to enhance *claims* on some classes of *policy* (perhaps in

the form of specially enhanced future bonus rates). In such circumstances, the present value of the costs of paying out a target asset share that is more than the projected *with-profits benefits reserve* for those classes of *policy* for which this practice is applicable should be included in the amount of the *future policy related liabilities*. For example, a *firm* may have a non-contractual commitment (arising from its regulatory duty to treat *customers* fairly) to pay enhanced benefits but have discretion not to make such payments in adverse circumstances. Such planned enhancements should be provided for in the realistic balance sheet, but allowance should be made for management action in the calculation of the *risk capital margin*.

- 1.3.143 G The valuation of *claims* in excess of targeted asset shares in respect of guarantees, options and smoothing, including those arising under guaranteed annuity rates, should be carried out in accordance with *INSPRU* 1.3.169R to *INSPRU* 1.3.186G.

Planned deductions for the costs of guarantees, options and smoothing from the with-profits benefits reserve

- 1.3.144 R Where a *firm* expects to deduct future charges from the *with-profits benefits reserve* for a *with-profits fund* to cover the costs of guarantees, options or smoothing for that fund, the *firm* must take credit for these future charges in calculating the *future policy related liabilities* for that fund.

- 1.3.145 G In calculating *future policy related liabilities* for a *with-profits fund*, a *firm* should take credit under *INSPRU* 1.3.137R(3) for the present value of the future "margins" available in respect of charges deducted to cover the costs of guarantees, options and smoothing. *INSPRU* 1.3.188R requires *firms* that accumulate the charges made less costs incurred to provide for any surplus on the experience account as a realistic liability. Any such provision should be made under *INSPRU* 1.3.137R(5), *INSPRU* 1.3.137R(7) or *INSPRU* 1.3.137R(8) depending on the nature of the charges made, and has no effect on the amount calculated under *INSPRU* 1.3.144R.

Planned deductions for other costs deemed chargeable to the with-profits benefits reserve

- 1.3.146 R Where a *firm* expects to deduct future charges (other than those valued in *INSPRU* 1.3.144R) from the *with-profits benefits reserve* for a *with-profits fund*, the *firm* must take credit for these future charges in calculating the *future policy-related liabilities* for that fund.

- 1.3.147 G A *firm* should take credit for the present value of the other future "margins" available. The circumstances where such margins may arise include:

- (1) where a *firm* is targeting *claims* at less than 100% of the *with-profits benefits reserve*, the amount of such shortfall; and
- (2) where a *firm* expects to deduct any future charges (other than those for guarantees, options and smoothing) from the *with-profits benefits reserve*.

- 1.3.148 R Future costs of contractual guarantees (other than financial options)
- A *firm* must make provision for the costs of paying excess *claim* amounts for a *with-profits fund* where the *firm* expects that the amount in (1) may be greater than the amount in (2), calculated as at the date of *claim*:
- (1) the value of guarantees arising under a *policy* or group of *policies* in the fund; and
- (2) the fund's *with-profits benefits reserve* allocated in respect of that *policy* or group of *policies*.
- 1.3.149 R For the purposes of *INSPRU* 1.3.148R, the future costs of guarantees cannot be negative.
- 1.3.150 G In carrying out projections to calculate the cost of guarantees under *INSPRU* 1.3.137R the opening liability should be set equal to the *with-profits benefit reserve* (see *INSPRU* 1.3.118R), adjusted for miscellaneous surplus or deficits (see *INSPRU* 1.3.137R(1)) and planned enhancements (see *INSPRU* 1.3.141R).
- 1.3.151 G In projecting forward the *with-profits benefits reserve*, adjusted as in *INSPRU* 1.3.150G, to the date of *claim* for the purposes of *INSPRU* 1.3.148R, the *firm* should use market consistent assumptions for the expected future *premium* and investment income (including realised and unrealised gains or losses), expenses and *claims*, any charges to be deducted, tax and any other item of income or outgo. This projection should be carried out on the same basis as is described in *INSPRU* 1.3.130R.
- 1.3.152 G *INSPRU* 1.3.169R to *INSPRU* 1.3.186G contain further *rules* and *guidance* on the valuation of guarantees, options and smoothing.
- 1.3.153 G Some examples of contractual guarantees are:
- (1) for conventional *with-profits insurance contracts*, guaranteed sums assured and bonuses on death, maturity or retirement; and
- (2) for *accumulating with-profits policies*, guarantees at a point in time or guaranteed minimum bonus rates.

Future costs of non-contractual commitments

- 1.3.154 R A *firm* must make provision for future costs in addition to those in *INSPRU* 1.3.148R where the *firm* expects to pay further amounts to meet non-contractual commitments to *customers* or pay other benefits that need to be provided to fulfil a *firm's* regulatory duty to treat its *customers* fairly.
- 1.3.155 G Some examples of these non-contractual commitments are:

- (1) statements by the *firm* regarding the ability of *policies* to cover defined amounts, such as the repayment of a mortgage;
- (2) statements by the *firm* regarding regular withdrawals from a *policy* being without penalty;
- (3) guaranteed annuity and cash option rates being provided beyond the strict interpretation of the *policy*; and
- (4) the costs of any promises to *customers* or other benefits that need to be provided to fulfil a *firm's* regulatory duty to treat its *customers* fairly.

Future costs of financial options

- 1.3.156 G Financial options include guaranteed annuity and cash option rates.
- 1.3.157 G *INSPRU* 1.3.169R to *INSPRU* 1.3.186G contain further *rules* and *guidance* on the valuation of options.

Future costs of smoothing

- 1.3.158 R A *firm* must make provision for future smoothing costs of a *with-profits fund* where the *firm* expects that the *claims* paid on a *policy* or group of *policies* in the fund will vary from the greater of:
 - (1) the value of guarantees determined in *INSPRU* 1.3.148R in respect of that *policy* or group of *policies*; and
 - (2) the fund's *with-profits benefits reserve* allocated in respect of that *policy* or group of *policies* which must be enhanced as described in *INSPRU* 1.3.141R; calculated as at the date of *claim*.
- 1.3.159 R For the purposes of *INSPRU* 1.3.158R, smoothing costs are defined as the present value of the difference between projected *claims* and the projected *with-profits benefit reserve* after enhancements (*INSPRU* 1.3.141R), other than payouts on guarantees (*INSPRU* 1.3.148R).
- 1.3.160 R Subject to *INSPRU* 1.3.188R, the future costs of smoothing can be negative.
- 1.3.161 G *INSPRU* 1.3.169R to *INSPRU* 1.3.186G contain further *rules* and *guidance* on the valuation of the future costs of smoothing.

Financing costs

- 1.3.162 R A *firm* must provide for future liabilities to repay financing costs of a *with-profits fund* where the *firm* expects to have to meet such liabilities and to the extent that these liabilities are not already provided for by amounts included in the fund's *realistic current liabilities* (*INSPRU* 1.3.190R and *INSPRU* 1.3.191R). The amount of the liabilities to repay financing costs must be assessed on a market-consistent basis.
- 1.3.163 G In *INSPRU* 1.3.162R, financing costs refer to the future costs incurred by way of capital, interest and fees payable to the provider. A *firm* should make a realistic assessment of the requirement to repay such financing in its

expected future circumstances (which may be worse than currently). Having taken account of its particular circumstances:

(1) where a *firm* has no liability to repay such financing, it should not include such repayment as a liability;

(2) where a *firm* has a reduced liability to repay such financing, it should include a reduced repayment as a liability.

- 1.3.164 G In *INSPRU* 1.3.162R, financing includes *reinsurance* financing arrangements and analogous non-*reinsurance* financing arrangements, such as contingent loans, securitisations and any other arrangements in respect of *contracts of insurance* that are analogous to contracts of *reinsurance* in terms of the risks transferred and the finance provided.

Other long-term insurance liabilities

- 1.3.165 R A *firm* must provide for any other *long-term insurance liabilities* arising from or in connection with *with-profits insurance contracts* in a *with-profits fund*, to the extent that adequate provision has not been made in the *with-profits benefits reserve* or in any other part of the *future policy related liabilities* for that fund.

Some examples of these other *long-term insurance liabilities* are:

- 1.3.166 G (1) pension and other mis-selling reserves;
(2) provisions for tax; and
(3) provisions for future shareholder transfers.

- 1.3.167 G In determining the realistic liability for taxation *firms* should apply the general principles set out in *INSPRU* 1.3.105R and the *guidance* given in *INSPRU* 1.3.107G.

- 1.3.168 G *INSPRU* 1.3.105R requires *firms* to provide for shareholder transfers out of the *with-profits fund* as a liability of the fund. The provision should be consistent with the methods and assumptions used in valuing the other realistic liabilities. So, for example, where the *with-profits benefits reserve* includes amounts that would be paid to *policyholders* through future bonuses, provision should also be made for future shareholder transfers associated with those bonuses.

Valuing the costs of guarantees, options and smoothing

- 1.3.169 R For the purposes of *INSPRU* 1.3.137R(5), *INSPRU* 1.3.137R(7) and *INSPRU* 1.3.137R(8), a *firm* must calculate the costs of any guarantees, options and smoothing using one or more of the following three methods:
(1) a stochastic approach using a market-consistent asset model (*INSPRU* 1.3.170R);
(2) using the market costs of hedging the guarantee or option;
(3) a series of deterministic projections with attributed probabilities.

The market-consistent asset model in *INSPRU* 1.3.169(1):

- 1.3.170 R (1) means a model that delivers prices for assets and liabilities that can be directly verified from the market; and
(2) must be calibrated to deliver market-consistent prices for those assets that reflect the nature and term of the *with-profits insurance liabilities* of the *with-profits fund*.
- 1.3.171 G Deterministic approaches will not usually capture the time value of the option generated by a guarantee. In order to calculate this value properly, *firms* are expected either to use market option values where these are readily available or to undertake a stochastic approach using a market-consistent asset model.
- 1.3.172 G The *FSA* considers stochastic modelling to be preferable for material groups or classes of *with-profits insurance contracts* unless it can be shown that more simplistic or alternative methods are both appropriate and sufficiently robust.
- 1.3.173 G Where the guarantee or option is relatively simple in nature, is capable of being hedged, and has a value unlikely to be affected by management actions (*INSPRU* 1.3.185R) (for example, a guaranteed annuity rate option) then the cost of the guarantee or option would be the market cost of hedging the guarantee. Where that is generally the case but, in respect of a minor part of a portfolio, no market exists for hedging the option generated by the guarantee, a *firm* should take the value of the nearest equivalent benefit or right for which a market exists and record how it has adjusted the valuation to reflect the original option. Where the market value of the hedge is used *firms* should also make provisions for the credit risk arising from the hedge, both that arising from exposure to a *counterparty* and that arising from credit risk in the underlying instrument. The extent to which the guarantee or option is capable of being hedged depends on a *firm's* assumptions regarding future investment mix, persistency, annuitant mortality and take-up rates. While the *FSA* recognises that the hedge may not be perfectly matched to the underlying guarantee or option, a *firm* should ensure that hedge is reasonably well matched having regard to the sensitivity of the guarantee or option to the *firm's* choice of key assumptions.
- 1.3.174 G Where a *firm* has large cohorts of guarantees and uses stochastic or deterministic approaches, a *firm* should have regard to whether the cost of the guarantees determined under those approaches bears a reasonable relationship to the market cost of hedging those guarantees (where it exists).
- 1.3.175 G In determining the costs of smoothing, a *firm* should consider:

- (1) the consistency of its assumptions (including the exercise of management discretion over bonus rates); and
- (2) where targeted payouts currently exceed retrospective reserves in respect of those *claims*, the assumptions used in reducing the excess, if applicable, having regard to the *firm's PPFM* and its regulatory duty to treat its *customers* fairly.

Stochastic approach

- 1.3.176 G For the purposes of *INSPRU* 1.3.169R(1), a stochastic approach would consist of an appropriate market-consistent asset model for projections of asset prices and yields (such as equity prices, fixed interest yields and property yields), together with a dynamic model incorporating the corresponding value of liabilities and the impact of any foreseeable actions to be taken by management. Under the stochastic approach, the cost of the guarantee, option or smoothing would be equal to the average of these stochastic projections.
- 1.3.177 G In performing the projections of assets and liabilities under the stochastic approach in *INSPRU* 1.3.169R(1), a *firm* should have regard to the aspects in (1) and (2).
- (1) The projection term should be long enough to capture all material cash flows arising from the contract or groups of contracts being valued. If the projection term does not extend to the term of the last *policy*, the *firm* should check that the shorter projection term does not significantly affect the results.
 - (2) The number of projections should be sufficient to ensure a reasonable degree of convergence in the results, including the determination of the result of the *risk capital margin*. The *firm* should test the sensitivity of the results to the number of projections.
- 1.3.178 G The *FSA* considers a holistic approach to stochastic modelling to be preferable so as to value all items of costs together rather than using separate methods for different items of the *realistic value of liabilities*. This approach requires the projection of all material cash flows arising under the contract or group of contracts for each stochastic projection, rather than only those arising from the guarantee or option within the contract. The advantages of this approach are that it ensures greater consistency in the valuation of different components of the contract and explicitly takes into account the underlying hedges or risk mitigation between components of the contract or group of contracts being valued. Where a *firm* can use a stochastic approach to value simultaneously all components of the contract or group of contracts, the *firm* should adopt this approach where practical and feasible.
- 1.3.179 G Where a stochastic approach is used, a *firm* should make and retain a record under *INSPRU* 1.3.17R of the nature of the asset model and of the assumptions used (including the volatility of asset values and any assumed correlations between asset classes or between asset classes and economic

indicators, such as inflation).

- 1.3.180 G In calibrating asset models for the purposes of *INSPRU* 1.3.170R, a *firm* should have regard to the aspects in (1), (2) and (3).

(1) Few (if any) asset models can replicate all the observable *market values* for a wide range of asset classes. A *firm* should calibrate its asset models to reflect the nature and term of the fund's liabilities giving rise to significant guarantee and option costs.

(2) A *firm* will need to apply judgement to determine suitable estimates of those parameters which cannot be implied from observable market prices (for example, long-term volatility). A *firm* should make and retain a record under *INSPRU* 1.3.17R of the choice of parameters and the reasons for their use.

(3) A *firm* should calibrate the model to the current risk-free yield curve. Risk-free yields should be determined after allowing for credit and all other risks arising. *Firms* may have regard to any guidance from the actuarial profession on the calculation of the risk-free yield but should not assume a higher yield than suggested by any such guidance.

Deterministic approach

- 1.3.181 R For the purposes of the deterministic approach in *INSPRU* 1.3.169R(3), a *firm* must calculate a series of deterministic projections of the values of assets and corresponding liabilities, where each deterministic projection corresponds to a possible economic scenario or outcome.

- 1.3.182 G A *firm* should determine a range of scenarios or outcomes appropriate to both valuing the costs of the guarantee, option or smoothing and the underlying asset mix, together with the associated probability of occurrence. These probabilities of occurrence should be weighted towards adverse scenarios to reflect market pricing for risk. The costs of the guarantee, option or smoothing should be equal to the expected cost based on a series of deterministic projections of the values of assets and corresponding liabilities. In using a series of deterministic projections, a *firm* should consider whether its approach provides a suitably robust estimate of the costs of the guarantee, option or smoothing.

- 1.3.183 G In performing the projections of assets and liabilities under the deterministic approach in *INSPRU* 1.3.169R(3), a *firm* should have regard to the aspects in (1) and (2).

(1) The projection term should be long enough to capture all material cash flows arising from the contract or group of contracts being valued. If the projection term does not extend to the term of the last contract, the *firm* should check that the shorter projection term does not significantly affect the results.

(2) The series of deterministic projections should be numerous enough to capture a wide range of possible outcomes and take into account the probability of each outcome's likelihood. The costs will be understated if only relatively benign or limited economic scenarios are considered.

- 1.3.184 G Where a series of deterministic projections is used, a *firm* should make and retain a record under *INSPRU* 1.3.17R of the range of projections and how the probabilities attributed to each projection or outcome were determined (including the period of reference for any relevant data on past experience).

Management and policyholder actions

- 1.3.185 R In calculating the costs of any guarantees, options or smoothing, a *firm*:
(1) may reflect its prospective management actions (within the meaning of *INSPRU* 1.3.53R); and
(2) must reflect a realistic assessment of the *policyholder* actions (within the meaning of *INSPRU* 1.3.59R);
in its projections of the value of assets and liabilities.

- 1.3.186 G For the purposes of *INSPRU* 1.3.185 R, the related *guidance* in *INSPRU* 1.3.54 G to *INSPRU* 1.3.57 G (management actions) and in *INSPRU* 1.3.60 G (policyholder actions) applies.

Treatment of surplus on guarantees, options and smoothing

- 1.3.187 R *INSPRU* 1.3.188R applies to *firms* calculating the costs of guarantees, options and smoothing to be included in the *future policy-related liabilities* in accordance with *INSPRU* 1.3.137R(5), *INSPRU* 1.3.137R(7) and *INSPRU* 1.3.137R(8).

- 1.3.188 R Where a *firm* accumulates past experience and deducts or is otherwise able to take credit for charges for guarantees or options or smoothing, the future costs of guarantees or options or smoothing (as appropriate) must not be less than the greater of:

(1) the prospective calculation of the future cost of guarantees (see *INSPRU* 1.3.148R) or options (see *INSPRU* 1.3.156G) or smoothing (see *INSPRU* 1.3.158R) (as appropriate); and

(2) the sum of:

(a) the accumulated charges (after deduction of past costs) for guarantees or options or smoothing (as appropriate); and

(b) the prospective calculation of the future charges deducted for guarantees or options or smoothing (see *INSPRU* 1.3.144R) (as appropriate).

- 1.3.189 G The extent to which the amount in *INSPRU* 1.3.188R(2) exceeds the amount

in *INSPRU* 1.3.188R(1) will determine the surplus available to support actions that would be taken by the *firm's* management. The purpose of *INSPRU* 1.3.188R is to ensure that any resulting surplus at the valuation date arising from the accumulation of charges less costs remains available to support foreseeable actions that would be taken by the *firm's* management. Any additional liability arising from *INSPRU* 1.3.188R is added to the liabilities under *INSPRU* 1.3.137R(5), *INSPRU* 1.3.137R(7) and *INSPRU* 1.3.137R(8), but has no impact on the adjustment for planned deductions for the costs of guarantees, options and smoothing (*INSPRU* 1.3.137R(3) and *INSPRU* 1.3.144R).

Realistic current liabilities

- 1.3.190 R For the purposes of *INSPRU* 1.3.40R(3), the *realistic current liabilities* of a *with-profits fund* are equal to the sum of the following amounts:
- (1) the *firm's* best estimate provision for those liabilities for which prudent provision is made in *regulatory current liabilities* (see *INSPRU* 1.3.30R); and
 - (2) to the extent that amounts have not been provided in (1), any tax and any other costs arising either in respect of excess *admissible assets* (within the meaning of *INSPRU* 1.3.36R) or on the recognition of future shareholder transfers.
- 1.3.191 R For the purpose of assessing the best estimate provision to be made under *INSPRU* 1.3.190R(1) in respect of a *defined benefit occupational pension scheme*, a *firm* must use either its *defined benefit liability* or its *deficit reduction amount*, consistent with the *firm's* election under *INSPRU* 1.3.5BR(2).

1.4 Equalisation provisions

Application

- 1.4.1 R *INSPRU* 1.4 applies to an *insurer* carrying on *general insurance business* unless it is:
- (1) a *non-directive friendly society*; or
 - (2) an *incoming EEA firm*; or
 - (3) an *incoming Treaty firm*.

- 1.4.2 G The scope of *INSPRU* 1.4.11R to *INSPRU* 1.4.37G (non-credit equalisation provisions) is not restricted to *firms* subject to the relevant EC directives.

- 1.4.3 G The requirements of this section apply to a *firm* on a solo basis.

Purpose

- 1.4.4 G This section sets out *rules* and *guidance* on the calculation of the amount of the *equalisation provisions* that are required to be maintained by *firms* that carry on non-credit *insurance business* or credit *insurance business*.

- 1.4.5 G *Credit* or *non-credit equalisation provisions* form part of the *technical provisions* that a *firm* is required to establish under *INSPRU* 1.1.12R(1). They help to smooth fluctuations in loss ratios in future years for business where *claims* in any future year may be subject to significant deviation from recent or average *claims* experience, or where trends in experience may be subject to change. Such volatile *claims* experience might arise in the case, for example, of insurance against losses caused by major catastrophes such as hurricanes or earthquakes.

- 1.4.6 G In general terms, *INSPRU* 1.4 sets out *rules* and *guidance* as to:
- (1) the circumstances in which a *firm* is required to maintain *equalisation provisions*;
 - (2) the methods to be used in calculating the amount of each provision;
 - (3) the geographical location of the business relevant to certain calculations for different types of *firm* - this is summarised in the Table in *INSPRU* 1.4.7G.

1.4.7 G

Table : Scope of <i>insurance business</i> to be included in calculations				
Type Of Firm		Credit Equalisation Provision		Non Credit Equalisation Provision
		Threshold in <i>INSPRU</i> 1.4.44R	Provision in <i>INSPRU</i> 1.4.43R	Threshold in <i>INSPRU</i> 1.4.18R(2) and provision in <i>INSPRU</i> 1.4.17R
<i>UK insurer</i>		World-wide	World-wide	World-wide
<i>Pure reinsurer with head office outside United Kingdom</i>		<i>UK</i>	World-wide	<i>UK</i>
<i>Pure reinsurer with head office in United Kingdom</i>		World-wide	World-wide	World-wide
<i>Non-EEA direct insurers</i>	<i>EEA-deposit insurer</i>	<i>UK</i>	<i>UK</i>	<i>UK</i>
	<i>Swiss general insurer</i>	<i>UK</i>	<i>UK</i>	<i>UK</i>
	<i>UK-deposit insurer</i>	All <i>EEA</i>	World-wide	<i>UK</i>
	All other non- <i>EEA direct insurers</i>	<i>UK</i>	World-wide	<i>UK</i>

- 1.4.8 G The *First Non-Life Directive* (as amended) and the *Reinsurance Directive* require the calculation of *credit equalisation provisions*. *Non-credit equalisation provisions* are a domestic *United Kingdom* requirement. For insurance regulatory purposes under EC Directives, *credit equalisation provisions* are classified as liabilities.
- 1.4.9 G However, *firms* are permitted to include *equalisation provisions* within their financial resources when demonstrating compliance with non-Directive capital requirements. Hence *equalisation provisions* are deducted from the available *capital resources* of a *firm* for the purpose of meeting its *minimum capital requirement* for *general insurance business*; but, in the calculation of a *firm's enhanced capital requirement* for *general insurance business* under *INSPRU* 7.1.11R, its *equalisation provisions* (if any) are added back to its *capital resources*.
- 1.4.10 G Under International Accounting Standards (IAS), which will apply to the financial statements of some *insurers* from 2005, there will be no requirement to treat *equalisation provisions* as liabilities in *insurers'* published financial statements. However, they will continue to be treated as liabilities for the purposes of demonstrating compliance with Directive capital requirements.

Non-credit equalisation provision

Firms carrying on non-credit insurance business

- 1.4.11 R (1) *INSPRU* 1.4.11R to *INSPRU* 1.4.37G apply to any *firm*, other than an *assessable mutual*, which carries on the business of *effecting* or *carrying out general insurance contracts* falling within any description in column 2 in Table *INSPRU* 1.4.12R ("non-credit *insurance business*").
 (2) A *firm* falling within (1) must classify all of its non-credit *insurance business* into separate *insurance business groupings*, as specified in Table *INSPRU* 1.4.12R.

- 1.4.12 R Table : Groupings of non-credit *insurance business*

<i>Insurance Business Grouping</i>		General Insurance Contracts
A	<i>Contracts of insurance</i> which fall within <i>general insurance business classes</i> 4, 8 or 9, other than:	
	(a)	<i>contracts of insurance</i> under non-proportional reinsurance treaties; and
	(b)	<i>contracts of insurance</i> against <i>nuclear risks</i> .
B	<i>Contracts of insurance</i> which fall within <i>general insurance business class</i> 16(a) , other than:	
	(a)	<i>contracts of insurance</i> under non-proportional reinsurance treaties; and
	(b)	<i>contracts of insurance</i> against <i>nuclear risks</i> .
C	<i>Contracts of insurance</i> which fall within <i>general insurance business classes</i> 5, 6, 11 or 12, other than:	
	(a)	<i>contracts of insurance</i> against <i>nuclear risks</i> ; and
	(b)	<i>reinsurance</i> contracts corresponding to contract in (a).
D	<i>Contracts of insurance</i> against <i>nuclear risks</i> .	
E	<i>Contracts of insurance</i> under non-proportional reinsurance treaties and which fall within <i>general insurance business classes</i> 4, 8, 9 or 16(a) other than <i>contracts of insurance</i> against <i>nuclear risks</i> .	

- 1.4.13 R For the purposes of *INSPRU* 1.4.11R to *INSPRU* 1.4.37G, a *firm* with its head office in the *United Kingdom* must take account of non-credit *insurance business* carried on by it world-wide.

- 1.4.14 R For the purposes of *INSPRU* 1.4.11R to *INSPRU* 1.4.37G, a *firm* with its head office outside the *United Kingdom* need only take account of non-

credit insurance business carried on by it from a *branch* in the *United Kingdom*.

- 1.4.15 G The *insurers* affected by *INSPRU* 1.4.11R include pure reinsurers, UK-deposit insurers, EEA-deposit insurer, and Swiss general insurers.
- 1.4.16 G For *insurers* (including *pure reinsurers*) with a head office in the *United Kingdom*, the calculations must be made in respect of world-wide business.

Requirement to maintain non-credit equalisation provision

- 1.4.17 R In respect of each *financial year*, a *firm* must, unless *INSPRU* 1.4.18R applies:
(1) calculate the amount of its *non-credit equalisation provision* as at the end of that year in accordance with *INSPRU* 1.4.20R; and
(2) maintain a *non-credit equalisation provision* calculated in accordance with *INSPRU* 1.4.20R for the following *financial year*.
- 1.4.18 R (1) *INSPRU* 1.4.17R does not apply to any *firm* in respect of any *financial year* if, as at the end of that year:
(a) no *non-credit equalisation provision* has been brought forward from the preceding *financial year*; and
(b) the amount of the *annualised net written premiums* for all the non-credit insurance business carried on by it in the *financial year* is less than the threshold amount.
(2) The threshold amount in respect of any *financial year* is the higher of:
(a) 1,500,000 Euro; and
(b) 4% of *net written premiums* in that *financial year* in respect of all its *general insurance business*, if this amount is less than 2,500,000 Euro.
- 1.4.19 G For *non-EEA insurers*, the calculation of the threshold amount in *INSPRU* 1.4.18R(2) is limited by *INSPRU* 1.4.14R to the business of the *firm* carried on in the *United Kingdom*. Such a *firm* may do little *UK non-credit insurance business*, and so would not be required to set up a *non-credit equalisation provision* under *INSPRU* 1.4, but may do significant business outside the *United Kingdom* characterised by high-impact, low-frequency *claims*. Such a *firm* is required by *INSPRU* 1.5.41R to hold adequate world-wide financial resources to avoid internal-contagion strain on the *branch* in the *United Kingdom*. In determining the adequacy of its financial resources, the *firm* should undertake stress and scenario testing of its underwriting and other risks as set out in *GENPRU* 1.2.

Calculating the amount of the provision

- 1.4.20 R (1) Unless *INSPRU* 1.4.22R applies, the amount of a *firm's non-credit equalisation provision* as at the end of a *financial year* is the higher of:
- (a) zero; and
 - (b) whichever is the lower of:
 - (i) the aggregate of the amounts of the maximum provision for each *insurance business grouping* as at the end of that *financial year*; and
 - (ii) the sum of A and B.
- (2) For the purposes of (1)(b)(ii):
- (a) A is the amount of the *non-credit equalisation provision*, if any, brought forward from the *financial year* immediately preceding that in respect of which the calculation is being performed; and
 - (b) B is:
 - (i) the aggregate of the amounts of the provisional transfers-in for each *insurance business grouping*; minus
 - (ii) the aggregate of the amounts of the provisional transfers-out for each *insurance business grouping*.
- (3) For any *insurance business grouping*:
- (a) the amount of the maximum provision in (1)(b)(i) is to be determined in accordance with *INSPRU* 1.4.24R;
 - (b) the amount of the provisional transfers-in in (2)(b)(i) is to be determined in accordance with *INSPRU* 1.4.26R; and
 - (c) the amount of the provisional transfers-out in (2)(b)(ii) is to be determined in accordance with *INSPRU* 1.4.29R.
- 1.4.21 G If provisional transfers-out are in excess of provisional transfers-in, the *non-credit equalisation provision* as calculated in accordance with *INSPRU* 1.4.20R in respect of a particular *financial year* may be less than that calculated for the preceding *financial year* although, by virtue of *INSPRU* 1.4.20R(1)(a), it cannot be negative.
- 1.4.22 R (1) The amount of a *firm's non-credit equalisation provision* as at the end of a *financial year* is zero if:

(a) as at the end of that year, the *firm* meets either of the conditions specified in (2) and (3); and

(b) the *annualised net written premiums* for all the non-credit *insurance business* carried on by the *firm* in that year are less than the threshold amount.

(2) The first condition is that the *firm* carried on non-credit *insurance business* in the first *financial year* of the relevant period and, for each of any two or more *financial years* of that period, the *annualised net written premiums* for business of that description were less than the threshold amount.

(3) The second condition is that the *firm* did not carry on non-credit *insurance business* in the first *financial year* of the relevant period and the average of the *annualised net written premiums* for business of that description carried on by the *firm* in each *financial year* of the relevant period was less than the threshold amount.

(4) For the purposes of this *rule*:

(a) the threshold amount is the amount determined in accordance with *INSPRU* 1.4.18R(2); and

(b) the relevant period is the period of four *financial years* ending immediately before the beginning of the *financial year* in (1).

- 1.4.23 G If *INSPRU* 1.4.22R applies, a *firm* may need to make sufficient transfers from its *non-credit equalisation provision* to bring the *non-credit equalisation provision* for that *financial year* to zero.

The calculation: the maximum provision

- 1.4.24 R (1) For the purposes of the calculation required by *INSPRU* 1.4.20R, the amount of the maximum provision for any *insurance business grouping* is to be determined in accordance with (2) to (5).
- (2) Unless (4) applies, the amount of the maximum provision for the grouping, as at the end of a *financial year*, is the amount determined by multiplying X and Y.
- (3) For the purposes of (2):
- (a) X is the percentage specified in Table *INSPRU* 1.4.25R in relation to the grouping; and
- (b) Y is the average of the amount of the *annualised net written premiums* for non-credit *insurance business* in the grouping carried on by the *firm* in each *financial year* of the relevant period.
- (4) Where Y is a negative amount, the maximum provision for that *insurance business grouping* is zero.
- (5) For the purposes of (3)(b), the relevant period is the five-year period comprising:
- (a) the *financial year* in (2); and
- (b) the previous four *financial years*.

- 1.4.25 R Table : Calculation of maximum provision for any *insurance business grouping*

Insurance Business Grouping	Percentage of average annualised net written premiums
A	20
B	20
C	40
D	600
E	75

The calculation: provisional transfers-in

- 1.4.26 R (1) For the purposes of the calculation required by *INSPRU* 1.4.20R, the amount of the provisional transfers-in for any *insurance business grouping* is to be determined in accordance with (2).
(2) The amount of the provisional transfers-in for the grouping, as at the end of a *financial year*, is the amount determined by multiplying X and Y.
(3) For the purposes of (2):
(a) X is the percentage specified in Table *INSPRU* 1.4.27R in relation to the grouping; and
(b) Y is the amount of the *net written premiums* for non-credit *insurance business* in the grouping that was carried on by the *firm* in the *financial year* in (2), including adjustments in respect of previous *financial years*.

- 1.4.27 R Table : Provisional transfers-in for any *insurance business grouping*

Insurance Business Grouping	Percentage of net written premiums
A	3
B	3
C	6
D	75
E	11

- 1.4.28 G Since each *insurance business grouping* should be assessed individually, negative *net written premiums* in relation to any *insurance business grouping* should be transferred in to the *non-credit equalisation provision*.

The calculation: provisional transfers-out

1.4.29 R (1) For the purposes of the calculation required by *INSPRU* 1.4.20R, the amount of the provisional transfers-out for any *insurance business grouping* is to be determined in accordance with (2).
 (2) The amount of the provisional transfers-out for the grouping, as at the end of a *financial year*, is the lower of:
 (a) the amount of the maximum provision for the grouping under *INSPRU* 1.4.24R for that *financial year*; and
 (b) the abnormal loss for the grouping under *INSPRU* 1.4.30R for that *financial year*.

1.4.30 R R For each *insurance business grouping*, the abnormal loss as at the end of a *financial year* in relation to which an *equalisation provision* is calculated is:
 (1) (for business within the *insurance business grouping* accounted for on an accident year basis) the amount, if any, by which the amount of net *claims* incurred exceeds the greater of:
 (a) zero; and
 (b) the percentage of *net earned premiums* in that *financial year* specified in the Table in *INSPRU* 1.4.31R; or
 (2) (for business within the *insurance business grouping* accounted for on an underwriting year basis) the amount, if any, by which the amount of net *claims* paid (plus adjustment for change in net *technical provisions*, other than any change in provisions for *claims* handling expenses or equalisation) exceeds the greater of:
 (a) zero; and
 (b) the percentage of *net written premiums* in that *financial year* specified in the Table in *INSPRU* 1.4.31R.

1.4.31 R Table : Abnormal loss for any *insurance business grouping*

Insurance business grouping	Percentage of net written premiums
A	72.5
B	72.5
C	95
D	25
E	100

Adjustments to calculations

Transfers of business from the firm

- 1.4.32 R (1) This *rule* applies to modify the application of *INSPRU* 1.4.24R and *INSPRU* 1.4.26R in any case where a *firm* has transferred to another *undertaking* any rights and obligations under *general insurance contracts* falling within any *insurance business grouping*.
(2) As at the end of the *financial year* in which the transfer takes place, *net written premiums* in respect of the transferred contracts in any grouping must be deducted from total *net written premiums* for that grouping before calculating the maximum provision under *INSPRU* 1.4.24R or provisional transfers-in under *INSPRU* 1.4.26R.
- 1.4.33 R If all the rights and obligations of a *firm* in relation to non-credit *insurance business* in any *insurance business grouping* have been transferred, the maximum provision for the grouping under *INSPRU* 1.4.24R is zero.
- Transfers of business to the firm
- 1.4.34 R (1) This *rule* applies to modify the application of *INSPRU* 1.4.24R, *INSPRU* 1.4.26R and *INSPRU* 1.4.29R in any case where another *undertaking* has transferred to a *firm* any rights and obligations under *general insurance contracts* falling within any *insurance business grouping*.
(2) As at the end of the *financial year* in which the transfer takes place a sum equal to that part of the consideration for the transfer that relates to business in an *insurance business grouping* must be:
(a) excluded from net *premiums* (written or earned) before performing the calculations required by *INSPRU* 1.4.24R (maximum provision) and *INSPRU* 1.4.26 R (provisional transfers in);
(b) included in net *premiums* (written or earned) before performing the calculation required by *INSPRU* 1.4.30R (abnormal loss); and
(c) excluded from net *claims* (paid or incurred) before performing the calculation required by *INSPRU* 1.4.30R (abnormal loss).
- 1.4.35 G For the purposes of *INSPRU* 1.4.34R, the consideration payable should be apportioned between *insurance business groupings* according to the groupings within which the *general insurance contracts* which are the subject of the acquisition fall. In appropriate cases, apportionment may reflect the split of liabilities acquired, including *unearned premium*.
- 1.4.36 G Where business is accounted for on an accounting year basis, in any year following the transfer, *net earned premiums* must include an appropriate amount in respect of the transfer.
- 1.4.37 G *INSPRU* 1.4.32R to *INSPRU* 1.4.34R apply to transfers by way of transfer under Part VII of the *Act* and by novation.
- Credit equalisation provisions
- Firms carrying on credit insurance business
- 1.4.38 R *INSPRU* 1.4.39R to *INSPRU* 1.4.47G apply to any *firm* which carries on the business of *effecting or carrying out general insurance contracts* falling

within *general insurance business class 14* (which business is referred to in *INSPRU 1.4* as "*credit insurance business*"), unless it is:

- (1) a *non-directive insurer*; or
 - (2) a *pure reinsurer* which became a *firm in run-off* before 31 December 2006 and whose *Part IV permission* has not subsequently been varied to add back the *regulated activity of effecting contracts of insurance*.
- 1.4.39 R For the purposes of *INSPRU 1.4.43R* and *INSPRU 1.4.44R*, a *firm* whose head office is in the *United Kingdom* must take account of the *credit insurance business* carried on by it world-wide.
- 1.4.40 R (1) For the purposes of *INSPRU 1.4.43R*:
- (a) a *Swiss general insurer* or an *EEA-deposit insurer* must take account of the *credit insurance business* carried on by it in the *United Kingdom*; and
 - (b) any other *firm* whose head office is outside the *United Kingdom* (including a *UK-deposit insurer*) must take account of the *credit insurance business* carried on by it world-wide.
- (2) For the purposes of *INSPRU 1.4.44R*:
- (a) a *UK-deposit insurer* need only take account of the *credit insurance business* carried on by it in all *EEA States*, taken together; and
 - (b) any other *firm* whose head office is outside the *United Kingdom* (including an *EEA-deposit insurer* and a *Swiss general insurer*) need only take account of the *credit insurance business* carried on by it in the *United Kingdom*.
- 1.4.41 G For *firms* whose head office is in the *United Kingdom* both calculations must be made in respect of world-wide business.
- 1.4.42 G The requirements of *INSPRU 1.4.39R* and *INSPRU 1.4.40R* are summarised in the table in *INSPRU 1.4.7G*.
- Requirement to maintain credit equalisation provision
- 1.4.43 R In respect of each *financial year*, a *firm* must, unless *INSPRU 1.4.44R* applies:
- (1) calculate the amount of its *credit equalisation provision* as at the end of that year in accordance with *INSPRU 1.4.45R*; and
 - (2) maintain a *credit equalisation provision* calculated in accordance with *INSPRU 1.4.45R* for the following *financial year*.
- 1.4.44 R *INSPRU 1.4.43R* does not apply to a *firm* in respect of any *financial year* if,

as at the end of that year, the *annualised net written premiums* for its credit *insurance business* are less than 4% of annualised *net written premiums* in that *financial year* in respect of all its *general insurance business*, if this amount is less than 2,500,000 Euro.

Calculating the amount of the provision

- 1.4.45 R (1) The amount of a *firm's credit equalisation provision* as at the end of a *financial year* ("*financial year A*") is the higher of:
- (a) zero; and
 - (b) whichever is the lower of:
 - (i) 150% of the highest amount of *net written premiums* for credit *insurance business* carried on by the *firm* in *financial year A* or in any of the previous four *financial years*; and
 - (ii) the amount of the *credit equalisation provision* brought forward from the preceding *financial year*, after making either of the adjustments in (2).
- (2) The adjustments are:
- (a) the deduction of the amount of any technical deficit arising in *financial year A*; or
 - (b) the addition of the lower of:
 - (i) 75% of the amount of any technical surplus arising in *financial year A*; and
 - (ii) 12% of the amount of the *net written premiums* for credit *insurance business* carried on by the *firm* in *financial year A*.
- (3) For the purposes of (2) the amount of technical deficit or technical surplus is to be determined in accordance with *INSPRU 1.4.46R*.
- 1.4.46 R For the purposes of the adjustments in *INSPRU 1.4.45R(2)*, technical surplus (or technical deficit) in respect of credit *insurance business* is the amount by which the aggregate of *net earned premiums* and other technical income exceeds (or falls short of) the sum of net *claims* incurred, *claims management costs* and any technical charges.
- 1.4.47 G The calculation of technical surplus or technical deficit should be made before tax and before any transfer to or from the *credit equalisation provision*. Investment income should not be included in these calculations.

Euro conversion

- 1.4.48 R For the purposes of *INSPRU 1.4*, the exchange rate from the Euro to the pound sterling for each year beginning on 31 December is the rate applicable on the last day of the preceding October for which the exchange rates for the currencies of all the European Union member states were published in the Official Journal of the European Union.

Application of *INSPRU 1.4* to Lloyd's

- 1.4.49 R *INSPRU* 1.4 applies to the *Society* in accordance with *INSPRU* 8.1.2R:
(1) with the modification set out in *INSPRU* 1.4.50R; and
(2) except *INSPRU* 1.4.11R to *INSPRU* 1.4.37G.
- 1.4.50 R The *Society* must calculate a *credit equalisation provision* for the aggregate *insurance business* of all *members*; it is not required to calculate a *credit equalisation provision* separately for the business of each *member*.
- 1.4.51 R The *Society* must allocate the result of *INSPRU* 1.4.50R between itself and each of the *members* on a fair and reasonable basis.

1.5 Internal-contagion risk

Application

- 1.5.1 R *INSPRU* 1.5 applies to an *insurer*.
- 1.5.2 R *INSPRU* 1.5 does not apply, to the extent stated, to any *insurer* in (1) to (4):
- (1) none of the provisions apply to *non-directive friendly societies*;
 - (2) none of the provisions, apart from *INSPRU* 1.5.33R (payment of financial penalties) apply to *firms* which qualify for authorisation under Schedule 3 or 4 of the *Act*;
 - (3) *INSPRU* 1.5.33R (payment of financial penalties) does not apply to *mutuals*;
 - (4) *INSPRU* 1.5.41R to *INSPRU* 1.5.57R (*UK branches* of certain *non-EEA insurers*) do not apply to:
 - (a) *UK insurers*; or
 - (b) *non-EEA insurers* whose *insurance business* in the *United Kingdom* is restricted to *reinsurance*; or
 - (c) *EEA-deposit insurers*; or
 - (d) *Swiss general insurers*.
- 1.5.3 G The scope of application of *INSPRU* 1.5 is not restricted to *firms* that are subject to the relevant EC directives.
- 1.5.4 R In its application to a *firm* with its head office in the *United Kingdom*, this section applies to the whole of the *firm's* business carried on world-wide.
- 1.5.5 R In the application of this section to activities carried on by a *non-EEA insurer*:
- (1) *INSPRU* 1.5.13R to *INSPRU* 1.5.15G and *INSPRU* 1.5.41R apply in relation to the whole of its business carried on world-wide;
 - (2) all other provisions of this section apply only in relation to:
 - (a) in the case of any *UK-deposit insurer*, activities carried on from *branches* in any *EEA State*; and
 - (b) in any other case, activities carried on from a *branch* in the *United Kingdom*.
- 1.5.6 G The adequacy of a *firm's* financial resources needs to be assessed in relation to all the activities of the *firm* and the risks to which they give rise.
- 1.5.7 G The requirements of this section apply to a *firm* on a solo basis.
- Purpose
- 1.5.8 G This section sets out requirements for a *firm* relating to 'internal-contagion risk'. This is the risk that losses or liabilities from one activity might deplete or divert financial resources held to meet liabilities from another activity. It

arises where the two activities are carried on within the same *firm*. It may also arise from the combination of activities within the same *group*, but this aspect of internal-contagion risk falls outside the scope of this section. Requirements relevant to *group* contagion risk are set out in *INSPRU 6*.

- 1.5.9 G Internal-contagion risk includes in particular the risk that arises where a *firm* carries on:
- (1) both insurance and non-insurance activities; or
 - (2) two or more different types of insurance activity; or
 - (3) insurance activities from offices or *branches* located in both the *United Kingdom* and overseas.
- 1.5.10 G This section requires *firms* other than *pure reinsurers* to limit non-insurance activities to those that directly arise from their *insurance business*, e.g. investing assets, employing insurance staff etc. It also requires that an adequate provision be established for non-insurance liabilities. *Pure reinsurers* must limit their activities to the business of *reinsurance* and related operations.
- 1.5.11 G This section also sets out requirements for the separation of different types of insurance activity. However, in most circumstances the combination of different types of insurance activity within the same *firm* is a source of strength. Adequate pooling and diversification of insurance risk is fundamental to sound business practice. The requirements, therefore, only apply in two specific cases where without adequate protection the combination might operate to the detriment of *policyholders*. They apply where a *firm* carries on both:
- (1) *general insurance business* and *long-term insurance business*;
 - (2) linked and non-linked *insurance business*.
- 1.5.12 G Finally, the section sets out requirements to protect *policyholders* of *branches* of non-*EEA firms* where these are supervised by the *FSA*. These apply only to a non-*EEA firm* that has established a *branch* in the *United Kingdom*.
- Requirements: Non-insurance activities
- Restriction of business
- 1.5.13 R (1) A *firm* other than a *pure reinsurer* must not carry on any commercial business other than *insurance business* and activities directly arising from that business.
- (2) (1) does not prevent a *friendly society* which was on 15 March 1979 carrying on *long-term insurance business* from continuing to carry on savings business.
- 1.5.13A R A *pure reinsurer* must not carry on any business other than the business of *reinsurance* and related operations.

- 1.5.13B G In *INSPRU* 1.5.13AR related operations include, for example, activities such as provision of statistical or actuarial advice, risk analysis or research for its clients. It may also include a *holding company* function and activities with respect to financial sector activities within the meaning of Article 2, point 8, of the *Financial Groups Directive*. But it does not allow the carrying on of, for example, unrelated banking and financial activities.

Financial limitation of non-insurance activities

- 1.5.14 R A *firm* must limit, manage and control its non-insurance activities so that there is no significant risk arising from those activities that it may be unable to meet its liabilities as they fall due.

- 1.5.15 G For the purpose of *INSPRU* 1.5.14R a *firm* should consider how the financial impact of non-insurance activities might diverge from expectations. However, it need only take into account unexpected variations in amount and timing in so far as they are reasonably possible and may take into account effective mitigating factors.

Requirements: long-term insurance business

- 1.5.16 G *INSPRU* 1.5.18R, *INSPRU* 1.5.21R, *INSPRU* 1.5.30R and *INSPRU* 1.5.31R require a *firm* to identify the assets attributable to the receipts of the *long-term insurance business*, called *long-term insurance assets*, and only to apply those assets for the purpose of that business. This has the effect of prohibiting a *composite firm* from using *long-term insurance assets* to meet *general insurance liabilities*. It also keeps *long-term insurance assets* separate from shareholder funds.

Permissions not to include both types of insurance

- 1.5.17 G Under section 31 of the *Act*, a *firm* may not carry on a *regulated activity* unless it has *permission* to do so (or is exempt in relation to the particular activity). Both *general insurance business* and *long-term insurance business* are *regulated activities* and *permission* will extend to the *effecting or carrying out* of one or more particular *classes of contracts of insurance*. A *firm's permission* can be varied so as to add other *classes*. It is *FSA* policy, in compliance with EC directives on insurance, not to grant or vary *permission* if that would allow a *firm* to engage in both *general insurance business* and *long-term insurance business*. This does not apply where a *firm's permission* is restricted to *reinsurance*. It also does not apply where a *firm's permission* extends to *effecting or carrying out life and annuity contracts of insurance*. This will automatically include *permission* to *effect or carry out accident contracts of insurance* or *sickness contracts of insurance* on an ancillary or supplementary basis (see article 2(1) of the Consolidated Life Directive).

Separately identify and maintain long term insurance assets

- 1.5.18 R A *firm* carrying on *long-term insurance business* must identify the assets

relating to its *long-term insurance business* which it is required to hold by virtue of *INSPRU* 1.1.20R or *INSPRU* 1.1.21R .

- 1.5.19 G *INSPRU* 1.1.16R requires a *firm* to establish adequate *technical provisions* for its *long-term insurance contracts*. *INSPRU* 1.1.20R requires a *firm* to hold *admissible assets* of a value at least equal to the amount of the *technical provisions* and its other *long-term insurance liabilities*. *INSPRU* 1.1.21R ensures that a *composite firm* identifies separate *admissible assets* with a value at least equal to the *technical provisions* for *long-term insurance business* and its other *long-term insurance liabilities* as well as holding other *admissible assets* of a value at least equal to the amount of its *technical provisions* for *general insurance business* and its other *general insurance liabilities*. The overall impact of these provisions in *INSPRU* 1.1, and of *INSPRU* 1.5.18R, is that any *firm* writing *long-term insurance business* must identify separately *admissible assets* of a value at least equal to the amount of its *long-term insurance business technical provisions* and its other *long-term insurance liabilities*.
- 1.5.20 G *INSPRU* 1.5.18R does not prohibit a *firm* from identifying other assets as being available to meet the liabilities of its *long-term insurance business*. It may transfer such other assets to a *long-term insurance fund* (see *INSPRU* 1.5.21R and *INSPRU* 1.5.22R) and the transfer will take effect when it is recorded in the *firm's* accounting records (see *INSPRU* 1.5.23R). After the transfer takes effect, a *firm* may not transfer the assets out of a *long-term insurance fund* except where they represent an *established surplus* (see *INSPRU* 1.5.27R).
- 1.5.21 R (1) A *firm's* long-term insurance assets are the items in (2), adjusted to take account of:
- (a) outgo in respect of the *firm's long-term insurance business*; and
 - (b) any transfers made in accordance with *INSPRU* 1.5.27R.
- (2) The items are:
- (a) the assets identified under *INSPRU* 1.5.18R (including assets into which those assets have been converted);
 - (b) any other assets identified by the *firm* as being available to cover its *long-term insurance liabilities*;
 - (c) *premiums* and other receivables in respect of *long-term insurance contracts*;
 - (d) other receipts of the *long-term insurance business*; and
 - (e) all income and capital receipts in respect of the items in (2).
- 1.5.22 R (1) Unless (2) applies, all the *long-term insurance assets* of the *firm* constitute its long-term insurance fund.
- (2) Where a *firm* identifies particular *long-term insurance assets* in connection with different parts of its *long-term insurance business*, the assets identified in relation to each such part constitute separate long-term insurance funds of the *firm*.

- 1.5.23 R A *firm* must maintain a separate accounting record in respect of each of its *long-term insurance funds* (including any *with-profits fund*).
- 1.5.24 G *Firms* must ensure that *long-term insurance assets* are separately identified and allocated to a *long-term insurance fund* at all times. Assets in external accounts, for example at banks, custodians, or brokers should be segregated in the *firm's* books and records into separate accounts for *long-term insurance business* and *general insurance business*. Where a *firm* has more than one *long-term insurance fund*, a separate accounting record must be maintained for each fund. Accounting records should clearly document the allocation.
- 1.5.25 G Where the surplus arising from business is shared between *policyholders* and shareholders in different ways for different blocks of business, it may be necessary to maintain a separate fund to ensure that *policyholders* are, and will be, treated fairly. For example, if a proprietary company writes some business on a with-profits basis, this should be written in a *with-profits fund* separate from any business where the surplus arising from that business is wholly owned by shareholders.
- 1.5.26 G Where a *firm* merges separate funds for different types of business, it will need to ensure that the merger will not result in *policyholders* being treated unfairly. When considering merging the funds, the *firm* should consider the impact on its *PPFM* (see *COB* 6.10) and on its obligations to notify the *FSA* (see *SUP* 15.3). In particular, a *firm* would need to consider how any *inherited estate* would be managed and how the fund would be run in future, such that *policyholders* are treated fairly.
- 1.5.27 R A *firm* may not transfer assets out of a *long-term insurance fund* unless:
- (1) the assets represent an *established surplus*; and
 - (2) no more than three months have passed since the determination of that surplus.
- 1.5.28 G As a result of *INSPRU* 1.5.27R(2), an *actuarial investigation* undertaken to determine an *established surplus* remains in-date for three months from the date as at which the determination of the surplus was made. However, even where the investigation is still in-date, the *firm* should not make the transfer unless there is sufficient surplus at the time of the transfer to allow it to be made without breach of *INSPRU* 1.1.20R or *INSPRU* 1.1.21R.
- 1.5.29 G *INSPRU* 1.1.27R and *INSPRU* 1.1.28R provide further constraints on the transfer of assets out of a *with-profits fund*. *INSPRU* 1.1.27R requires a *firm* to have *admissible assets* in each of its *with-profits funds* to cover the *technical provisions* and other *long-term insurance liabilities* relating to all the business in that fund. *INSPRU* 1.1.28R requires a *realistic basis life firm* to ensure that the *realistic value of assets* for each of its *with-profits funds* is at least equal to the *realistic value of liabilities* of that fund.

Exclusive use of long-term insurance assets

- 1.5.30 R (1) A *firm* must apply a *long-term insurance asset* only for the purposes of its *long-term insurance business*.
(2) For the purpose of (1), applying an asset includes coming under any obligation (even if only contingently) to apply that asset.
- 1.5.31 R A *firm* must not agree to, or allow, any mortgage or charge on its *long-term insurance assets* other than in respect of a *long-term insurance liability*.
- 1.5.32 G The purposes of the *long-term insurance business* include the payment of *claims*, expenses and liabilities arising from that business, the acquisition of lawful access to fixed assets to be used in that business and the investment of assets. The payment of liabilities may include repaying a loan but only where that loan was incurred for the purpose of the *long-term insurance business*. The purchase or investment of assets may include an exchange at fair *market value* of assets (including *money*) between the *long-term insurance fund* and other assets of the *firm*. A *firm* may also lend *securities* held in a *long-term insurance fund* under a *stock lending* transaction or transfer assets as *collateral* for a *stock lending* transaction where the *firm* is the borrower, where such lending or transfer is for the benefit of the *long-term insurance business*.

Payment of financial penalties

- 1.5.33 R If the *FSA* imposes a financial penalty on a *long-term insurer*, the *firm* must not pay that financial penalty from a *long-term insurance fund*.
- 1.5.34 G *INSPRU* 1.5.2R states that this provision applies to all *firms*, except *mutuals*, and includes *firms* qualifying for authorisation under Schedule 3 or 4 to the *Act*.

Requirements: property-linked funds

- 1.5.35 G *INSPRU* 3.1.57R requires a *firm* to cover, as closely as possible, its *property-linked liabilities* by the property to which those liabilities are linked. In order to comply with this *rule*, a *firm* should identify the assets it holds to cover *property-linked liabilities* and should not apply those assets (as long as they are needed to cover the *property-linked liabilities*) for any purpose other than to meet those liabilities.
- 1.5.36 R A *firm* must select, allocate and manage the assets to which its *property-linked liabilities* are linked taking into account:
- (1) the *firm's* contractual obligations to holders of *property-linked policies*; and
- (2) its regulatory duty to treat *customers* fairly, including in the way it makes discretionary decisions as to how it selects, allocates and manages assets.
- 1.5.37 G *Property-linked liabilities* may be linked either to specified assets (with no contractual discretion given to the *firm* as to the choice of assets) or to assets

of a specified kind where the selection of the actual assets is left to the *firm*.

Requirements: UK branches of certain non-EEA firms

- 1.5.38 G The purpose of the *rules* and *guidance* set out in *INSPRU* 1.5.38G to *INSPRU* 1.5.57R is to protect against the risk that the financial resources required in respect of the activities of the *United Kingdom* (or *EEA*) *branch(es)* might be depleted by the other activities of the *non-EEA direct insurer*.
- 1.5.39 G By virtue of *INSPRU* 1.5.2R(4), the *rules* in *INSPRU* 1.5.41R to *INSPRU* 1.5.57R apply to *non-EEA direct insurers* except for *Swiss general insurers* and *EEA-deposit insurers*. Responsibility for determining the adequacy of the world-wide financial resources of *Swiss general insurers* or *EEA-deposit insurers* rests exclusively with the Swiss authorities or the authorities in the *EEA state* (other than the *United Kingdom*) in which the deposit was made.
- 1.5.40 G (1) *INSPRU* 1.5.41R requires a *non-EEA direct insurer* to hold adequate world-wide resources to meet the needs of the world-wide business without the need to rely on *UK* or *EEA branch* assets other than to meet *branch* liabilities.
(2) *INSPRU* 1.5.42R to *INSPRU* 1.5.47R require *non-EEA direct insurers* to calculate a local *MCR* and to hold assets representing that requirement in the *EEA* or the *United Kingdom*.
(3) *INSPRU* 1.5.48R to *INSPRU* 1.5.52R require *non-EEA direct insurers* to hold a minimum level of assets in the *United Kingdom* or *EEA*.
(4) *INSPRU* 1.5.54R requires the deposit of a minimum level of assets in the *United Kingdom*.
(5) *INSPRU* 1.5.56R and *INSPRU* 1.5.57R require *non-EEA direct insurers* to keep adequate accounting records in the *United Kingdom*.

Worldwide financial resources

- 1.5.41 R (1) A *non-EEA direct insurer* must maintain adequate worldwide financial resources, to ensure that there is no significant risk that its liabilities cannot be met as they fall due.
(2) For the purpose of (1):
(a) a *UK-deposit insurer* must not rely upon the assets held under *INSPRU* 1.1.20R as available to meet liabilities other than those arising from the activities of its *branches* in *EEA States*;
(b) other *non-EEA direct insurers* to whom (1) applies must not rely upon the assets held under *INSPRU* 1.1.20R as available to meet liabilities other than those arising from the activities of any *UK branch*.

UK or EEA MCR to be covered by admissible assets

- 1.5.42 R A *non-EEA direct insurer* must:
(1) calculate a *UK* or *EEA MCR* in accordance with *INSPRU* 1.5.44R to *INSPRU* 1.5.47R; and
(2) hold *admissible assets* (in addition to those required under *INSPRU* 1.1.20R) to represent its *UK* or *EEA MCR* calculated under (1).
- 1.5.43 R The assets held under *INSPRU* 1.5.42R(2) must be identified and valued as if the *non-EEA direct insurer* was a *firm* with its head office in the *United Kingdom*.
- 1.5.44 R For the purposes of *INSPRU* 1.5.42R, a *non-EEA direct insurer* (except a *UK-deposit insurer*) must calculate a *UK MCR*:

(1) for *long-term insurance business*, in accordance with *INSPRU* 1.1.81R to *INSPRU* 1.1.91R but only in relation to business carried on by the *firm* in the *United Kingdom*;
(2) for *general insurance business*, in accordance with *INSPRU* 1.1.45R to *INSPRU* 1.1.72R but only in relation to business carried on by the *firm* in the *United Kingdom*.
- 1.5.45 R For a *composite firm*, the *UK MCR* is the sum of the amounts arrived at under *INSPRU* 1.5.44R(1) and *INSPRU* 1.5.44R(2).
- 1.5.46 R For the purposes of *INSPRU* 1.5.42R, a *UK-deposit insurer* must calculate an *EEA MCR*:

(1) for *long-term insurance business*, in accordance with *INSPRU* 1.1.81R to *INSPRU* 1.1.91R but only in relation to business carried on by the *firm* in all *EEA States*, taken together;
(2) for *general insurance business*, in accordance with *INSPRU* 1.1.45R to *INSPRU* 1.1.72R but only in relation to business carried on by the *firm* in all *EEA States*, taken together.
- 1.5.47 R For a *composite firm*, the *EEA MCR* is the sum of the amounts arrived at under *INSPRU* 1.5.46R(1) and *INSPRU* 1.5.46R(2).

Localisation of assets

- 1.5.48 R A *non-EEA direct insurer* (except a *UK-deposit insurer*) must hold:
(1) *admissible assets* which are required to cover its *technical provisions* in accordance with *INSPRU 1.1.20R(1)* or *INSPRU 1.1.21R(1)(a)* and (2)(a); and
(2) other *admissible assets* not required to cover *property-linked liabilities* or *index-linked liabilities* in accordance with *INSPRU 3.1.57R* or *INSPRU 3.1.58R* which represent its *UK MCR* as calculated in accordance with *INSPRU 1.5.44R*;
as follows:
(a) (where the assets cover the *technical provisions* and the *guarantee fund*) in the *United Kingdom*;
(b) (where the assets represent the amount of the *UK MCR* in excess of the *guarantee fund*) in any *EEA State*.
- 1.5.49 R A *UK-deposit insurer* must hold:
(1) *admissible assets* which are required to cover its technical provisions in accordance with *INSPRU 1.1.20R(1)* or *INSPRU 1.1.21R(1)(a)* and (2)(a); and
(2) other *admissible assets* not required to cover *property-linked liabilities* or *index-linked liabilities* in accordance with *INSPRU 3.1.57R* or *INSPRU 3.1.58R* which represent its *EEA MCR* as calculated in accordance with *INSPRU 1.5.46R*;
as follows:
(a) (where the assets cover the *technical provisions* and the *guarantee fund*) within the *EEA* states where the *firm* carries on *insurance business*;
(b) (where the assets represent the amount of the *EEA MCR* in excess of the *guarantee fund*) in any *EEA State*.
- 1.5.50 R *INSPRU 1.5.48R* and *INSPRU 1.5.49R* do not apply to assets covering *technical provisions* which are debts owed by *reinsurers*.
- 1.5.51 G The *admissible assets* in excess of the *technical provisions* and *UK* or *EEA MCR* may be held outside the *EEA*.
- 1.5.52 R For the purpose of *INSPRU 1.5.48R* and *INSPRU 1.5.49R* :
(1) a tangible asset is to be treated as held in the country or territory where it is situated;
(2) an *admissible asset* consisting of a *claim* against a debtor is to be regarded as held in any country or territory where it can be enforced by legal action;
(3) a *listed security* is to be treated as held in any country or territory where there is a *regulated market* in which the security is dealt; and
(4) a *security* which is not a *listed security* is to be treated as held in the country or territory in which the *issuer* has its head office.
- 1.5.53 G *INSPRU 3.1.53R* to *INSPRU 3.1.55R* (currency matching of assets and liabilities) apply to the assets held to match insurance liabilities calculated under *INSPRU 1.1.12R* or *INSPRU 1.1.16R*.

Deposit of assets as security

- 1.5.54 R A *non-EEA direct insurer* must keep assets of a value at least equal to one quarter of the *base capital resources requirement* on deposit in the *United Kingdom* with a *BCD credit institution*.
- 1.5.55 G The assets deposited as security may count towards the assets required under *INSPRU 1.5.48R* and *INSPRU 1.5.49R*. If, after the deposit is made, the value of the deposited assets falls below one quarter of the *base capital resources requirement*, the *firm* should deposit further *admissible assets* in order to comply with *INSPRU 1.5.48R* and *INSPRU 1.5.49R*. Deposited assets may be exchanged for other *admissible assets* and excess assets may be withdrawn, provided that the exchange or deposit does not cause a breach of *INSPRU 1.5.48R* or *INSPRU 1.5.49R*.

Branch accounting records in the United Kingdom

- 1.5.56 R A *non-EEA direct insurer* must maintain at a place of business in the *United Kingdom* adequate records relating to:
(1) the activities carried on from its *United Kingdom branch*; and
(2) if it is an *EEA-deposit insurer*, the activities carried on from the *branches* in other *EEA States*.
- 1.5.57 R The records maintained as required by *INSPRU 1.5.56R* must include a record of:
(1) the income, expenditure and liabilities arising from activities of the *branch* or *branches*; and
(2) the assets identified under *INSPRU 1.1.20R* as available to meet those liabilities.

Application of *INSPRU 1.5* to Lloyd's

- 1.5.58 R *INSPRU 1.5* applies to *managing agents* and to the *Society* in accordance with:
(1) for *managing agents*, *INSPRU 8.1.4R*; and
(2) for the *Society*, *INSPRU 8.1.2R*.
- 1.5.59 R The *Society* and *managing agents* must take all reasonable steps to ensure that:
(1) a *corporate member* does not carry on any commercial business other than *insurance business* and activities arising directly from that business; and
(2) *individual members* do not, in their capacity as *underwriting members*, carry on any commercial business other than *insurance business* and activities arising directly from that business.
- 1.5.60 R A *managing agent* must not permit both *general insurance business* and *long-term insurance business* to be carried on together through any *syndicate* managed by it.

1.6 Insurance Special Purpose Vehicles

Application and Purpose

- 1.6.1 R (1) *INSPRU 1.6.5R to INSPRU 1.6.12R* apply to a *UK ISPV*.
- (2) *INSPRU 1.6.13G to INSPRU 1.6.18G* apply to an *insurer* which has a contract of *reinsurance* with an *ISPV*.
- 1.6.2 G An *ISPV* is a special purpose vehicle which assumes risks from *insurance undertakings* or *reinsurance undertakings* and which fully funds its exposure to such risks through the proceeds of a debt issuance or some other financing mechanism where the repayment rights of the providers of such debt or other financing mechanism are subordinated to the *reinsurance* obligations of that vehicle. The special feature of an *ISPV*, when compared to other *reinsurers*, is that it is fully funded to meet its *reinsurance* liabilities. It is, therefore, not subject to insurance risk to the same extent as other *reinsurers*. The *Reinsurance Directive* permits *ISPVs* to be subject to different rules to those applying to other *reinsurers*.
- 1.6.3 G To satisfy the definition of an *ISPV* under the *Reinsurance Directive* the *ISPV* must be fully funded. The *FSA* considers that to be fully funded an *ISPV* must have actually received the proceeds of the debt issuance or other mechanism by which it is financed. The *FSA* would not, therefore, grant a *Part IV permission* to an *ISPV* where part of the financing for its *reinsurance* liabilities was on a contingent basis, for example, a standby facility or letter of credit.
- 1.6.4 G The purpose of *INSPRU 1.6* is:
- (1) to set out the *rules* applying to *UK ISPVs* in respect of:
- (a) their assets and liabilities; and
- (b) their contractual arrangements; and
- (2) to set out the conditions that must be met in order for an *insurer* to claim credit for *reinsurance* with an *ISPV*.

Assets and liabilities

- 1.6.5 R A *UK ISPV* must ensure that at all times its assets are equal to or greater than its liabilities.
- 1.6.6 G In addition to liability under its contracts of *reinsurance*, an *ISPV* will incur liability for other expenses, for example, staff and accommodation costs, *claims* handling arrangements and professional advisers' fees. *INSPRU 1.6.5R* requires a *UK ISPV* to ensure that it always has sufficient assets to meet its liabilities.
- 1.6.7 R A *UK ISPV* must invest its assets in accordance with the requirements set

out in *INSPRU* 3.1.61AR.

- 1.6.8 R A *UK ISPV's* assets must be held by, or on behalf of:
- (1) the *UK ISPV*; or
 - (2) the *insurance undertaking* or *reinsurance undertaking* which cedes to the *UK ISPV* the risks in respect of which the relevant assets are held.

Contractual arrangements

- 1.6.9 R A *UK ISPV* must include in each of its contracts of *reinsurance* terms which secure that its aggregate maximum liability at any time under those contracts of *reinsurance* does not exceed the amount of its assets at that time.
- 1.6.10 G *INSPRU* 1.6.9R requires that a *UK ISPV's* contracts of *reinsurance* should include terms that secure that its maximum *reinsurance* liability is capped at a level that is no greater than the *ISPV's* assets. In the *FSA's* view, this is a necessary condition of the *ISPV* being fully funded, as it means that the *ISPV* should not find that its assets are insufficient to meet its *reinsurance* liabilities.
- 1.6.11 R A *UK ISPV* must ensure that under the terms of any debt issuance or other financing arrangement used to fund its *reinsurance* liabilities the rights of the providers of that debt or other financing are fully subordinated to the claims of creditors under its contracts of *reinsurance*.
- 1.6.12 R A *UK ISPV* must only enter into contracts or otherwise assume obligations which are necessary for it to give effect to the *reinsurance* arrangements which represent the special purpose for which it has been established.

Reinsurance with an *ISPV*

- 1.6.13 G As a result of *GENPRU* 1.3.55R, *GENPRU* 2 Ann 7R, *INSPRU* 1.1.92AR and *INSPRU* 1.2.28R an *insurer* may not:
- (1) treat amounts recoverable from an *ISPV* as:
 - (a) an *admissible asset*, or
 - (b) *reinsurance* for the purposes of calculating its *mathematical reserves*, or
 - (c) *reinsurance* reducing its *MCR*, or
 - (2) otherwise ascribe a value to such amounts,

unless it first obtains a *waiver* from the *FSA*. *INSPRU* 1.6.14G to *INSPRU* 1.6.18G set out the information which the *FSA* will expect to receive as part of the application for the *waiver*. Those paragraphs also set out the factors, in addition to the statutory tests under section 148 of the *Act*, to which the

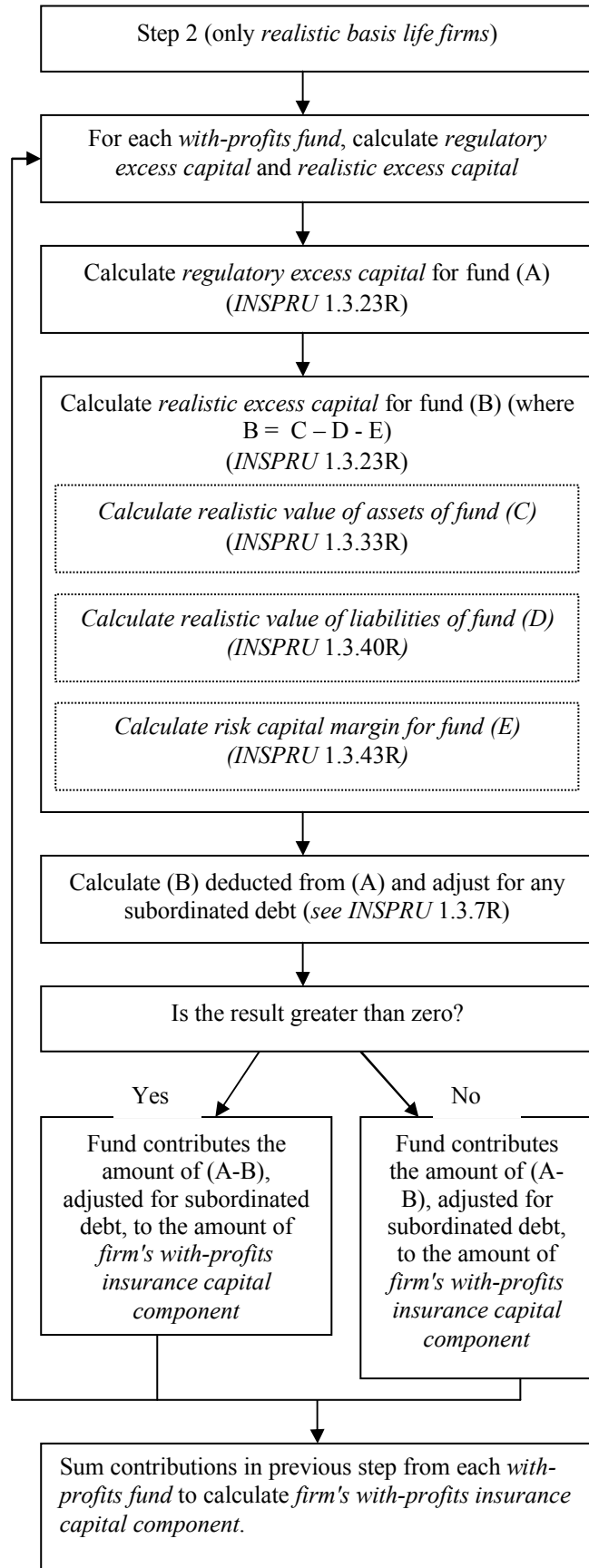
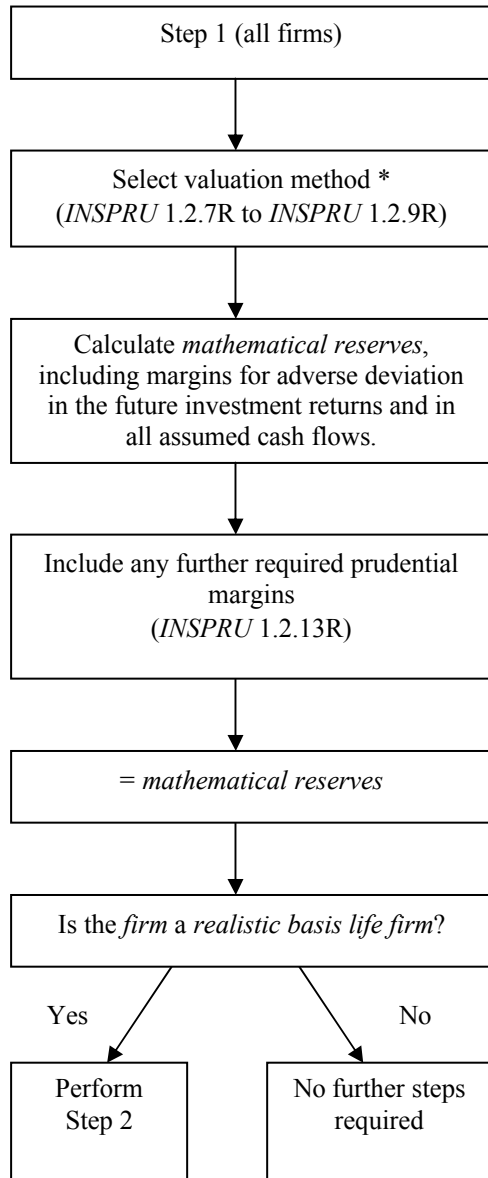
FSA will have regard in deciding:

- (i) whether to grant such a *waiver* (assuming the section 148 conditions are met); and
- (ii) the amount recoverable from the *ISPV* which it will allow the *insurer* to bring into account for these purposes.

- 1.6.14 G Where the *ISPV* is a *UK ISPV*, the *FSA* will wish to be satisfied that the *UK ISPV* complies with *INSPRU* 1.6.5R to *INSPRU* 1.6.12R. The *FSA* may rely on information supplied in connection with its application for *authorisation*. However, if the application for a *waiver* is made some time after *authorisation* was granted, the *FSA* may request confirmation that there has been no material change to the information originally supplied.
- 1.6.15 G Where the *ISPV* is not a *UK ISPV*, the *FSA* will expect to receive confirmation that the *ISPV* has received an official authorisation in accordance with article 46 of the *Reinsurance Directive* in the *EEA State* in which it has been established. In addition, it will need details of the debt issuance or other financing mechanism by which the *ISPV's reinsurance* liabilities are funded. The *FSA* will also expect to receive information about the *ISPV's* key management and control functions, including details of the *ISPV's* auditors and arrangements for *claims* handling, and any material *outsourcing* agreements. The *FSA* will also need information about the structure of any *group* of which the *ISPV* is a member.
- 1.6.16 G No credit may be taken for a contract of *reinsurance* with an *ISPV* unless the contract meets the risk transfer principle set out in *INSPRU* 1.1.19AR. The *FSA* will require evidence that the contract of *reinsurance* and the extent of the credit that the *firm* proposes to take for it satisfy the risk transfer principle.
- 1.6.17 G The *FSA* will require information about the impact of the *ISPV* arrangement on the ceding *firm's* individual capital assessment carried out in accordance with *INSPRU* 7.1. This should include evidence that all residual risks associated with the arrangement (including credit, market, liquidity and operational risks) are reflected in that assessment.
- 1.6.18 G The *FSA* will also expect to receive an analysis of the potential for risk to revert to the *firm* or any of its *associates* under realistic adverse scenarios or for liabilities to arise in respect of the risks transferred for which no provision has been made.

Annex 1G

INSPRU 1.2 (Mathematical reserves) and INSPRU 1.3 (With-profits insurance capital component)



* For conventional *with-profits insurance business*, where a firm is a *regulatory basis only firm* (see INSPRU 1.2.5G), the *net premium* method of valuation has to be used (INSPRU 1.2.37R to INSPRU 1.2.45G)

2.1 Credit risk in insurance

Application

- 2.1.1 R *INSPRU* 2.1 applies to an *insurer* unless it is:
- (1) a *non-directive friendly society*; or
 - (2) an *incoming EEA firm*; or
 - (3) an *incoming Treaty firm*.
- 2.1.2 R All of *INSPRU* 2.1, except *INSPRU* 2.1.20R and *INSPRU* 2.1.23R to *INSPRU* 2.1.32G, applies to:
- (1) an *EEA-deposit insurer*; and
 - (2) a *Swiss general insurer*;
- but only in respect of the activities of the *firm* carried on from a *branch* in the *United Kingdom*.
- 2.1.3 G The scope of application of *INSPRU* 2.1 is not restricted to *firms* that are subject to relevant EC directives.
- 2.1.4 R
- (1) This section applies to a *firm* in relation to the whole of its business, except where a particular provision provides for a narrower scope.
 - (2) Where a *firm* carries on both *long-term insurance business* and *general insurance business*, this section applies separately to each type of business.
- Purpose
- 2.1.5 G The purpose of this section is to protect *policyholders* and potential *policyholders* by setting out the requirements applicable to a *firm* in respect of credit risk. Credit risk is incurred whenever a *firm* is exposed to loss if a *counterparty* fails to perform its contractual obligations including failure to perform them in a timely manner. Credit risk may therefore have an impact upon a firm's ability to meet its valid *claims* as they fall due. Credit risk can also arise from underlying causes that have an impact upon the creditworthiness of all *counterparties* of a particular description or geographical location. A detailed explanation of credit risk is given at *SYSC* 15.1.4G.
- 2.1.6 G The requirements in this section address both current and contingent exposure to credit risk. *PRIN* and *SYSC* require a *firm* to establish adequate internal systems and controls for exposure to credit risk. This section requires a *firm* to restrict its exposure to different *counterparties* and assets to prudent levels and to ensure that those exposures are adequately diversified. It also requires a *firm* to make deductions from the value of assets in respect of exposures to one asset, *counterparty* or group of closely related *counterparties* in excess of prescribed limits.
- 2.1.7 G This section also sets limits on the *market risk* arising from holding assets

including securities issued or guaranteed by *counterparties*. This *market risk* is incurred whenever a *firm* is exposed to loss if an asset were to reduce in value or even become worthless. These *market risk* limits are set out in this section rather than the *market risk* sections in *INSPRU* because they are closely linked to the *counterparty* limits set out in this section.

Overall limitation of credit risk

- 2.1.8 R Taking into account relevant risks, a *firm* must restrict its *counterparty* exposures and asset exposures to prudent levels and ensure that those exposures are adequately diversified.
- 2.1.9 R
- (1) For the purposes of *INSPRU* 2.1, *counterparty* exposure is the amount a *firm* would lose if a *counterparty* were to fail to meet its obligations (either to the *firm* or to any other *person*) and if simultaneously securities issued or guaranteed by the *counterparty* were to become worthless.
 - (2) For the purposes of *INSPRU* 2.1, asset exposure is the amount a *firm* would lose if an asset or class of identical assets (whether or not held directly by the *firm*) were to become worthless.
 - (3) For the purposes of (1) and (2), the amount of loss is the amount, if any, by which the *firm's* capital resources (as calculated in accordance with the *capital resources table* but without making any deduction for assets in excess of *market risk* and *counterparty* limits) would decrease as a result of the *counterparty* failing to meet its obligations and the *securities* or assets becoming worthless.
 - (4) In determining the amount of loss in accordance with (3), the *firm* must take into account decreases in its capital resources that would result not only from its own direct exposures but also from:
 - (a) exposures held by any of its *subsidiary undertakings*; and
 - (b) synthetic exposures arising from *derivatives* or quasi-derivatives held or entered into by the *firm* or any of its *subsidiary undertakings*.
 - (5) If a *firm* elects under *INSPRU* 2.1.35R to make a deduction in respect of *collateral*, the *firm* must deduct from the amount of loss determined in accordance with (3) so much of the value of that *collateral* as:
 - (a) would be realised by the *firm* were it to exercise its rights in relation to the *collateral*; and
 - (b) does not exceed any of the relevant limits in *INSPRU* 2.1.22R(3).
- 2.1.10 G Exposure is defined in terms of loss (which is decrease in capital). It does not include exposures arising from assets that are not represented in capital or exposures which if crystallised in a loss would be offset by a consequent gain, reduction in liabilities or release of provisions, but only in so far as that gain, reduction or release would itself lead to an offsetting increase in *capital resources*. Examples include:
- (1) exposure from the holding of assets to which the *firm* has attributed no value;

(2) exposure from the holding of assets that the *firm* has deducted from *capital resources*; and

(3) exposure in respect of which (and to the extent that) the *firm* has established a provision.

- 2.1.11 G In assessing the adequacy of diversification required by *INSPRU 2.1.8R*, a *firm* should take into account concentrations of exposure including those arising from:
- (1) different types of exposure to the same *counterparty*, such as *deposits*, loans, securities, *reinsurance* and *derivatives*;
 - (2) links between *counterparties* such that default by one might have an impact upon the creditworthiness of another; and
 - (3) possible changes in circumstance that would have an impact upon the creditworthiness of all *counterparties* of particular description or geographical location.
- 2.1.12 G A *firm* should consider how the spreading of credit risk will impact on overall *counterparty* quality.
- 2.1.13 G In assessing its exposure to a *counterparty* for the purpose of *INSPRU 2.1.8R*, a *firm* should take into account:
- (1) the period for which the exposure to that *counterparty* might continue;
 - (2) the likelihood of default during that period by the *counterparty*; and
 - (3) the loss that might result in the event of default.
- 2.1.14 G In assessing the loss that might result from the default of a *counterparty* for the purposes of *INSPRU 2.1.8R*, a *firm* should take into account the circumstances that might lead to default and, in particular, how these might have an impact upon:
- (1) the amount of exposure to the *counterparty*; and
 - (2) the effectiveness of any loss mitigation techniques employed by the *firm*.
- 2.1.15 G Often the same circumstances which lead to the crystallisation of contingent credit exposure, e.g. a significant *claims* event or a significant movement in interest, currency or asset values, also lead to an increase in the risk of default by the *counterparty*. In particular, if a *reinsurer* or *derivative counterparty* is being relied upon to provide protection against the consequences of an event or circumstance, a *firm* should take into account how that event or circumstance might have an impact upon the creditworthiness of the *reinsurer* or *derivative counterparty*.
- 2.1.16 R For the purposes of *INSPRU 2.1.8R* and of determining *counterparty* exposure and asset exposure in accordance with *INSPRU 2.1.9R* and *reinsurance* exposure in accordance with *INSPRU 2.1.25R*, a *firm* must only rely upon a loss mitigation technique where it has good reason to believe that, taking into account the possible circumstances of default, it is likely to

be effective.

- 2.1.17 G Loss mitigation techniques include:
- (1) the right, upon default, to preferential access to some or all of the *counterparty's* assets, for example by exercising rights of set off, holding *collateral* or assets deposited back, or exercising rights under fixed or floating charges;
 - (2) rights against third parties upon default by the *counterparty*, such as guarantees, credit insurance and credit *derivatives*; and
 - (3) where the *counterparty* is a *reinsurer*, having back-up or flexible *reinsurance* which covers the gap in coverage left by the *reinsurer's* default, for example 'top and drop' *reinsurance*.
- 2.1.18 R For the purposes of *INSPRU* 2.1.8R and of determining *counterparty* exposure and asset exposure in accordance with *INSPRU* 2.1.9R and *reinsurance* exposure in accordance with *INSPRU* 2.1.25R, a *firm* must not rely upon preferential access to assets unless it has taken into account appropriate professional advice as to its effectiveness.
- 2.1.19 G In particular, a *firm* should consider whether any preferential access to a *counterparty's* assets would be effective even if the *counterparty* were wound up by a court or other legal process or it were to be subject to any other insolvency process. A *firm* should also consider, where it is relying upon a right against a third party, whether, in the circumstances of the *counterparty's* default, the creditworthiness of that third party might be impaired.

Large exposure limits

- 2.1.20 R
- (1) A *firm* must take reasonable steps to limit its *counterparty* exposure or asset exposure to:
 - (a) a single *counterparty*;
 - (b) each of the *counterparties* within a group of closely related counterparties; and
 - (c) an asset or class of identical assets;to a level where, if a total default were to occur, the *firm* would not become unable to meet its liabilities as they fall due.
 - (2) In (1), a total default occurs where:
 - (a) the single *counterparty* or all of the *counterparties* within the group of closely related *counterparties* fail to meet its or their obligations and simultaneously any securities issued or guaranteed by it or any of them become worthless; or
 - (b) the asset becomes worthless or all of the assets within the identical class become worthless at the same time.
 - (3) (1) does not apply to:

- (a) a *reinsurance* exposure; or
- (b) a *counterparty* exposure or asset exposure to an *approved credit institution*.

2.1.21 G In assessing its exposure to a *counterparty* or group of closely related *counterparties*, a *firm* should consider exposures from different sources including *deposits*, loans, *securities* and *derivatives*.

Market risk and *counterparty* limits

- 2.1.22 R
- (1) A *firm* must calculate the amount of the deduction from total capital required by stage L in the *capital resources table* in respect of assets in excess of *market risk* and *counterparty* limits as the aggregate amount by which its *counterparty* exposures and asset exposures exceed the relevant limits set out in (3).
 - (2) Except where the contrary is expressly stated in *INSPRU*, whenever:
 - (a) a *rule* in *INSPRU* refers to assets of a *firm*, or of any part of a firm, or of any fund or part of a fund within a *firm*, which are assets of a kind referred to in any of the limits in (3); and
 - (b) the *firm's counterparty* exposure (or aggregate exposure arising from the *counterparty* exposures to each member of a group of closely related persons) or asset exposure in respect of those assets exceeds any of the limits in (3);the *firm* must deduct from the measure of the value of those assets (as determined in accordance with *GENPRU* 1.3) the amount by which that exposure exceeds the relevant limit in (3), or that portion of the deduction that relates to the part of the *firm* or fund or part of a fund in question.
 - (3) The limits referred to in (1) and (2) are the following, expressed as a percentage of the *firm's* business amount:
 - (a) for a *counterparty* exposure to an individual, unincorporated body of individuals or the aggregate exposure arising from the *counterparty* exposures to each member of a group of closely related individuals or unincorporated bodies of individuals:
 - (i) ¼% for that part of the exposure that arises from *unsecured debt*;
 - (ii) 1% for the whole exposure (after deduction of the excess arising from the limit in (a)(i));
 - (b) for a *counterparty* exposure to an *approved counterparty* or the aggregate exposure arising from the *counterparty* exposures to each member of a group of closely related approved counterparties:
 - (i) 5% for that part of the exposure not arising from short term *deposits* made with an *approved credit institution*; this limit is increased to 10% if the total of exposures which are greater than 5% arising from applying a 10% limit does not exceed 40%;
 - (ii) 20% or £2 million if larger for the whole exposure (after deduction of the excess arising from the limit in (b)(i));
 - (c) for a *counterparty* exposure to a *person*, or the aggregate exposure

arising from the *counterparty* exposures to each member of a group of closely related *persons*, who do not fall into the categories of *counterparty* to whom (a) and (b) apply:

(i) 1% for that part of the exposure arising from *unsecured debt*; this limit is increased to 2.5% in the case of an exposure to a *regulated institution*;

(ii) 1% for that part of the exposure arising from *shares* and other variable yield participations, bonds, *debt securities* and other *money market instruments* and capital market instruments from the same *counterparty* that are not dealt in on a *regulated market*, or any beneficial interest in a *collective investment scheme* which is not a *UCITS scheme*, a *non-UCITS retail scheme* or a recognised scheme; the limit for that part of the exposure arising from *debt securities* (other than hybrid securities) issued by the same *regulated institution* is increased to 5%;

(iii) 5% for the whole exposure (after deduction of the excesses arising from the limits in (c)(i) and (ii));

(d) 5% for the aggregate of all *counterparty* exposures that fall within (c)(i) whether or not they arise from *persons* who are closely related, but excluding amounts that are in excess of the limit in (c)(i);

(e) 10% for the aggregate of all *counterparty* exposures that fall within (c)(ii) whether or not they arise from *persons* who are closely related, but excluding amounts that are in excess of the limit in (c)(ii);

(f) 5% for the aggregate of all *counterparty* exposures arising from unsecured loans, other than those falling within (3)(b);

(g) 3% for the asset exposure arising from all cash in hand;

(h) 10% for the asset exposure (including an exposure arising from a reversionary interest) arising from any one piece of land or building, or a number of pieces of land or buildings close enough to each other to be considered effectively as one investment.

(4) In (3) a *firm's* business amount means the sum of:

(a) the *firm's* total gross *technical provisions*;

(b) the amount of its other liabilities (except those included in the calculation of capital resources in accordance with the *capital resources table*); and

(c) such amount as the *firm* may select not exceeding, in the case of a *firm* which is not a *participating insurance undertaking*, the amount of the *firm's* total capital after deductions as calculated at stage M of the *capital resources table* or, in the case of a *firm* which is a *participating insurance undertaking*, the amount calculated in accordance with (5A) or, in either case, if higher:

(i) in the case of a *firm* carrying on *general insurance business*, the amount of its *general insurance capital requirement*; and

(ii) in the case of a *firm* carrying on *long-term insurance business*, the amount of its *long-term insurance capital requirement* and the amount of its *resilience capital requirement*.

(5) For the purpose of (4)(a), a *firm's* total gross *technical provisions*

exclude *technical provisions* in respect of *index-linked liabilities* or *property-linked liabilities*, except that where the *linked long-term contract of insurance* in question includes a guarantee of investment performance or some other guaranteed benefit, the total gross *technical provisions* include the *technical provisions* in respect of that guaranteed element.

(5A) For the purpose of (4)(c), a *firm* which is a *participating insurance undertaking* must calculate the amount of the *firm's group capital resources* less the difference between:

- (a) the *firm's group capital resources requirement*; and
- (b) the *firm's capital resources requirement*.

(5B) In (3)(b)(i) short term *deposit* means a *deposit* which may be withdrawn at the discretion of the lender without penalty or loss of accrued interest by giving notice of withdrawal of one month or less.

(6) In (3)(c)(ii) hybrid security means a *debt security*, other than an *approved security*, the terms of which provide, or have the effect that, the holder does not, or would not, have an unconditional entitlement to payment of interest and repayment of capital in full within 75 years of the date on which the *security* is being valued.

2.1.22A R *INSPRU* 2.1.22R does not apply to a *pure reinsurer*.

Large exposure calculation for reinsurance exposures

2.1.23 R A *firm* must notify the *FSA* in accordance with *SUP* 15.7 as soon as it first becomes aware that:

- (1) a *reinsurance* exposure to a *reinsurer* or group of closely related *reinsurers* is reasonably likely to exceed 100% of its *capital resources*; or
- (2) if (1) does not apply, that it has exceeded this limit.

2.1.24 R Upon notification under *INSPRU* 2.1.23R, a *firm* must:

- (1) demonstrate that prudent provision has been made for the *reinsurance* exposure in excess of the 100% limit, or explain why in the opinion of the *firm* no provision is required; and
- (2) explain how the *reinsurance* exposure is being safely managed.

2.1.25 R (1) For the purposes of *INSPRU* 2.1, a *reinsurance* exposure is the amount of loss which a *firm* would suffer if a *reinsurer* or group of closely related *reinsurers* were to fail to meet its or their obligations under contracts of *reinsurance* reinsuring any of the *firm's* contracts of insurance.

(2) For the purposes of (1), the amount of loss is the amount, if any, by which the *firm's* capital resources (as calculated in accordance with the *capital resources table* but without making any deduction for assets in excess of *market risk* and *counterparty* limits) would decrease as a result of the *reinsurer* or group of closely related *reinsurers* failing to meet its or their obligations under the contracts of *reinsurance*.

(3) If a *firm* elects under *INSPRU* 2.1.35R to make a deduction in respect of

collateral, the *firm* must deduct from the amount of loss determined in accordance with (2) so much of the value of that *collateral* as:

(a) would be realised by the *firm* were it to exercise its rights in relation to the *collateral*; and

(b) does not exceed any of the relevant limits in *INSPRU* 2.1.22R(3).

- 2.1.26 R A *firm* must, in determining its *reinsurance* exposures for the purposes of *INSPRU* 2.1, aggregate any *reinsurance* exposure where the identity of the *reinsurer* is not known by the *firm* with the highest *reinsurance* exposure where it does know the identity of the *reinsurer*.
- 2.1.27 G *INSPRU* 2.1.8R provides that, taking into account relevant risks, a *firm* must restrict to prudent levels, and adequately diversify, its exposure to *counterparties*.
- 2.1.28 E (1) In each *financial year*, a *firm* should restrict the *gross earned premiums* which it pays to a *reinsurer* or group of closely related *reinsurers* to the higher of:
- (a) 20% of the *firm's* projected *gross earned premiums* for that *financial year*; or
- (b) £4 million.
- (2) Compliance with this provision may be relied upon as tending to establish compliance with *INSPRU* 2.1.8R.
- 2.1.29 R A *firm* must notify the *FSA* immediately in accordance with *SUP* 15.7 if it has exceeded, or anticipates exceeding, the limit expressed in *INSPRU* 2.1.28E.
- 2.1.30 R Upon notification under *INSPRU* 2.1.29 R, a *firm* must explain to the *FSA* how, despite the excess *reinsurance* concentration, the credit risk is being safely managed.
- 2.1.31 G For the purposes of *INSPRU* 2.1.24R and *INSPRU* 2.1.30R, a *firm's* explanation of how a *reinsurance* exposure is being safely managed should also describe the *reinsurance* market in which the exposure has occurred, and the nature of the *reinsurance* contract. If appropriate, the *firm* should also provide a detailed plan and timetable explaining how the excess exposure will be reduced to an acceptable level. The explanation should be approved by a person at the *firm* of appropriate seniority.
- 2.1.32 G Where a *firm* can demonstrate that the arrangement does not give rise to unacceptable levels of credit risk it is unlikely that further action will be required.
- Exposures excluded from limits
- 2.1.33 R In *INSPRU* 2.1.20R and *INSPRU* 2.1.22R, references to a *counterparty* exposure or an asset exposure do not include such an exposure arising from:

- (1) [deleted]
- (2) *premium* debts;
- (3) advances secured on, and not exceeding the *surrender value* of, *long-term insurance contracts* of the *firm*;
- (4) rights of salvage or subrogation;
- (5) *deferred acquisition costs*;
- (6) assets held to cover *index-linked liabilities* or *property-linked liabilities*, except that where the *linked long-term contract of insurance* in question includes a guarantee of investment performance or some other guaranteed benefit, *INSPRU 2.1.20R* and *INSPRU 2.1.22R* will nevertheless apply to assets held to cover that guaranteed element;
- (7) *moneys* due from, or guaranteed by, a *Zone A country*;
- (8) an *approved security*;
- (9) a holding in a *collective investment scheme* falling within the *UCITS Directive*.

- 2.1.34 R In *INSPRU 2.1.22 R* references to a *counterparty* exposure or an asset exposure do not include such an exposure arising from *reinsurance* debts and the *reinsurer's* share of *technical provisions*.
- 2.1.35 R If:
- (1) a *firm* has a *counterparty* exposure, an asset exposure or a *reinsurance* exposure in respect of which it has rights over *collateral* (except where that *collateral* is a letter of credit - see *INSPRU 2.1.36R* and *INSPRU 2.1.37R*); and
 - (2) the assets constituting that *collateral* would, if owned by the *firm*, be admissible assets;
- the *firm* may, in determining the amount of that exposure, deduct the value of that *collateral* in accordance with *INSPRU 2.1.9R(5)* or, in the case of a *reinsurance* exposure, *INSPRU 2.1.25R(3)*.
- 2.1.36 R If a *firm* has a *counterparty* exposure, asset exposure or reinsurance exposure the whole or any part of which is:
- (1) guaranteed by a *credit institution* or an *investment firm* subject in either case to the *Capital Adequacy Directive* or supervision by a third country (non-EEA) supervisory authority with a Capital Adequacy Directive-equivalent regime; or
 - (2) adequately mitigated by a *credit derivative*;
- the *firm* may, for the purposes of *INSPRU 2.1.20R*, *INSPRU 2.1.22R* and *INSPRU 2.1.23R*, treat that exposure, or that part of the exposure which is so guaranteed or mitigated, as an exposure to the guarantor or derivative *counterparty*, rather than to the original *counterparty*, asset or *reinsurer*.
- 2.1.37 R For the purposes of *INSPRU 2.1.36R*, references to an exposure being guaranteed include an exposure secured by a letter of credit, but to fall

within *INSPRU* 2.1.36 R the guarantee or letter of credit must be direct, explicit, unconditional and irrevocable.

2.1.38 G The portion of exposure which is guaranteed or mitigated by a credit *derivative* is itself, as an exposure to the guarantor or derivative *counterparty*, subject to the limits in *INSPRU* 2.1.20R and *INSPRU* 2.1.22R.

2.1.39 R For the purposes of *INSPRU* 2.1.20R and *INSPRU* 2.1.22R, a *UCITS scheme*, a *non-UCITS retail scheme*, a *recognised scheme* or any other *collective investment scheme* that invests only in *admissible assets* (including any *derivatives* or quasi-derivatives held by the scheme) is to be treated as closely related to the *issuer* of the *units* in that scheme.

Meaning of closely related

2.1.40 R For the purposes of *INSPRU* 2.1, a group of *persons* is closely related if it consists solely of two or more natural or legal persons who, unless it is shown otherwise, constitute a single risk because as between any two of them one or other of the following relationships apply:

(1) one of them, directly or indirectly, has control, as defined in *INSPRU* 2.1.41R, over the other or they are both controlled by the same third party; or

(2) there is no relationship of control as defined in *INSPRU* 2.1.41R but they are to be regarded as constituting a single risk because they are so interconnected that, if one of them were to experience financial problems, the other would be likely to encounter repayment difficulties.

2.1.41 R For the purposes of *INSPRU* 2.1.40R, control means the relationship between a *parent undertaking* and a *subsidiary undertaking*, as defined in Article 1 of the Consolidated Accounts Directive (83/349/EEC), or a similar relationship between any natural or legal person and an *undertaking*.

Application of *INSPRU* 2.1 to Lloyd's

2.1.42 R Subject to *INSPRU* 2.1.43R, *INSPRU* 2.1 applies to *managing agents* and to the *Society* in accordance with:

(1) for *managing agents*, *INSPRU* 8.1.4R; and

(2) for the *Society*, *INSPRU* 8.1.2R.

2.1.43 R *INSPRU* 2.1.23R to *INSPRU* 2.1.32G (Large exposure calculation for reinsurance exposures) do not apply to the *Society*.

Overall limitation of credit risk

2.1.44 G For Lloyd's, *counterparty* exposure is:

(1) for *managing agents*, the amount by which the net assets managed by or under the direction of a *managing agent* in respect of a *syndicate* together with any relevant *balancing amount* would decrease if the *counterparty* were to default;

(2) for the *Society*, the amount by which its net assets (which include those

of its subsidiary undertakings) would decrease if the *counterparty* were to default; and

(3) for the *Society's* management of each *member's funds at Lloyd's*, the amount by which the *member's* net assets would decrease if the *counterparty* were to default.

Large exposures

- 2.1.45 R For the purposes of *INSPRU* 2.1.20R (Large exposure limits: counterparty exposure and asset exposure), the *Society* may determine the exposure to any letters of credit, guarantees or *members' life assurance policies* as an exposure of the *members* in aggregate.
- 2.1.46 R For the purposes of *INSPRU* 2.1.22R (Large exposure limits: market risk and counterparty limits), the *Society* must calculate the amount of and deduct from *capital resources*:
- (1) an exposure (expressed as a percentage of the relevant *member's capital resources* held as *funds at Lloyd's*), other than to the assets identified in *INSPRU* 2.1.46R(2)(a) to *INSPRU* 2.1.46R(2)(c), of a *member's capital resources* held as *funds at Lloyd's* to a *counterparty*, in excess of the limits in *INSPRU* 2.1.22R;
 - (2) an exposure in excess of 20% (expressed as a percentage of the aggregate of *capital resources* held as *funds at Lloyd's*) of the aggregate of *capital resources* held as *funds at Lloyd's* to a single issuer of:
 - (a) letters of credit;
 - (b) guarantees; or
 - (c) *members' life assurance policies*;
 - (3) an exposure of its own to a *counterparty*, in excess of the limits in *INSPRU* 2.1.22R, expressed as a percentage of the *Society's* own assets.
- 2.1.47 R For the purposes of *INSPRU* 2.1.22R (Large exposure limits: market risk and counterparty limits), *managing agents* must calculate the amount of and deduct from *capital resources* an exposure (expressed as a percentage of the *admissible assets* held in respect of the relevant *syndicate*) of *admissible assets* held in respect of a *syndicate* to a *counterparty* in excess of the limits in *INSPRU* 2.1.22R.
- 2.1.48 R If the exposures of *capital resources* held as *funds at Lloyd's* for *members* in the aggregate do not exceed the limits in *INSPRU* 2.1.22R(3)(c), then, for each *individual member*, that limit may be replaced by 10%.

Exposures excluded from the large exposure limits

- 2.1.49 R For *managing agents*, in *INSPRU* 2.1.33R and *INSPRU* 2.1.35R, references to an exposure do not include exposure arising from *balancing amounts*.

2.2 Asset-related Capital Requirement

Application

- 2.2.1 R *INSPRU 2.2* applies to an *insurer* unless it is:
- (1) a *non-directive friendly society*; or
 - (2) a *Swiss general insurer*; or
 - (3) an *EEA-deposit insurer*; or
 - (4) an *incoming EEA firm*; or
 - (5) an *incoming Treaty firm*.
- 2.2.2 G The scope of application of *INSPRU 2.2* is not restricted to *firms* that are subject to the relevant EC directives.
- 2.2.3 R *INSPRU 2.2* applies to a *firm* only in relation to its *general insurance business*.
- 2.2.4 G The adequacy of a *firm's* financial resources needs to be assessed in relation to all the activities of the *firm* and the risks to which they give rise.
- 2.2.5 G The requirements in *INSPRU 2.2* apply to a *firm* on a solo basis.

Purpose

- 2.2.6 G *GENPRU 2.1.13R* requires that a *firm* must maintain at all times *capital resources* equal to or in excess of its *capital resources requirement*. *GENPRU 2.1.17R* provides that for a *firm* carrying on *general insurance business* the *firm's capital resources requirement* is the *minimum capital requirement*.
- 2.2.7 G The *FSA* will use the *enhanced capital requirement* as the benchmark for *individual capital guidance* for a *firm* carrying on *general insurance business*, other than a *non-directive insurer*. The *enhanced capital requirement* is the sum of the *asset-related capital requirement* and the *insurance-related capital requirement* less the *firm's* equalisation provisions. This section sets out *rules and guidance* relating to the *asset-related capital requirement*. *Rules and guidance* relating to the *insurance-related capital requirement* are set out in *INSPRU 1.1*.
- 2.2.8 G The *asset-related capital requirement* is a measure of the capital that a *firm* should hold against the risk of loss if another party fails to perform its financial obligations to the *firm* or from adverse movements in the value of

assets.

- 2.2.9 G The *asset-related capital requirement* is calculated by applying capital charge factors, expressed as a percentage, to different categories of a *firm's* assets. A *firm* should refer to *GENPRU* 1.3 which sets out how a *firm* must recognise and value assets and liabilities.

Calculation of asset-related capital requirement

- 2.2.10 R A *firm* must calculate its *asset-related capital requirement* in accordance with *INSPRU* 2.2.11R.

- 2.2.11 R (1) The value of each of the *firm's* assets of a kind listed in the table in *INSPRU* 2.2.16R must be multiplied by the corresponding capital charge factor.
- (2) If any amount which is to be multiplied by a capital charge factor is a negative amount, that amount shall be treated as zero.
- (3) No account shall be taken of:
- (a) the value of any asset which is not an *admissible asset*;
 - (b) the amount (if any) by which the value of any assets exceeds the limits on exposures to a type of asset or *counterparty* as set out in *INSPRU* 2.1.22R.
- (4) Where a *firm* has entered into a *derivative*, then for the purposes of applying the appropriate capital charge factor as set out in *INSPRU* 2.2.16R, it must treat the value of the *derivative* and the value of the asset associated with the *derivative* as a single asset of a type and value which most closely reflects the economic risk to the *firm* of the combined rights and obligations associated with the *derivative* and the asset associated with the *derivative*.
- (5) The amounts resulting from multiplying each of the asset items referred to in (1) by the corresponding capital charge factor must be aggregated.
- (6) The *asset-related capital requirement* is the amount resulting from the aggregation in (5).

- 2.2.12 G *Options*: some *derivatives* may allow a *firm* an *option* whether to buy or sell a particular asset. If an *option* has a positive market value (that is, in-the-money) it is likely that the *firm* will exercise the *option* in the future and the current value of the *derivative* and associated asset will generally acquire new characteristics and volatility (a 'synthetic asset'). For instance, an *option* to acquire *shares* at a price below their current market value is likely to be exercised and the appropriate *asset-related capital requirement* calculation would be to combine the cash cost of acquiring the number of *shares* covered by the *option* with the value of the *derivative* and apply a factor of 16% to that combined value. If an *option* has no market value (that is, out-of-the-money) then it is unlikely that a *firm* would exercise the *option* in which case the appropriate *asset-related capital requirement* charge would be zero in respect of the *derivative*, and the corresponding capital charge

contained in Table *INSPRU* 2.2.16R in relation to the asset associated with the *derivative*.

2.2.13 G *Futures* and swaps: *futures* or swaps may not allow the *firm* such an option in which case the appropriate asset-related capital charge factor to apply is the one corresponding to the asset that would be held on fulfilment of the contract and the value to which this should be applied would be the value of the asset held after the contract is fulfilled.

2.2.14 R (1) The asset-related capital charge factor for money market funds set out in the Table *INSPRU* 2.2.16R must be applied to exposures to funds that meet the definition in (2).

(2) In *INSPRU* 2.2 an investment in a money market fund means a participation in a *collective investment scheme* which satisfies the following conditions:

(a) the primary investment objective of the *collective investment scheme* is:

(i) to maintain the net asset value of the *collective investment scheme* constant at par (net of earnings); or

(ii) to maintain the net asset value of the *collective investment scheme* at the value of investors' initial capital plus earnings;

(b) in order to pursue its primary investment objective the *collective investment scheme* invests exclusively in cash or in short term instruments with characteristics similar to cash or both; and

(c) the *collective investment scheme* undertakes to abide by the following conditions:

(i) not to allow the assets held in the *collective investment scheme* to exceed a weighted average maturity of 60 days;

(ii) not to invest in equity or securities with characteristics similar to equity; and

(iii) on a basis of marking-to-market at least weekly, not to permit the value of each *collective investment scheme* unit at any point in time to move by more than 50 basis points (0.5% of total *collective investment scheme* value).

2.2.15 R In *INSPRU* 2.2.16R an insurance dependant means a *regulated related undertaking* which is an *insurance undertaking* or an *insurance holding company*.

2.2.16 R Table: Asset-related capital charge factors

Asset item	ECR asset-related capital charge factor
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Investments	Land and Buildings		7.5%	
	<i>Investments in group undertakings and participating interests</i>	<i>Shares in group undertakings excluding participating interests</i>	Insurance dependants	0%
			Other	7.5%
		<i>Debt securities issued by, and loans to, group undertakings</i>		3.5%
		Participating interests		7.5%
		<i>Debt securities issued by, and loans to, undertakings in which the insurer has a participating interest</i>		3.5%
	Other financial investments	<i>Shares and other variable-yield securities and units in unit trusts</i>		16.0%
		Money market funds		0%
		<i>Debt securities and other fixed income securities</i>	<i>Approved securities</i>	3.5%
			Other	3.5%
		Participation in investment pools		16.0%
		Loans secured by mortgages		2.5%
		Other loans		2.5%
<i>Deposits with approved credit institutions and approved financial institutions</i>		0%		
Other		7.5%		
	Deposits with ceding undertakings		3.5%	
<i>Reinsurers' share of technical provisions</i>	Provision for <i>unearned premium</i>		2.5%	
	<i>Claims outstanding</i>		2.5%	
	Other		2.5%	
Debtors	Debtors arising out of direct insurance operations	<i>Policyholders</i>	4.5%	
		Intermediaries	3.5%	
	Debtors arising out of <i>reinsurance</i> operations		2.5%	

	Other debtors	1.5%
	Called up <i>share</i> capital not paid	0%
Other Assets	Tangible assets	7.5%
	Cash at bank and in hand	0%
	Other	0%
Prepayments and accrued income	Accrued interest and rent	0%
	<i>Deferred acquisition costs</i>	0%
	Other prepayments and accrued income	0%

Application of INSPRU 2.2 to Lloyd's

- 2.2.17 R *INSPRU 2.2* applies to *managing agents* and to the *Society* in accordance with:
- (1) for *managing agents*, *INSPRU 8.1.4R*; and
 - (2) for the *Society*, *INSPRU 8.1.2R*
- 2.2.18 R This chapter applies to the *Society* for each *member*, including the capital charge relating to *central assets*, to the extent that those assets are held to support a particular *member*.

3.1 Market risk in insurance

- 3.1.1 R *INSPRU* 3.1 applies to an *insurer*, unless it is:
- (1) a *non-directive friendly society*; or
 - (2) an *incoming EEA firm*; or
 - (3) an *incoming Treaty firm*.
- 3.1.2 G *INSPRU* 3.1 applies to *pure reinsurers*, with the exception of *INSPRU* 3.1.53R, *INSPRU* 3.1.57R and *INSPRU* 3.1.58R.
- 3.1.3 R (1) *INSPRU* 3.1 applies to a *firm* in relation to the whole of its business, except where a particular provision provides for a narrower scope.
- (2) Where a *firm* carries on both *long-term insurance business* and *general insurance business*, *INSPRU* 3.1 applies separately to each type of business.

Purpose

- 3.1.4 G This section sets out *rules* and *guidance* relating to *market risk*. Under *INSPRU* 1.1.20R and *INSPRU* 1.1.21R, a *firm* is required to hold *admissible assets* of a value sufficient to cover its *technical provisions* and its other *long-term insurance* or *general insurance liabilities*. In addition, *INSPRU* 1.1.34R sets the requirement that a *firm* must hold assets of appropriate amount, currency, term, safety and yield, to ensure that the cash inflows from those assets will be sufficient to meet expected cash outflows from its insurance liabilities as they are due.
- 3.1.5 G *Market risk* is the risk that as a result of market movements a *firm* may be exposed to fluctuations in the value of its assets, the amount of its liabilities, or the income from its assets. Sources of general *market risk* include movements in interest rates, equities, exchange rates and real estate prices. It is important to note that none of these sources of risk is independent of the others. For example, fluctuations in interest rates often have an impact upon equity and currency values and vice versa. Giving due consideration to these correlations is an important aspect of the prudent management of *market risk*.
- 3.1.6 G A *firm* may also be exposed to specific *market risk*, which is the risk that the *market value* of a specific asset, or income from that asset, may fluctuate for reasons that are not dependent on general market movements. The limits in *INSPRU* 2.1.22R cover *market risk* as well as *counterparty* risk.
- 3.1.7 G *INSPRU* 3.1 addresses the impact of *market risk* on *insurance business* in the ways set out below:
- (1) Any *firm* that carries on *long-term insurance business* must comply with

the *resilience capital requirement*. This requires the *firm* to hold capital to cover *market risk*. The *resilience capital requirement* is dealt with in *INSPRU 3.1.9G* to *INSPRU 3.1.26R*.

(2) For a *firm* that carries on *long-term insurance business*, the assets that it must hold must be of a value sufficient to cover the *firm's technical provisions* and other *long-term insurance liabilities*. *INSPRU 1.2* contains *rules and guidance* as to the methods and assumptions to be used in calculating the *mathematical reserves*. One of these assumptions is the assumed rate of interest to be used in calculating the present value of future payments by or to a *firm*. *INSPRU 3.1.28R* to *INSPRU 3.1.48G* set out the methodology to be used in relation to *long-term insurance liabilities*.

(3) *Firms* carrying on either *long-term insurance business* or *general insurance business* are also subject to currency risk. That is, the risk that fluctuations in exchange rates may impact adversely on a *firm*. *INSPRU 3.1.49G* to *INSPRU 3.1.56G* set out the requirements a *firm* must meet so as to cover this risk.

(4) For a *firm* carrying on *general insurance business*, the *Enhanced Capital Requirement* already captures some elements of *market risk*. In addition, the requirements as to the assumed rate of interest used in calculating the present value of *general insurance liabilities* are contained in the *insurance accounts rules*, and these requirements are outlined in *INSPRU 3.1.27G*.

(5) *Firms* carrying on *long-term insurance business* that have *property-linked liabilities* or *index-linked liabilities* must cover these liabilities by holding appropriate assets. *INSPRU 3.1.57R* and *INSPRU 3.1.58R* set out these cover requirements.

(6) The *Reinsurance Directive* applies to *pure reinsurers* "prudent person" investment principles in relation to the investment of their assets. *INSPRU 3.1.61AR* sets out these principles.

Definitions

3.1.8 R For the purposes of *INSPRU 3.1*:

(1) real estate means an interest in land, buildings or other immovable property;

(2) a significant territory is any country or territory in which more than 2.5% of a *firm's long-term insurance assets* (by *market value*), excluding assets held to cover *index-linked liabilities* or *property-linked liabilities* (see *INSPRU 3.1.57R* and *INSPRU 3.1.58R*), are invested;

(3) the long term gilt yield means the annualised equivalent of the fifteen year gilt yield for the *United Kingdom* Government fixed-interest *securities* index jointly compiled by the Financial Times, the Institute of Actuaries and the Faculty of Actuaries; and

(4) the member states of the European Union which have adopted the Euro as the official currency may be treated as a single territory.

Resilience capital requirement (applicable to long-term insurance business only)

- 3.1.9 G The *resilience capital requirement* forms part of the calculation of the *capital resources requirement* for all *firms* carrying on *long-term insurance business*. *GENPRU 2.1.18R* to *GENPRU 2.1.23R* set out the different elements of this calculation. These include the *Minimum Capital Requirement* and the *Enhanced Capital Requirement*. The *resilience capital requirement* forms part of both of these requirements (see *GENPRU 2.1.25R(2)* and *GENPRU 2.1.38R(2)*).
- 3.1.10 R (1) A *firm* that carries on *long-term insurance business* must calculate a *resilience capital requirement* in accordance with (2) to (5).
- (2) The *firm* must identify relevant assets (see *INSPRU 3.1.10AR*) which, after applying the scenarios in (3), have a value that is equal to the *firm's long-term insurance liabilities* under those scenarios.
- (3) For the purpose of (2), the scenarios are:
- (a) for those relevant assets invested in the *United Kingdom*, the *market risk* scenario set out in *INSPRU 3.1.16R*;
- (b) subject to (c) and to *INSPRU 3.1.26R*, for those relevant assets invested outside of the *United Kingdom*, the *market risk* scenario set out in *INSPRU 3.1.23R*; and
- (c) where the relevant assets in (b) are:
- (i) held to cover *index-linked liabilities* or *property-linked liabilities*; or
- (ii) not invested in a significant territory outside the *United Kingdom*; the *market risk* scenario set out in *INSPRU 3.1.16R*.
- (4) The *resilience capital requirement* is the result of deducting B from A, where:
- (a) A is the value of the relevant assets which will produce the result described in (2); and
- (b) B is the *firm's long-term insurance liabilities*.
- (5) In calculating the value of the *firm's long-term insurance liabilities* under any scenario, a *firm* is not required to adjust the provision made under *GENPRU 1.3.4R* in respect of a *defined benefits pension scheme*.
- 3.1.10A R In *INSPRU 3.1.10R* relevant assets means a range of assets which must be selected by the *firm* from the assets specified in (1) and (2) in the order specified:
- (1) its *long-term insurance assets*; and
- (2) only where the *firm* has selected all the assets within (1), its shareholder assets, other than assets of an amount and kind required:
- (a) to cover its liabilities arising outside its *long-term insurance funds*; or
- (b) to meet any regulatory capital requirements in respect of business

written outside its *long-term insurance funds*.

- 3.1.11 G The purpose of the *resilience capital requirement* is to cover adverse deviation from:
- (1) the value of *long-term insurance liabilities*;
 - (2) the value of assets held to cover *long-term insurance liabilities*; and
 - (3) the value of assets held to cover the resilience capital requirement;
- arising from the effects of *market risk* for equities, real estate and fixed interest securities. Other risks are not explicitly addressed by the *resilience capital requirement*.
- 3.1.12 G The amount of the *resilience capital requirement* calculated by the *firm* will depend on the *firm's* choice of assets held to cover the *resilience capital requirement*. The *resilience capital requirement* is held to cover not only the shortfall between the change in the value of *long-term insurance liabilities* and the change in the value of the assets identified to cover those liabilities, but also the change in the value of the assets identified to cover the *resilience capital requirement* itself.
- 3.1.13 G As part of the assessment of the financial resources a *firm* needs to hold to comply with the *overall financial adequacy rule*, the *general stress and scenario testing rule* requires a *firm* to carry out stress tests and scenario analyses appropriate to the major sources of risk to its ability to meet its liabilities as they fall due identified in accordance with the *overall Pillar 2 rule*. In considering the stress tests and scenario analyses relevant to the major sources of risk in the category of *market risk*, a *firm* should consider the extent to which the *market risk* scenarios set out in *INSPRU 3.1.16R* to *INSPRU 3.1.26R* are appropriate to the nature of its asset portfolio. A *firm* may judge that given the nature of its portfolio, a more severe stress should be adopted. The *firm* may also wish to bring in other asset classes, such as index-linked bonds, which should be stressed on appropriate bases, and to consider the impact of currency mismatching and any *derivative* positions held.
- 3.1.13A G In the *market risk* scenarios set out in *INSPRU 3.1.16R* to *INSPRU 3.1.26R*, a *firm* is required to assess the changed value of its assets and liabilities in the economic conditions of the scenarios set out in *INSPRU 3.1.16R* and *INSPRU 3.1.23R*. A *firm* is required to assess the changed value of each relevant asset (as defined in *INSPRU 3.1.10AR*), notwithstanding any uncertainty about the appropriate valuation basis for that asset. In valuing an asset in the specified scenarios, a *firm* should have regard to the economic substance of the asset, rather than its legal form, and assess its value accordingly. Consider, for example, a convertible bond that is close to its conversion date and where the conversion option has value. The value of the convertible bond in the specified scenarios is likely to be sensitive primarily to equity market scenarios and to a lesser extent to interest rate scenarios. The *firm* should value the asset according to its expected market value in the

economic conditions underlying the specified scenarios.

- 3.1.13B G In determining where particular assets are invested for the purpose of determining which *market risk* scenario should be applied to those assets, or whether a country or territory in which a *firm* has invested part of its *long-term insurance assets* is a significant territory, a *firm* should generally treat:
- (1) a *security* dealt in on a *regulated market* as invested in any country or territory in which a *regulated market* on which the *security* is dealt is situated;
 - (2) a *security* which is not dealt in on a *regulated market* as invested in the country or territory in which the *issuer* has its head office;
 - (3) an asset consisting of a claim against a debtor as invested in any country or territory where it can be enforced by legal action;
 - (4) real estate as invested in the country or territory in which the land, buildings or other immovable property is situated;
 - (5) a tangible asset as invested in the country or territory where it is situated; and
 - (6) a *derivative* or *quasi-derivative* as invested in the country or territory in which the assets to which the *firm* is exposed by reason of having entered into the *derivative* or *quasi-derivative* are situated.

Where, however, the nature of a *firm's* investment is such that the economic risks to which it is principally exposed are risks relating to assets invested in, or the currency of, a different country or territory to that in which are invested the assets directly invested in by the *firm*, then the *firm* should consider whether it would be more reasonable to treat the assets as invested in that other country or territory. For example, if a *firm* has invested in the *securities* of a *collective investment scheme* which are dealt in on a *regulated market* in country A, but the scheme principally invests in real estate situated in country B, the *firm* should consider whether its principal exposure is in fact to the country in which the underlying assets are situated (that is, country B). Another example might be where a *firm* has invested in a bond or other fixed interest *security* that is denominated in the currency of a country or territory other than that in which the *security* would be treated as invested under (1) or (2) above. The *firm* may wish to consider whether that bond or fixed interest *security* should be treated as invested in the country or territory of the currency of denomination.

- 3.1.14 G The *resilience capital requirement* requires *firms* to assume different adverse *market risk* scenarios for equities, real estate and fixed interest securities (see *INSPRU* 3.1.16R and *INSPRU* 3.1.23R) to those required by *INSPRU* 1.3.68R (UK and certain other assets) and *INSPRU* 1.3.73R (non-UK assets) in relation to the calculation of the *risk capital margin* for a *with-profits fund* by a *realistic basis life firm* calculating its *with-profits insurance capital component*.

- 3.1.15 G Where the *resilience capital requirement* is affected by the presence of *derivative* or *quasi-derivative* instruments, the *firm* will need to consider

whether the protection afforded is of suitable length or security. The *firm* should include the exposure to *counterparties* in the credit considerations of *INSPRU* 3.1.41R both before and after calculating the resilience capital requirement. If the *derivative* protection is very short term the *firm* should consider whether issues arise under *INSPRU* 1.2.26R (Avoidance of future valuation strain); when a *derivative* expires the financial position of the *firm* may deteriorate as a result of, for example, falls in asset values. Unless the *firm* holds a further reserve, the *firm* is likely to need to have either undertaken a fresh protection strategy or carried through the alternative to the *derivative* protection (such as selling equities in place of a put *option*) if the existing protection expires before the financial year end. If the existing *derivative* protection continues beyond the time of financial year end the *firm* must have sufficient confidence that it can renew its *derivative* protection or an alternative to achieve the same effect.

Market risk scenario for assets invested in the United Kingdom

- 3.1.16 R In *INSPRU* 3.1.10R(3)(a), the *market risk* scenario for assets invested in the *United Kingdom* and for assets (including assets invested outside the *United Kingdom*) held to cover *index-linked liabilities* or *property-linked liabilities* which a *firm* must assume is:
- (1) a fall in the *market value* of equities of at least 10% or, if greater, the lower of:
 - (a) a percentage fall in the *market value* of equities which would produce an earnings yield on the FTSE Actuaries All Share Index equal to 4/3 rds of the long-term gilt yield; and
 - (b) a fall in the *market value* of equities of 25% less the *equity market adjustment ratio* (see *INSPRU* 3.1.19R);
 - (2) a fall in real estate values of 20% less the *real estate market adjustment ratio* for an appropriate real estate index (see *INSPRU* 3.1.21R);
 - (3)
 - (a) the more onerous of either a fall or rise in yields on all fixed interest securities by the percentage point amount determined in (b);
 - (b) for the purpose of (a), the percentage point amount is equal to 20% of the long-term gilt yield.
- 3.1.17 R For the purposes of *INSPRU* 3.1.16R(1) and *INSPRU* 3.1.16R(2), a *firm* must:
- (1) assume that earnings for equities and rack rents for real estate fall by 10%, but dividends for equities remain unaltered (see *INSPRU* 3.1.36R to *INSPRU* 3.1.38R); and
 - (2) model a fall in equity and real estate markets as if the fall occurred instantaneously.
- 3.1.18 G An example of *INSPRU* 3.1.16R(3) is that, where the long-term gilt yield is currently 6%, a *firm* would assume an increase of 20% in that yield, that is,

a change of 1.2 percentage points. For the purpose of the scenario in *INSPRU* 3.1.16R(3)(a), the *firm* would assume a fall or rise of 1.2 percentage points in yields on all fixed interest securities.

Equity market adjustment ratio

- 3.1.19 R The equity market adjustment ratio referred to in *INSPRU* 3.1.16R(1)(b) is:
- (1) if the ratio calculated in (a) and (b) lies between 75% and 100%, the result of 100% less the ratio (expressed as a percentage) of:
 - (a) the current value of the FTSE Actuaries All Share Index; to
 - (b) the average value of the FTSE Actuaries All Share Index over the preceding 90 calendar days;
 - (2) 0%, if the ratio calculated in (1)(a) and (b) is more than 100%; and
 - (3) 25%, if the ratio calculated in (1)(a) and (b) is less than 75%.
- 3.1.20 R In *INSPRU* 3.1.19R, the average value of the FTSE Actuaries All Share Index over any period of 90 calendar days means the arithmetic mean based on levels at the close of business on each of the days in that period on which the London Stock Exchange was open for trading.

Real estate market adjustment ratio

- 3.1.21 R The real estate market adjustment ratio for a real estate index referred to in *INSPRU* 3.1.16R(2) and *INSPRU* 3.1.23R(2) is:
- (1) if the ratio calculated in (a) and (b) lies between 90% and 100%, the result of 100% less the ratio (expressed as a percentage) of:
 - (a) the current value of the real estate index; to
 - (b) the average value of that real estate index over the three preceding *financial years*;
 - (2) 0%, if the ratio calculated in (1)(a) and (b) is more than 100%; and
 - (3) 10%, if the ratio calculated in (1)(a) and (b) is less than 90%.
- 3.1.22 G For the purpose of calculating the *real estate market adjustment ratio* in *INSPRU* 3.1.21R, a *firm* should select an appropriate index of real estate values such that:
- (1) the constituents of the index are reasonably representative of the nature and territory of the real estate included in the range of assets identified in accordance with *INSPRU* 3.1.10R; and
 - (2) the frequency of, and historical data relating to, published values of the index are sufficient to enable an average value(s) of the index to be calculated over the three preceding *financial years*.

Market risk scenario for assets invested outside the United Kingdom

- 3.1.23 R In *INSPRU* 3.1.10R(3)(b), subject to *INSPRU* 3.1.26R, the *market risk* scenario for assets invested outside the *United Kingdom* (other than assets held to cover *index-linked liabilities* or *property-linked liabilities*) which a *firm* must assume is, for each significant territory in which assets are invested outside the *United Kingdom*:
- (1) an appropriate fall in the *market value* of equities invested in that territory, which is at least equal to the percentage fall determined in *INSPRU* 3.1.16R;
 - (2) a fall in real estate values in that territory of 20% less the real estate market adjustment ratio for an appropriate real estate index for that territory (see *INSPRU* 3.1.21R); and
 - (3)
 - (a) the more onerous of either a fall or a rise in yields on all fixed interest securities by the percentage point amount determined in (b);
 - (b) for the purpose of (a), the percentage point amount is equal to 20% of the nearest equivalent (in respect of the method of calculation) to the long term gilt yield.
- 3.1.24 R For the purposes of *INSPRU* 3.1.23R(1), an appropriate fall in the *market value* of equities invested in a significant territory must be determined having regard to:
- (1) an appropriate equity market index for that territory; and
 - (2) the historical volatility of the equity market index selected in (1).
- 3.1.25 G For the purpose of *INSPRU* 3.1.24R(1), an appropriate equity market index for a territory is such that:
- (1) the constituents of the index are reasonably representative of the nature of the equities held in that territory which are included in the range of assets identified in accordance with *INSPRU* 3.1.10R; and
 - (2) the frequency of, and historical data relating to, published values of the index are sufficient to enable an average value(s) and historical volatility of the index to be calculated over at least the three preceding *financial years*.
- 3.1.26 R Where the assets of a *firm* invested in a significant territory of a kind referred to in *INSPRU* 3.1.23R(1), *INSPRU* 3.1.23R(2) or *INSPRU* 3.1.23R(3)(a) represent less than 0.5% of the *firm's long-term insurance assets* (excluding assets held to cover *index-linked liabilities* or *property-linked liabilities*), measured by *market value*, the *firm* may assume for those assets the *market risk* scenario for assets of that kind invested in the *United Kingdom* set out in *INSPRU* 3.1.16R instead of the *market risk* scenario set out in *INSPRU* 3.1.23R.

Interest rates: general insurance liabilities

- 3.1.27 G The rates of interest to be used for the calculation of the present values of *general insurance liabilities* are specified in the *insurance accounts rules*, except where benefits resulting from a *claim* must be paid in the form of an annuity, in which case the rules require calculation by recognised actuarial methods. In the case of *claims* not payable in the form of an annuity, the *insurance accounts rules* state that the rate of interest to be used must not exceed the lowest of:
- (1) a rate prudently estimated by the *firm* to be earned by assets of the *firm* that are appropriate in magnitude and nature to cover the provisions for *claims* being discounted, during the period necessary for the payment of such *claims*;
 - (2) a rate justified by the performance of such assets over the preceding five years; and
 - (3) a rate justified by the performance of such assets during the year preceding the balance sheet date.

Interest rates: long-term insurance liabilities

- 3.1.28 R The rates of interest required by *INSPRU* 1.2.33R to be used by a *firm* for the calculation of the present value of a *long-term insurance liability* must not exceed 97.5% of the risk-adjusted yield (see *INSPRU* 3.1.30R to *INSPRU* 3.1.48G) that is expected to be achieved on:
- (1) the assets allocated to cover that liability;
 - (2) the reinvestment of sums expected to be received from those assets (see *INSPRU* 3.1.45R to *INSPRU* 3.1.48G); and
 - (3) the investment of future *premium* receipts (see *INSPRU* 3.1.45R to *INSPRU* 3.1.48G).
- 3.1.29 R For the purposes of *INSPRU* 3.1.28R, the rates of interest assumed must allow appropriately for the rates of tax that apply to the investment return on policyholder assets. The rates of tax assumed must be such that the *firm's* total implied liability for tax arising from the allocation of assets to liabilities is not less than the *firm's* actual expected liability for tax for the period in respect of which tax is to be assessed.
- 3.1.29A G *INSPRU* 3.1.28R applies only to *long-term insurance contracts* that are treated as liabilities. Where a *firm* treats a *long-term insurance contract* as an asset (see *INSPRU* 1.2.24R), in calculating the present value of future net cash flows under that contract, it must include margins for adverse variation in accordance with *INSPRU* 1.2.13R. These margins should include margins for *market risk* and, where relevant, credit risk. For those margins to be sufficiently prudent as required by *INSPRU* 1.2.13R, the rate of interest used may need to be higher than that which would apply under *INSPRU* 3.1.28R.

Risk-adjusted yield

- 3.1.30 R A risk-adjusted yield on an asset must be calculated by:
- (1) taking the asset together with any covering *derivatives*, forward transactions and quasi-derivatives;
 - (2) assuming that the factors which affect the yield will remain unchanged after the valuation date (see *INSPRU* 3.1.33R);
 - (3) valuing the asset (together with any offsetting transaction) in accordance with *GENPRU* 1.3 (Valuation);
 - (4) making reasonable assumptions as to whether, and if so when, any options or other rights embedded in the asset (or in any offsetting transaction) will be exercised.
- 3.1.31 G Examples of calculating a combined yield for the purposes of *INSPRU* 3.1.30R(1):
- (1) 1000 £1 *shares* (fully paid) of ABC plc covered by a sold *future* on the *shares*. Calculating the combined yield effectively results in a position that behaves like cash (with dividend income but no capital gain or loss on the value of the assets); and
 - (2) where a covering *derivative* contains an *option* exercisable by the *firm* (e.g. a bought put *option* or receiver swaption), the calculation of the risk adjusted yield should take into account the fact that on the valuation assumptions any time value will reduce over time (known as the 'wasting' nature of the time value of the *option*), for example, an at-the money *option* will expire worthless and hence the covering *derivative* will effectively be a negative yielding asset. There are various ways of allowing for this, for example a *firm* could treat the covering *derivative* and the asset as a single asset and calculate an internal rate of return on this combined asset. Alternatively, an explicit reserve could be set up equal and opposite to the time value of the covering *derivative* which would be written off in the same way as the time value on the covering *derivative*.
- 3.1.32 G The requirements in relation to offsetting transactions are set out in *INSPRU* 3.2. The options and other rights referred to in *INSPRU* 3.1.30R(4) include those exercisable by the *firm* as well as those exercisable by other parties.
- 3.1.33 R For the purpose of *INSPRU* 3.1.30R(2), the factors that affect yield should be ascertained as at the valuation date (that is, the date to which present values of cash flows are being calculated). All changes known to have occurred by that date must be taken into account including:
- (1) changes in the rental income from real estate;
 - (2) changes in dividends or audited profit on equities;
 - (3) known or forecast changes in dividends which have been publicly announced by the issuer by the valuation date;
 - (4) known or forecast changes in earnings which have been publicly announced by the issuer by the valuation date;

- (5) alterations in capital structure; and
- (6) the value (at the most recent date at or before the valuation date for which it is known) of any determinant of the amount of any future interest or capital payment.

3.1.34 R The risk-adjusted yield is either:
(1) (for equities and real estate) a running yield (see *INSPRU* 3.1.36R to *INSPRU* 3.1.38R, *INSPRU* 3.1.41R and *INSPRU* 3.1.44R); or
(2) (for all other assets) the internal rate of return (see *INSPRU* 3.1.39R, *INSPRU* 3.1.41R and *INSPRU* 3.1.44R).

3.1.35 R The risk-adjusted yield on a basket of assets is the arithmetic mean of the risk-adjusted yield on each asset weighted by that asset's *market value*.

The running yield for real estate

3.1.36 R For real estate the running yield is the ratio of:
(1) the rental income arising from the real estate over the previous 12 months; to
(2) the *market value* of the real estate.

The running yield for equities

3.1.37 R For equities the running yield is:
(1) the dividend yield, if the dividend yield is more than the earnings yield;
(2) otherwise, the sum of the dividend yield and the earnings yield, divided by two.

3.1.38 R For the purposes of *INSPRU* 3.1.37R:
(1) the dividend yield is the ratio (expressed as a percentage) of dividend income over the previous 12 months from the equities for which the running yield is being calculated ("the relevant equities") to the *market value* of those equities;
(2) the earnings yield is the ratio (expressed as a percentage) of the audited profit (including exceptional items and extraordinary items) for the preceding *financial year* of the issuer of the relevant equities to the *market value* of those equities;
(3) the earnings yield must be calculated in accordance with whichever is most appropriate (to the issuer of the relevant equities) of *United Kingdom*, US or international generally accepted accounting practice.

The internal rate of return

- 3.1.39 R The internal rate of return on an asset is the annual rate of interest which, if used to calculate the present value of future income (before deduction of tax) and of repayments of capital (before deduction of tax) would result in the sum of those amounts being equal to the *market value* of the asset.
- 3.1.40 G The risk adjusted yield for a *collective investment scheme* may be determined as the weighted average of the yields on each of the investments held by the *collective investment scheme*.

Credit risk

- 3.1.41 R In both the running yield and internal rate of return the yield must be reduced to exclude that part of the yield that represents compensation for credit risk arising from the asset.
- 3.1.42 G An allowance for credit risk should be made for all securities except risk-free securities.
- 3.1.43 G Provision for credit risk for credit-rated securities may be made by reference to historic default rates of securities with a similar credit rating. However, allowance should be made both for any recent or expected changes in market conditions that may invalidate historic default rates and for the likelihood that the credit ratings on securities may deteriorate or (following such deterioration) that the issuer may default.
- 3.1.44 R Provision for credit risk for securities that are not credit-rated must be made on principles at least as prudent as those adopted for credit-rated securities.

Investment and reinvestment

- 3.1.45 R Except as provided in *INSPRU* 3.1.46R:
- (1) the risk-adjusted yield assumed for the investment or reinvestment of sterling sums (other than sums expected to be received within the next three years) must not exceed the lowest of:
- (a) the long-term gilt yield;
 - (b) 3% per annum, increased by two thirds of the excess, if any, of the long-term gilt yield over 3% per annum; and
 - (c) 6.5% per annum; and
- (2) the risk-adjusted yield assumed for the investment or reinvestment of those sterling sums expected to be received within the next three years must not exceed the risk-adjusted yield on the assets actually held adjusted linearly over the three-year period to the risk-adjusted yield determined under (1).
- 3.1.46 R For the with-profits insurance contracts of a *realistic basis life firm*, the risk-

adjusted yield assumed for the investment or reinvestment of sums denominated in sterling must be no more than rates derived from the forward gilts yield.

- 3.1.47 R The risk-adjusted yield assumed for the investment or reinvestment of non-sterling sums must be at least as prudent as in *INSPRU* 3.1.45R and *INSPRU* 3.1.46R.
- 3.1.48 G The purpose of *INSPRU* 3.1.45R to *INSPRU* 3.1.47R is to help protect against 'reinvestment risk'. Reinvestment risk is the risk that, when the sums are actually received, interest rates (and so yields available on assets) might have fallen below current expectations.

Currency risk

- 3.1.49 G Fluctuations in foreign exchange rates may impact adversely upon a *firm*, including where it holds an open position in a foreign currency. This is where future cash outflows (that is liabilities) in one currency are matched by future cash inflows (that is assets) in a different currency. The circumstances in which this could arise include where the *firm*:
- (1) has entered into contracts for the purchase or sale of foreign currency; or
 - (2) has entered into *contracts of insurance* under which *claims* are payable in, or determined by reference to a value or price expressed in, a foreign currency; or
 - (3) holds assets denominated in a foreign currency.

Cover for spot and forward currency transactions

- 3.1.50 R A *firm* must cover a contract providing for the purchase or sale of foreign currency by:
- (1) holding the currency that must be paid by the *firm* under the contract; or
 - (2) being subject to an offsetting transaction.

- 3.1.51 G The requirements in relation to cover and offsetting transactions are set out in *INSPRU* 3.2.

Currency matching of assets and liabilities

- 3.1.52 G *INSPRU* 1.1.34R requires a *firm* to cover its liabilities with assets that enable it to match, in timing, amount and currency, the cash inflows and outflows from those assets and liabilities. This permits some currency mismatching of assets and liabilities, but only if sufficient excess assets are held to cover the exposure arising from such mismatching. The level of permitted currency mismatching is also limited by *INSPRU* 3.1.53R.

- 3.1.53 R (1) Subject to *INSPRU* 3.1.54R, a *firm* must hold *admissible assets* in each currency of an amount equal to at least 80% of the amount of its liabilities in that currency arising under or in connection with *contracts of insurance* (but excluding, for a *firm* that carries on *general insurance business*, any *equalisation provision*), except where the amount of those assets does not exceed 7% of the assets in other currencies.
- (2) In (1) references to an asset in a currency are to an asset which is expressed in or capable of being realised (without exchange risk) in that currency, and an asset is capable of being so realised if it is reasonably capable of being realised in that currency without risk that changes in exchange rates would reduce the cover for liabilities in that currency.
- 3.1.54 R *INSPRU* 3.1.53R does not apply to:
- (1) a *pure reinsurer*; or
- (2) assets held to cover *index-linked liabilities* or *property-linked liabilities*.
- 3.1.55 R For the purpose of *INSPRU* 3.1.53R, the currency of the liability under a *contract of insurance* is the currency in which the cover under the *contract of insurance* is expressed or, if the contract does not specify a currency:
- (1) the currency of the country or territory in which the risk is situated; or
- (2) if the *firm* on reasonable grounds so decides, the currency in which the *premium* payable under the contract is expressed; or
- (3) if, taking into account the nature of the risks insured, the *firm* considers it more appropriate:
- (a) the currency (based on past experience) in which it expects the *claims* to be paid; or
- (b) if there is no past experience, the currency of the country or territory in which the *firm* or relevant branch is established:
- (i) for contracts covering risks falling within general insurance business classes 4, 5, 6, 7, 11, 12 and 13 (producer's liability only); and
- (ii) for contracts covering risks falling within any other general insurance business class where, in accordance with the nature of the risks, the *firm's* liabilities are liabilities to be provided in a currency other than that which would result from the application of (1) or (2); or
- (4) (where a *claim* has been notified to the *firm* and the *firm's* liability in respect of that *claim* is payable in a currency other than that which would result from the application of (1), (2) or (3)) the currency in which the *claim* is to be paid; or
- (5) (where a *claim* is assessed in a currency known to the *firm* in advance and is a currency other than that which would result from the application of (1), (2), (3) or (4)) the currency in which the *claim* is to be assessed.
- 3.1.56 G The reasonable grounds in *INSPRU* 3.1.55R(2) include if, from the time the contract is entered into, it appears likely that a *claim* will be paid in the

currency of the *premium* and not in the currency of the country in which the risk is situated.

Covering linked liabilities

- 3.1.57 R A *firm* must cover its *property-linked liabilities* with:
- (1) (as closely as possible) the assets to which those liabilities are linked; or
 - (2) a property-linked *reinsurance* contract; or
 - (3) a combination of (1) and (2).
- 3.1.58 R A *firm* must cover its *index-linked liabilities* with:
- (1) either:
 - (a) the assets which represent that index; or
 - (b) assets of appropriate security and marketability which correspond, as closely as possible, to the assets which are comprised in, or which form, the index or other reference of value to which those liabilities are linked; or
 - (2) a portfolio of assets whose value or yield is reasonably expected to correspond closely with the *index-linked liability*; or
 - (3) an index-linked *reinsurance* contract; or
 - (4) an index-linked *approved derivative*; or
 - (5) an index-linked *approved quasi-derivative*; or
 - (6) a combination of any of (1) to (5).
- 3.1.58A R *INSPRU* 3.1.57R and *INSPRU* 3.1.58R do not apply to a *pure reinsurer*.
- 3.1.59 G For the purposes of *INSPRU* 3.1.57R and *INSPRU* 3.1.58R, a *firm* is not permitted to hold different assets and to cover the mismatch by holding excess assets.
- 3.1.60 G If a *firm* has incurred a *policy* liability which cannot be exactly matched by appropriate assets (for example the Limited Price Index (LPI)), the *firm* should seek to match assets that at least cover the liabilities. For example, an LPI limited to 5% per annum may be matched by an RPI bond or a fixed interest investment matching cash flows increasing at 5% per annum compound.
- 3.1.61 G In selecting the appropriate cover, the *firm* should ensure that both credit risk, and the risk that the value or yield in the assets will not, in all circumstances, match fluctuations in the relevant index, are within acceptable limits. *Rules* and *guidance* relating to credit risk are set out in *INSPRU* 2.1.

Pure reinsurers

3.1.61A R A *pure reinsurer* must invest its assets in accordance with the following requirements:

- (1) the assets must take account of the type of business carried out by the *firm*, in particular the nature, amount and duration of expected *claims* payments, in such a way as to secure the sufficiency, liquidity, security, quality, profitability and matching of its investments;
- (2) the *firm* must ensure that the assets are diversified and adequately spread and allow the *firm* to respond adequately to changing economic circumstances, in particular developments in the financial markets and real estate markets or major catastrophic events; the *firm* must assess the impact of irregular market circumstances on its assets and must diversify the assets in such a way as to reduce such impact;
- (3) investment in assets which are not admitted to trading on a *regulated market* must be kept to prudent levels;
- (4) investment in *derivatives* and *quasi-derivatives* must contribute to a reduction of investment risks or facilitate efficient portfolio management and such investments must be valued on a prudent basis, taking into account the underlying assets, and included in the valuation of the *firm's* assets. The *firm* must avoid excessive risk exposure to a single *counterparty* and to other *derivative* or *quasi-derivative* operations;
- (5) the assets must be properly diversified in such a way as to avoid:
 - (a) excessive reliance on any one particular asset, *issuer* or *group* of *undertakings*; and
 - (b) accumulations of risk in the portfolio as a whole.

Investments in assets issued by the same *issuer* or by *issuers* belonging to the same *group* must not expose the *firm* to excessive risk concentration; and
- (6) (5) does not apply to investment in government bonds.

Application of INSPRU 3.1 to Lloyd's

3.1.62 R *INSPRU* 3.1 applies to *managing agents* and to the *Society* in accordance with:

- (1) for *managing agents* *INSPRU* 8.1.4R, subject to *INSPRU* 3.1.65R below; and

(2) for the *Society*, *INSPRU* 8.1.2R.

Resilience capital requirement (applicable to long-term business only)

3.1.63 R *Managing agents* must calculate the amount of the *resilience capital requirement* for the *long-term insurance business* carried on through the *syndicates* they manage.

3.1.64 R The *Society* must determine the *resilience capital requirement* for the *insurance business* of each *member* under *INSPRU* 3.1.10R as the *member's* proportionate share of the *resilience capital requirement* calculated by the *managing agent* for the *long-term insurance business* carried on through the *syndicate*.

Currency risk: matching of assets and liabilities

3.1.65 R For the purposes of *INSPRU* 3.1.53R, a *managing agent* must ensure that:
(1) *syndicate liabilities* are covered by matching *syndicate assets* as required by *INSPRU* 3.2.53R; or that
(2) it immediately notifies to the *Society* the nature and extent of any *syndicate liabilities* not covered by matching assets under (1).

3.1.66 R On receipt of a notification by a *managing agent* under *INSPRU* 3.1.65(2), the *Society* must ensure that the liabilities in respect of the *insurance business* of the members in aggregate are covered with matching assets complying with *INSPRU* 3.1.53R.

3.2 Derivatives in insurance

Application

- 3.2.1 R This section applies to an *insurer*, unless it is:
- (1) a *non-directive friendly society*; or
 - (2) an *incoming EEA firm*; or
 - (3) an *incoming Treaty firm*; or
 - (4) a *pure reinsurer*.
- 3.2.2 G The scope of application of *INSPRU* 3.2 is not restricted to *firms* that are subject to the relevant EC directives.
- 3.2.3 R (1) This section applies to a *firm* in relation to the whole of its business, except where a particular provision provides for a narrower scope.
- (2) Where a *firm* carries on both *long-term insurance business* and *general insurance business*, this section applies separately to each type of business.

Purpose

- 3.2.4 G *GENPRU* 2.2.17R requires a *firm* to calculate its *capital resources* for the purpose of *GENPRU* in accordance with the *capital resources table*, subject to the limits in *GENPRU* 2.2.32R to *GENPRU* 2.2.41R. The *capital resources table* and *GENPRU* 2.2.251R require a *firm* to deduct from total *capital resources* the value of any asset included in an insurance fund which is not an *admissible asset* as listed in *GENPRU* 2 Annex 7R. *GENPRU* 2 Annex 7R provides that a *derivative*, *quasi-derivative* or *stock lending transaction* will only be an *admissible asset* if it is approved. This section sets out the criteria for determining when a *derivative*, *quasi-derivative* or *stock lending transaction* is approved for this purpose. *INSPRU* 3.2.5R to *INSPRU* 3.2.35R set out the criteria for *derivatives* and *quasi-derivatives*. *INSPRU* 3.2.36R to *INSPRU* 3.2.41R set out the criteria for *stock lending transactions*.

Derivatives and quasi-derivatives

- 3.2.5 R For the purpose of *GENPRU* 2 Annex 7R (Admissible assets in insurance), a *derivative* or *quasi-derivative* is approved if:
- (1) it is held for the purpose of efficient portfolio management (*INSPRU* 3.2.6R to *INSPRU* 3.2.7R) or reduction of investment risk (*INSPRU* 3.2.8R to *INSPRU* 3.2.13G);
 - (2) it is covered (*INSPRU* 3.2.14R to *INSPRU* 3.2.33G); and
 - (3) it is effected or issued:

- (a) on or under the rules of a *regulated market*; or
- (b) off-market with an *approved counterparty* and, except for a forward transaction, on approved terms and is capable of valuation (*INSPRU* 3.2.34R to *INSPRU* 3.2.35R).

Efficient portfolio management

- 3.2.6 R A *derivative* or *quasi-derivative* is held for the purpose of efficient portfolio management if the *firm* reasonably believes the *derivative* or *quasi-derivative* (either alone or together with any other covered transactions) enables the *firm* to achieve its investment objectives by one of the following:
- (1) generating additional capital or income in one of the ways described in *INSPRU* 3.2.7R; or
 - (2) reducing tax or investment cost in relation to *admissible assets*; or
 - (3) acquiring or disposing of rights in relation to *admissible assets*, or their equivalent, more efficiently or effectively.

Generation of additional capital or income

- 3.2.7 R The generation of additional capital or income falls within *INSPRU* 3.2.6R(1) where it arises from:
- (1) taking advantage of pricing imperfections in relation to the acquisition and disposal (or disposal and acquisition) of rights in relation to assets the same as, or equivalent to, *admissible assets*; or
 - (2) receiving a premium for selling a covered call *option* or its equivalent, the underlying of which is an *admissible asset*, even if that additional capital or income is obtained at the expense of surrendering the chance of greater capital or income.

Reduction of investment risk

- 3.2.8 R A *derivative* or *quasi-derivative* is held for the purpose of reducing investment risk if the *derivative* or *quasi-derivative* (either alone or together with other fully covered transactions) reduces any aspect of investment risk without significantly increasing any other aspect of that risk.

Significant increase in risk

- 3.2.9 R For the purposes of *INSPRU* 3.2.8R, an increase in risk from a *derivative* or *quasi-derivative* is significant unless:
- (1) relative to any reduction in investment risk it is both small and reasonable; or
 - (2) the risk is remote.

3.2.10 G *INSPRU* 3.2.8R does not require that a *derivative* or *quasi-derivative* has no possible adverse consequences. Often a *derivative* or *quasi-derivative* is effected to protect against a severe adverse consequence that only arises in one circumstance. In all other circumstances it may itself lead to adverse consequences, even if only because it expires worthless resulting in the loss of the purchase price. Conversely a *derivative* or *quasi-derivative* may reduce risk in a wide range of circumstances but lead to adverse consequences when a particular circumstance arises, e.g. the default of the *counterparty*. Only rarely does a *derivative* or *quasi-derivative* give rise to no adverse consequences in any circumstances. The test is merely that the increase in risk should not be significant, that is it should be both small and reasonable, or the risk should be remote.

3.2.11 G *Firms* are reminded that *INSPRU* 2.1 (Credit risk in insurance) sets out the different types of loss mitigation techniques.

Investment risk

3.2.12 R For the purposes of *INSPRU* 3.2.8R, investment risk is the risk that the assets held by a *firm*:

(1) (where they are *admissible assets* held by the *firm* to cover its *technical provisions*) might not be:

(a) of a value at least equal to the amount of those *technical provisions* as required by *INSPRU* 1.1.20R; or

(b) of appropriate safety, yield and marketability as required by *INSPRU* 1.1.34R(1)(a); or

(c) of an appropriate currency match as required by *INSPRU* 3.1.53R;

(2) (where they are held to cover *index-linked liabilities*) might not be appropriate cover for those liabilities as required by *INSPRU* 3.1.58R; and

(3) (where they are held to cover *property-linked liabilities*) might not be appropriately selected in accordance with contractual and constructive liabilities as required by *INSPRU* 1.5.36R and appropriate cover for those liabilities as required by *INSPRU* 3.1.57R.

3.2.13 G In assessing whether investment risk is reduced, the impact of a transaction on both the assets and liabilities should be considered. In particular, where the amount of liabilities depends upon the fluctuations in an index or other factor, investment risk is reduced where assets whose value fluctuates in the same way match those liabilities. In appropriate circumstances this may include:

(1) a *derivative* or *quasi-derivative* that is linked to the same index as the liabilities from the index-linked contracts; and

(2) a *derivative* or *quasi-derivative* whose value depends upon the factors which give rise to general insurance claims, e.g. a weather *quasi-derivative*.

Cover

- 3.2.14 R A *firm* must cover an obligation to transfer assets or pay monetary amounts that arises from:
- (1) a *derivative* or *quasi-derivative*; or
 - (2) a contract (other than a *contract of insurance*) for the purchase, sale or exchange of assets.
- 3.2.15 R An obligation to transfer assets or pay monetary amounts (see *INSPRU* 3.2.14R) must be covered:
- (1) by assets, a liability or a provision (see *INSPRU* 3.2.16R to *INSPRU* 3.2.24R); or
 - (2) by an offsetting transaction (see *INSPRU* 3.2.25R to *INSPRU* 3.2.27R).
- 3.2.16 R An obligation to transfer assets (other than *money*) or to pay monetary amounts based on the value of, or income from, assets is covered if the *firm* holds:
- (1) those assets; or
 - (2) in the case of an index or basket of assets, a reasonable approximation to those assets.
- 3.2.17 R An obligation to pay a monetary amount (whether or not falling in *INSPRU* 3.2.16R) is covered if:
- (1) the *firm* holds *admissible assets* that are sufficient in value so that the *firm* reasonably believes that following reasonably foreseeable adverse variations (relying solely on cashflows from, or from realising, those assets) it could pay the monetary amount in the right currency when it falls due; or
 - (2) the obligation to pay the monetary amount is offset by a liability. An obligation is offset by a liability where an increase in the amount of that obligation would be offset by a decrease in the amount of that liability; or
 - (3) a provision at least equal to the value of the assets in (1) is implicitly or explicitly set up. A provision is implicitly set up to the extent that the obligation to pay the monetary amount is recognised under *GENPRU* 1.3 (Valuation) either by offset against an asset or as a separate liability. A provision is explicitly set up if it is in addition to an implicit provision.
- 3.2.18 R A *firm* must implicitly or explicitly set up a provision equal to the value of the assets or offsetting transactions held to cover a non-approved *derivative* or *quasi-derivative* transaction.
- 3.2.19 G Where a *firm* partially covers a *derivative* (or other contract falling within *INSPRU* 3.2.14R(1) and *INSPRU* 3.2.14R(2)), the *firm* may split the *derivative* into a covered portion and an uncovered portion. The portion of the *derivative* that is covered (after taking into account the requirement to cover reasonably foreseeable adverse variations in *INSPRU* 3.2.17R(1)) is an *approved*

derivative, provided it also meets the requirements in *INSPRU* 3.2.5R(1) and *INSPRU* 3.2.5R(3); the uncovered portion is not an *approved derivative*.

- 3.2.20 G Exposure to a transaction includes exposure that arises from a right at the *firm's* (or its *subsidiary undertaking's*) option to dispose of assets.
- 3.2.21 G Cover serves three purposes. First, it protects against exposure to loss from the transaction which is being covered. The value of the cover increases (or if the cover is a liability the amount of that liability decreases) to match any increase in obligations under the transaction.
- 3.2.22 G The second purpose of cover is that it prevents excessive gearing in the investment portfolio by the use of *options* and their equivalent. A *firm* is required to cover all obligations under an admissible transaction including obligations that would arise only at the option of the *firm*, e.g. the liability to pay the exercise price under a bought *option*.
- 3.2.23 G The third purpose of cover is that it protects against the risk that the *firm* may not be able to deliver assets (including *money* in any currency) of the right type when the obligation falls due under the transaction. An obligation to deliver assets is covered only if the *firm* holds those assets or has entered into an offsetting transaction that would deliver those assets when needed. An obligation to pay *money* is offset only if the *firm* holds cash in the right currency, its equivalent or assets that could reliably be converted into cash in the right currency.
- 3.2.24 R Cover used for one transaction must not be used for cover in respect of another transaction or any other agreement to acquire, or dispose of, assets or to pay or repay *money*.

Offsetting transactions

- 3.2.25 R An offsetting transaction means:
(1) an *approved derivative*, *approved stock lending transaction* or an *approved quasi-derivative*; or
(2) a covered transaction with an *approved counterparty* for the purchase of assets.
- 3.2.26 R A transaction offsets an obligation to transfer assets away from the *firm* only if it provides for the transfer to the *firm* of those assets, or their value, at the time, or before, the obligation falls due.
- 3.2.27 R A transaction offsets an obligation to pay a monetary amount only if it provides for that monetary amount to be paid to the *firm* at or before the earliest date on which the obligation might fall due.

Lending and borrowing assets

- 3.2.28 R Assets that have been lent by the *firm* are not available for cover, unless:
- (1) they are non-monetary assets that have been lent under a transaction that fulfils the conditions in *INSPRU* 3.2.36R; and
 - (2) the *firm* reasonably believes the assets to be obtainable (by return or re-acquisition) in time to meet the obligation for which cover is required.
- 3.2.29 R Assets that have been borrowed by the *firm* are not available for cover except as allowed by *INSPRU* 3.2.30R.
- 3.2.30 R Borrowed *money* may be used as cover only where:
- (1) the *money* has been advanced or an *approved credit institution* has committed itself to advance the *money*; and
 - (2) the borrowing is or would be covered.
- 3.2.31 G *INSPRU* 3.2.30R in effect allows borrowings to be used to bridge the gap between an obligation under a transaction that might fall due at one date and cash or its equivalent that would only become due at a later date. Borrowings may not be used to gear the investment portfolio.

Examples of cover requirements

- 3.2.32 G Examples of cover by assets for the purposes of *INSPRU* 3.2.16R:
- (1) a bought put *option* (or a sold call *option*) on 1000 £1 *shares* (fully paid) of ABC plc is covered by an existing holding in the fund of 1000 £1 *shares* (fully paid) of ABC plc;
 - (2) a bought call *option* (or sold put *option*) on 1000 ordinary £1 *shares* (fully paid) of ABC plc is covered by cash (or its equivalent) which is sufficient in amount to meet the purchase price of the *shares* on exercise of the *option*;
 - (3) a bought or sold *contract for differences* on short-dated sterling is covered by cash (or its equivalent), the value of which together at least match the notional principal of the contract. For example, a LIFFE short sterling contract, or a successive series of such contracts, is covered by £500,000; and
 - (4) a sold *future* on the FT-SE 100 index is covered by holdings of equities, which satisfy the reasonable approximation test for cover in *INSPRU* 3.2.16R(2) in relation to that *future*, and the values of which together at least match the current mark to market valuation of the *future*. For example, if the multiplier per full point is £10, and if the eventual obligation under the *future* is currently 2800, the valuation of the *futures* position is $2800 \times £10 = £28,000$.
- 3.2.33 G Examples of cover by offsetting transactions for the purpose of *INSPRU* 3.2.25R would include a bought *future* which is guaranteed to deliver to the *firm* at the relevant time sufficient assets to cover liabilities under a sold call

option.

Off-market transactions

- 3.2.34 R For the purpose of *INSPRU 3.2.5R(3)(b)*, a *derivative* or *quasi-derivative* is on approved terms only if the *firm* reasonably believes that it could, in all reasonably foreseeable circumstances and under normal market conditions, readily enter into a further transaction with the *counterparty* or a third party to close out the *derivative* or *quasi-derivative* at a price not less than the value attributed to it by the *firm*, taking into account any valuation adjustments or reserves established by the *firm* under *GENPRU 1.3.29R* to *GENPRU 1.3.34R*.
- 3.2.34 G In considering whether the first transaction could be readily closed out in all
A reasonably foreseeable circumstances under normal market conditions, the *firm* should satisfy itself that it cannot reasonably foresee any circumstances in which it would need to close out all or part of the contract at a few days' notice, and would not be able to do so.
- 3.2.35 R For the purpose of *INSPRU 3.2.5R(3)(b)*, a *derivative* or *quasi-derivative* is capable of valuation only if the *firm*:
- (1) is able to value it with reasonable accuracy on a reliable basis in compliance with *GENPRU 1.3.41R*; and
 - (2) reasonably believes that it will be able to do so throughout the life of the transaction.
- 3.2.35 G The purpose of *INSPRU 3.2.34R* and *INSPRU 3.2.35R* is to ensure the
A appropriate application of *GENPRU 1.3* to *derivatives* and *quasi-derivatives* effected or issued off-market with an *approved counterparty*.

Stock lending

- 3.2.36 R (1) For the purposes of *GENPRU 2 Annex 7R* (Admissible assets in insurance), a *stock lending* transaction is approved if:
- (a) the assets lent are *admissible assets*;
 - (b) the *counterparty* is an *authorised person*, an *approved counterparty*, a *person* registered as a broker-dealer with the Securities and Exchange Commission of the United States of America or a bank, or a branch of a bank, supervised, and authorised to deal in investments as principal, with respect to *OTC derivatives* by at least one of the following federal banking supervisory authorities of the United States of America:
 - (i) the Office of the Comptroller of the Currency;
 - (ii) the Federal Deposit Insurance Corporation;
 - (iii) the Board of Governors of the Federal Reserve System; and

(iv) the Office of Thrift Supervision; and
(c) adequate and sufficiently immediate *collateral* (*INSPRU* 3.2.38R to *INSPRU* 3.2.41R) is obtained to secure the obligation of the *counterparty*.

(2) *INSPRU* 3.2.36R(1)(c) does not apply to a *stock lending* transaction made through Euroclear Bank SA/NV's Securities Lending and Borrowing Programme.

3.2.37 G *INSPRU* 3.2.36R refers only to *stock lending* transactions where the *firm* is the lender. There are no special *rules* for a transaction under which the *firm* borrows securities.

Collateral

3.2.38 R For the purposes of *INSPRU* 3.2.36R(1)(c), *collateral* is adequate only if it:

(1) is transferred to the *firm* or its agent or, in the case of a letter of credit, meets the conditions described in *INSPRU* 3.2.38AR;

(2) is, at the time of the transfer or, in the case of a letter of credit, at the time of issue, at least equal in value to the value of the securities transferred, or consideration provided, by the *firm*; and

(3) is of adequate quality.

3.2.38 R The conditions referred to in *INSPRU* 3.2.38R(1) are that the letter of credit is:

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(1) direct, explicit, unconditional and irrevocable; and

(2) issued by an *undertaking* which is:

(a) not a *related undertaking* of the *counterparty*; and

(b) either an *approved credit institution* or a bank, or a branch of a bank, whether chartered by the federal government of the United States of America or a US state, that is supervised and examined by at least one of the following US federal banking supervisory authorities:

(i) the Office of the Comptroller of the Currency;

(ii) the Federal Deposit Insurance Corporation;

(iii) the Board of Governors of the Federal Reserve System; and

(iv) the Office of Thrift Supervision.

3.2.39 G For the purposes of assessing adequate quality in *INSPRU* 3.2.38R(3), reference should be made to the criteria for credit risk loss mitigation set out in *INSPRU* 2.1.16R. The valuation rules in *GENPRU* 1.3 apply for the purpose of determining the value of both *collateral* received, and the *securities* transferred, by the *firm*. In addition, where *collateral* takes the form of assets transferred, under the *rules* in *GENPRU* any such asset that is not an *admissible asset* (see *GENPRU* 2 Ann 7R) does not have a value.

3.2.40 R For the purposes of *INSPRU* 3.2.36R(1)(c), *collateral* is sufficiently

immediate only if:

(1) it is transferred or, in the case of a letter of credit, issued before, or at the same time as, the transfer of the *securities* by the *firm*; or

(2) it will be transferred or, in the case of a letter of credit, issued, at latest, by the close of business on the day of the transfer.

3.2.41 R *Collateral* continues to be adequate only if its value is at all times at least equal to the value of the *securities* transferred by the *firm*. This will be satisfied in respect of *collateral* where the validity of the *collateral* or the *firm's* interest in the *collateral* is about to expire or has expired if sufficient *collateral* will again be transferred or issued at the latest by the close of business on the day of expiry.

3.2.42 G References in *INSPRU* 3.2.40R(2) and *INSPRU* 3.2.41R to the close of business on the day of the transfer or the day of expiry are to close of business on that day in all time regions.

Application of *INSPRU* 3.2 to Lloyd's

3.2.43 R *INSPRU* 3.2 applies to *managing agents* and to the *Society* in accordance with:
(1) for *managing agents*, *INSPRU* 8.1.4R; and
(2) for the *Society*, *INSPRU* 8.1.2R.

4.1 Liquidity risk management

Application

- 4.1.1 R *INSPRU* 4.1 applies to an *insurer* unless *INSPRU* 4.1.4R applies.
- 4.1.2 R All of *INSPRU* 4.1, except *INSPRU* 4.1.16G, applies to:
(1) an *EEA-deposit insurer*; and
(2) a *Swiss general insurer*;
but only in respect of the activities of the *firm* carried on from a *branch* in the *United Kingdom*.
- 4.1.3 R If a *firm* carries on:
(1) *long-term insurance business*; and
(2) *general insurance business*;
this section applies separately to each type of business.
- 4.1.4 R This section does not apply to:
(1) a *non-directive friendly society*; or
(2) an *incoming EEA firm*; or
(3) an *incoming Treaty firm*.

Purpose

- 4.1.5 G The purpose of this section is to amplify parts of *INSPRU* in their application to *liquidity risk* and, in so doing, to suggest minimum standards for management of that risk. The main relevant part, *SYSC* 14 (Prudential risk management and associated systems and controls), itself amplifies *Principle 3* (Management and control) and *SYSC* (Senior management arrangements, Systems and Controls).
- 4.1.6 G Appropriate management of *liquidity risk* will vary with the scale, nature and complexity of the *firm's* activities. Most of the material in this section is, therefore, *guidance*. The section lays out some of the main issues that the *FSA* expects a *firm* to consider in relation to *liquidity risk*. A *firm* should assess the appropriateness of any particular item of *guidance* in the light of the scale, nature and complexity of its activities as well as its obligations as set out in *Principle 3* to organise and control its affairs responsibly and effectively.
- 4.1.7 G For *insurers*, references to *liquidity risk* in this section are intended to cover only those aspects of *liquidity risk* that do not fall under the heading of

insurance risk. For such *firms*, the *FSA* sees the coverage of this section, broadly, as the management of risk arising from short-term cash-flows, rather than the risk arising from longer-term matching of assets and liabilities, which is part of insurance risk. *Guidance* on systems and controls for managing insurance risk is set out in *SYSC 17* (Insurance risk systems and controls).

- 4.1.8 G This section addresses the need to deal both with liquidity management issues under normal market conditions, and with stressed or extreme situations resulting from either general market turbulence or firm-specific difficulties.

Requirements

- 4.1.9 G High level requirements for prudential systems and controls including for *liquidity risk* are set out in *SYSC 14* (Prudential risk management and associated systems and controls). In particular:
- (1) *SYSC 14.1.18R* requires a *firm*, among other things, to take reasonable steps to ensure the establishment of a business plan and appropriate systems for the management of prudential risk; and
 - (2) *SYSC 14.1.19R(2)* requires a *firm*, among other things, to document its policy for managing *liquidity risk*, including its appetite or tolerance for this risk and how it identifies, measures, monitors and controls this risk.

- 4.1.10 G This section sets out *guidance* on each of these areas, and notes a number of matters which the *FSA* would expect a *firm* to deal with in its *liquidity risk* policy statement as follows:
- (1) its *liquidity risk* strategy (see *INSPRU 4.1.12G* to *INSPRU 4.1.14G*), including:
 - (a) the role of marketable, or otherwise realisable, assets (see *INSPRU 4.1.21G*); and
 - (b) its strategy for mitigating *liquidity risk* on the liability side (see *INSPRU 4.1.26G*);
 - (2) its method for measuring *liquidity risk* (see *INSPRU 4.1.44G*)

Managing liquidity risk

- 4.1.11 G This section amplifies the general requirements in *SYSC 14* by describing the key high level arrangements that the *FSA* would normally expect to be in place to ensure that a *firm's liquidity risk* management system is adequate.

Governing body and senior management oversight

- 4.1.12 G *SYSC 14.1.11G* amplifies *SYSC 2.1.1R* and *SYSC 2.1.3R* which require the apportionment, and allocation, of significant responsibilities to be such that the business and affairs of the *firm* can be adequately monitored and

controlled by the *directors*, relevant senior executives and *governing body* of the *firm*. Effective *liquidity risk* management entails an informed board, capable management and appropriate staffing. The *governing body* and senior management are responsible for understanding the nature and level of *liquidity risk* assumed by the *firm* and the tools used to manage that risk.

- 4.1.13 G In relation to *liquidity risk*, the *governing body's* responsibilities should normally include:
- (1) approving the *firm's liquidity risk* policy, which includes taking reasonable steps to ensure that it is consistent with the *firm's* expressed risk tolerance (see *INSPRU* 4.1.15G to *INSPRU* 4.1.17G);
 - (2) establishing a structure for the management of *liquidity risk* including the allocation of appropriate senior managers who have the authority and responsibility to manage *liquidity risk* effectively, including the establishment and maintenance of the *firm's liquidity risk* policy;
 - (3) monitoring the *firm's* overall *liquidity risk* profile on a regular basis and being made aware of any material changes in the *firm's* current or prospective *liquidity risk* profile; and
 - (4) taking reasonable steps to ensure that *liquidity risk* is adequately identified, measured, monitored and controlled.
- 4.1.14 G A *firm* should have an appropriate senior management structure in place to oversee the daily and long-term management of *liquidity risk* in line with the *governing body-* approved *liquidity risk* policy (see *INSPRU* 4.1.15G to *INSPRU* 4.1.17G). The *FSA* would normally expect the senior management to:
- (1) oversee the development, establishment and maintenance of procedures and practices that translate the goals, objectives and risk tolerances approved by the *governing body* into operating standards that are consistent with the *governing body's* intent and understood by the relevant members of a *firm's* personnel;
 - (2) adhere to the lines of authority and responsibility that the *governing body* has established for managing *liquidity risk*;
 - (3) oversee the establishment and maintenance of management information (see *INSPRU* 4.1.53G to *INSPRU* 4.1.55G) and other systems that identify, measure, monitor and control the *firm's liquidity risk*; and
 - (4) oversee the establishment of effective *internal controls* over the *liquidity risk* management process (see *INSPRU* 4.1.56G to *INSPRU* 4.1.68G (Controlling liquidity risk)).

Liquidity risk policy

- 4.1.15 G *SYSC* 3.2.17G gives *guidance*, which amplifies *SYSC* 3.2.6R, on the need for a *firm* to plan its business appropriately so that it is able to identify, measure, monitor and control risks of regulatory concern. A *firm* should, therefore, have an agreed policy for the day-to-day and longer term

management of *liquidity risk* which is appropriate to the nature, scale and complexity of the activities carried on.

- 4.1.16 G The *liquidity risk* policy should cover the general approach that the *firm* will take to *liquidity risk* management, including, as appropriate, various quantitative and qualitative targets. This general approach should be communicated to all relevant functions within the organisation and be included in the *firm's liquidity risk* policy statement.
- 4.1.17 G The policy for managing *liquidity risk* should cover specific aspects of *liquidity risk* management. So far as appropriate to the nature, scale and complexity of the activities carried on, such aspects might include:
- (1) the basis for managing liquidity (for example, regional or central);
 - (2) the degree of concentrations, potentially affecting *liquidity risk*, that are acceptable to the *firm*;
 - (3) a policy for managing the liability side of *liquidity risk* (see *INSPRU* 4.1.26G);
 - (4) the role of marketable, or otherwise realisable, assets (see *INSPRU* 4.1.21G);
 - (5) ways of managing both the *firm's* aggregate foreign currency liquidity needs and its needs in each individual currency;
 - (6) ways of managing market access;
 - (7) the use of *derivatives* to minimise *liquidity risk*; and
 - (8) the management of intra-day liquidity, where this is appropriate, for instance where the *firm* is a member of or participates (directly or indirectly) in a system for the intra-day settlement of payments or transactions in investments.

Identifying liquidity risk

- 4.1.18 G In order to manage *liquidity risk* successfully, a *firm* should be aware of the ways in which its activities can affect its *liquidity risk* profile, and how outside influences may affect its liquidity position. A *firm* should consider not only its current *liquidity risk*, but how existing activities may affect its *liquidity risk* profile in the future; it should also consider the implications of new products or business lines. This section identifies the main sources of *liquidity risk* and the key factors that a *firm* might consider when analysing its *liquidity risk* profile.
- 4.1.19 G The *overall financial adequacy rule* states that a *firm* must maintain overall financial resources adequate, both as to amount and quality, to ensure that there is no significant risk that its liabilities cannot be met as they fall due. The *firm* should, therefore, ensure that, overall, its financial resources are of appropriate maturity, and in a form which is sufficiently marketable or otherwise realisable, having regard to the expected timing of liabilities and the risk that liabilities may fall due earlier than expected (for which prudent

allowance must be made when assessing whether assets are of appropriate maturity or sufficiently realisable).

Asset liquidity

- 4.1.20 G A *firm's* asset portfolio can provide liquidity in three major ways:
- (a) through the maturity of an asset;
 - (b) the sale of an asset for cash; or
 - (c) the use of an asset as *collateral* to back other transactions, such as for secured borrowing (including repos), or for deposits with insureds or cedants to back insurance or *reinsurance* transactions.
- 4.1.21 G A *firm* may incur *liquidity risk* where inflows from the realisation of assets (at either maturity or time of sale) are less than anticipated because of the crystallisation of credit risk or *market risk*. Inflows arising from the renewal of secured funding, including repos, are similarly affected, if the haircut (the difference between the value of an asset and the amount lent to the *firm* by the counterparty using that security as *collateral*) required by a *firm's* counterparty is larger than anticipated (see *INSPRU* 4.1.28G).
- 4.1.22 G Asset concentrations often increase these sources of *liquidity risk*. A *firm* should, therefore, identify significant concentrations within its asset portfolio, including in relation to:
- (1) individual counterparties or related groups of counterparties;
 - (2) credit ratings of the assets in its portfolio;
 - (3) the proportion of an issue held;
 - (4) instrument types;
 - (5) geographical regions; and
 - (6) economic sectors.

Marketable assets

- 4.1.23 G Criteria for the marketability of its assets should be decided by the *firm* and may reflect the *firm's* access to, and expertise in, individual markets. In determining the appropriateness of the marketability or realisability of assets, a *firm* may take into account:
- (1) the depth and liquidity of the market, including:
 - (a) the speed with which assets may be realised;
 - (b) the likelihood and extent of forced-sale loss; and
 - (c) the potential for using the asset as *collateral* in secured funding and the size of the haircut (see *INSPRU* 4.1.18G) likely to be required by the counterparty;
 - (2) the expected date of maturity, redemption, repayment or disposal;

- (3) the proportion of an issue held;
- (4) the credit ratings of the assets;
- (5) the impact of exchange rate risk on the realised value of the asset, where assets are denominated in different currencies from its liabilities; and
- (6) where applicable, the impact on certain assets' liquidity of their use as eligible *collateral* either in open-market operations conducted by, or in real-time or other payment systems operated by, a central bank.

- 4.1.24 G The role of marketable, or otherwise realisable, assets in a *firm's liquidity risk* policy, in both normal and stressed conditions, should be set out in its *liquidity risk* policy statement.
- 4.1.25 G In considering the marketability of an asset, a *firm* should assess how its value and liquidity would be affected in a variety of scenarios (see SYSC 11 (Liquidity risk management systems and controls) at SYSC 11.1.18G, SYSC 11.1.20G, SYSC 11.1.21E and SYSC 11.1.22G).

Adjusting for the behavioural characteristics of assets

- 4.1.26 G In order to manage its *liquidity risk* effectively, a *firm* should be able to adjust for the behavioural characteristics of the repayment profiles of assets, that is how their actual behaviour may vary from that suggested by their contractual terms. Such an adjustment may be necessary in order to reduce the risk of wrongly estimating the inflows in relation to, in particular:
- (1) standby facilities or other commitments that have already been drawn down;
 - (2) retail and wholesale overdrafts;
 - (3) mortgages; and
 - (4) credit cards.
- 4.1.27 G The repayment profiles should be considered under both normal market conditions and stressed conditions resulting from either general market turbulence or *firm*-specific difficulties (see SYSC 11 (Liquidity risk management systems and controls) at SYSC 11.1.18G, SYSC 11.1.20G, SYSC 11.1.21E, SYSC 11.1.22G, SYSC 11.1.23G and SYSC 11.1.24E).

Inflows from off balance sheet items

- 4.1.28 G Where a *firm* has in place a committed facility for the provision of a portion of its funding, it should take care to monitor any covenants included in the agreement. It should also make efforts to retain a good relationship with the provider of the facility and, where possible without jeopardising that relationship, regularly test access to the funds. A *firm* should also assess the extent to which committed facilities can be relied upon under stressed

conditions (see SYSC 11.1.22G and SYSC 11.1.24E).

Liability liquidity

- 4.1.29 G Holding marketable, or otherwise realisable, assets is not the only way for a *firm* to mitigate the *liquidity risk* it faces. There are a number of liability-side strategies that can be used to reduce a *firm's liquidity risk*, such as ensuring a spread of maturities and lengthening the term structure of its liabilities. In order to manage its *liquidity risk* effectively a *firm* should have a liability-side policy that is appropriate to the nature and scale of its activities; this policy should be described in its *liquidity risk* policy statement.
- 4.1.30 G When determining the appropriate mix of liabilities, a *firm's* management should consider potential concentrations. A concentration exists when a single decision or factor could cause a significant and sudden claim on liabilities. What constitutes a liability concentration depends on the nature and scale of a *firm's* activities. A *firm* should, however, normally consider:
- (1) the term structure of its liabilities;
 - (2) the credit-sensitivity of its liabilities;
 - (3) the mix of secured and unsecured funding;
 - (4) concentrations among its liability providers, or related groups of liability providers;
 - (5) reliance on particular instruments or products;
 - (6) the geographical location of liability providers; and
 - (7) reliance on intra-group funding.
- 4.1.31 G A *firm* with credit-sensitive liabilities should be aware that, in times of market turbulence, a proportion of that funding may be withdrawn, particularly funding which is unsecured. Secured funding may also be affected, with counterparties seeking better quality *collateral* or larger haircuts (see INSPRU 4.1.18G) on *collateral*. A *firm* should recognise these characteristics of its credit-sensitive liabilities and take account of them in its stress testing and scenario analysis and *contingency funding plan* (see SYSC 11 (Liquidity risk management systems and controls) at SYSC 11.1.18G, SYSC 11.1.20G, SYSC 11.1.21E, SYSC 11.1.22G, SYSC 11.1.23G and SYSC 11.1.24E).
- 4.1.32 G A *firm* should consider the dynamics of its *liquidity risk* including, for example, the normal level of roll-overs, and growth, of liabilities.

Adjusting for the behavioural characteristics of liabilities

- 4.1.33 G In order to meet the requirement to maintain sufficient liquid financial resources (see INSPRU 4.1.16G), a *firm* should consider the behavioural

characteristics of its liabilities, that is how their actual behaviour may vary from that suggested by their contractual terms.

- 4.1.34 G In assessing how to adjust for the behavioural characteristics of its liabilities in the context of *liquidity risk*, an *insurer* may take into account:
- (1) the type of *insurance business*;
 - (2) the past history of volatility in the pattern of *claims* payment;
 - (3) options available to *policyholders* and the circumstances in which they are likely to be exercised;
 - (4) options available to the *insurer* and any incentive for the *insurer* to exercise them;
 - (5) any relevant requirements to deposit *collateral* either with the insured (or cedants) under the terms of the insurance Treaty or by requirements of overseas regulators as a condition for covering risks in a particular territory; and
 - (6) the other cash flow needs of the business.

Outflows from off balance sheet items

- 4.1.35 G The contingent or optional nature of many off balance sheet instruments adds to the complexity of managing off balance sheet cash flows. In particular, in stressed conditions off balance sheet commitments may be a significant drain on liquidity.
- 4.1.36 G A *firm* should consider how its wholesale off balance sheet activities affect its cash flows and *liquidity risk* profile under both normal and stressed conditions. In particular, as appropriate, it should consider the amount of funding required by:
- (1) commitments given;
 - (2) standby facilities given;
 - (3) wholesale overdraft facilities given;
 - (4) proprietary *derivatives* positions; and
 - (5) liquidity facilities given for securitisation transactions.
- 4.1.37 G Similarly, a *firm* with retail *customers* should be able to assess the likely draw-down on retail products under a variety of circumstances and taking into account seasonal factors. In particular, as appropriate, it should consider the amount of funding required in relation to:
- (1) mortgages that have been agreed but not yet drawn down;
 - (2) overdrafts; and
 - (3) credit cards.

Asset securitisations

- 4.1.38 G If controlled properly, asset securitisation can be a useful tool in enhancing a *firm's* liquidity. However, features of certain securitisations, such as early amortisation triggers, as well as excessive reliance on a single funding vehicle, can increase *liquidity risk*.
- 4.1.39 G The implications of securitisations on a *firm's* liquidity position should be considered for both day-to-day liquidity management and its contingency planning for *liquidity risk*. A contemplated securitisation should be analysed for its impact on *liquidity risk*. A *firm* using securitisation should consider:
- (1) the volume of securities issued in connection with the securitisation that are scheduled to amortise during any particular period;
 - (2) the existence of early amortisation triggers (see also SYSC 11.1.22G);
 - (3) its plans for meeting its funding requirements (including their timing);
 - (4) strategies for obtaining substantial amounts of liquidity at short notice (see also SYSC 11.1.24E); and
 - (5) operational issues associated with the rollover of short-dated securities, particularly commercial paper.
- 4.1.40 G If a *firm* is a provider of liquidity facilities for securitisation transactions it should be able to assess the probability and scale of draw-down and make provision for it.
- 4.1.41 G A *firm* using securitisation should also be aware that its ability to securitise assets may diminish in stressed market conditions and take account of this in its stress testing and *contingency funding plan*. In addition, the time taken to organise a securitisation transaction may mean that it cannot be relied upon to provide liquidity at short notice.

Foreign currency liquidity

- 4.1.42 G Foreign currency *liquidity risk* arises where a *firm* faces actual or potential future outflows in a particular currency which it may not be able to meet from likely available inflows in that currency. A *firm's* exposure to foreign currency *liquidity risk* depends on the nature, scale and complexity of its business. Where a *firm* has significant, unhedged liquidity mismatches in particular currencies, it should consider:
- (1) the volatilities of the exchange rates of the mismatched currencies;
 - (2) likely access to the foreign exchange markets in normal and stressed conditions; and
 - (3) the stickiness of deposits in those currencies with the *firm* in stressed conditions.

- 4.1.43 G A possible strategy for mitigating foreign currency *liquidity risk*, which is effective and simple, is for a *firm* to hold assets in a particular currency in an amount equal to, and realisable at maturities no later than, its liabilities in that currency. This strategy may be worth considering particularly where, as a result of the nature, scale and complexity of its business, a *firm's liquidity risk* is relatively small.

Intra-day liquidity

- 4.1.44 G *SYSC 3.1.1R* requires a *firm* to take reasonable care to establish and maintain systems and controls appropriate to its business. This includes appropriate systems and controls over activities that give rise to significant *market, credit, liquidity, insurance, operational or group risk*, including over the processes of settling and paying debts and other commitments that arise from those activities.
- 4.1.45 G Structural and operational changes in payment systems have increased the importance of intra-day liquidity for many *firms*. Within real time gross settlement systems, for example, a *firm* needs to take appropriate steps to ensure that it has sufficient *collateral* to cover cash positions and has systems capable of monitoring intra-day liquidity positions and cash needs.
- 4.1.46 G A *firm* should be aware that in stressed conditions it is likely to require more intra-day liquidity than in normal market conditions, for a variety of reasons including payments due to the *firm* being delayed and wholesale depositors withdrawing from the market. A *firm* should take account of this in its stress testing and scenario analysis.

Measuring liquidity risk

- 4.1.47 G A *firm* should establish and maintain a process for the measurement of *liquidity risk*, using a robust and consistent method which should be described in its *liquidity risk* policy statement.
- 4.1.48 G A number of techniques can be used for measuring *liquidity risk*, ranging from simple calculations to highly sophisticated modelling; a *firm* should use a measurement method which is appropriate to the nature, scale and complexity of its activities.
- 4.1.49 G The method that a *firm* uses for measuring *liquidity risk* should be capable of:
- (1) measuring the extent of the *liquidity risk* it is incurring;
 - (2) dealing with the dynamic aspects of a *firm's* liquidity profile (for example, rollovers of funding and assets or new business);
 - (3) assessing the behavioural characteristics of its on and off balance sheet instruments; and

(4) where appropriate, measuring the *firm's* exposure to foreign currency *liquidity risk*.

Monitoring liquidity risk

- 4.1.50 G A *firm* should establish and maintain an appropriate system for monitoring its *liquidity risk*, which should be described in its *liquidity risk* policy statement.
- 4.1.51 G A *firm* should establish and maintain a system of management reporting which provides clear, concise, timely and accurate *liquidity risk* reports to relevant functions within the *firm*. These reports should alert management when the *firm* approaches, or breaches, predefined thresholds or limits, including quantitative limits imposed by the *FSA* or another regulator.
- 4.1.52 G Where a *firm* is a member of a *group*, it should be able to assess the potential impact on it of *liquidity risk* arising in other parts of the *group*.

Management information systems

- 4.1.53 G A *firm* should have adequate information systems for controlling and reporting *liquidity risk*. The management information system should be used to check for compliance with the *firm's* established policies, procedures and limits.
- 4.1.54 G Reports on *liquidity risk* should be provided on a timely basis to the *firm's* governing body, senior management and other appropriate personnel. The appropriate content and format of reports depends on a *firm's* liquidity management practices and the nature, scale and complexity of the *firm's* business. Reports to the *firm's* governing body may be less detailed and less frequent than reports to senior management with responsibility for managing *liquidity risk*.
- 4.1.55 G When considering what else might be included in *liquidity risk* management information, a *firm* should consider other types of information that may be important for understanding its *liquidity risk* profile.

Controlling liquidity risk

- 4.1.56 G A *firm* should establish and maintain an appropriate system for controlling its *liquidity risk*, which should be described in its *liquidity risk* policy statement. Such a system should allow the *firm's* governing body and senior management to review compliance with established limits and operating procedures.
- 4.1.57 G A *firm* should have in place appropriate approval processes, limits and other mechanisms designed to provide reasonable assurance that the *firm's*

liquidity risk management processes are adhered to.

- 4.1.58 G When revisions or enhancements to *internal controls* are warranted, a *firm* should implement them in a timely manner.
- 4.1.59 G The effectiveness of a *firm's liquidity risk* management system should be regularly reviewed and evaluated by individuals unconnected with day-to-day *liquidity risk* management in order to check that personnel are following established policies and procedures, and that procedures accomplish the intended objectives.
- 4.1.60 G In addition to the regular review and evaluation described in *INSPRU* 4.1.59G, a *firm's* internal audit function should periodically review the *liquidity risk* management process in order to identify any weaknesses or problems. Any weaknesses should be addressed by management in a timely and effective manner.

Limit Setting

- 4.1.61 G A *firm's* senior management should decide what limits need to be set, in accordance with the nature, scale and complexity of its activities. The structure of limits should reflect the need for a *firm* to have systems and controls in place to guard against a spectrum of possible risks, from those arising in day-to-day *liquidity risk* management to those arising in stressed conditions.
- 4.1.62 G *SYSC* 14.1.18R states that a *firm* must take reasonable steps to ensure the establishment and maintenance of a business plan and appropriate systems for the management of prudential risk.
- 4.1.63 E (1) If a *firm* has *liquidity risk* that arises because it has substantial exposures in foreign currencies, the risk management systems of the *firm* referred to in *SYSC* 14.1.18R should include systems and procedures that are designed to ensure that the *firm* does not, except in accordance with those procedures, exceed limits that are designed to limit:
- (a) the aggregate amount of its *liquidity risk* for all exposures in foreign currencies; and
- (b) the amount of its *liquidity risk* for each individual currency in which it has a significant exposure.
- (2) Contravention of (1) may be relied upon as tending to establish contravention of *SYSC* 14.1.18R.
- 4.1.64 G A *firm* should periodically review and, where appropriate, adjust its limits when conditions or risk tolerances change.

- 4.1.65 G Policy or limit exceptions should receive the prompt attention of the appropriate management and should be resolved according to processes described in approved policies.

Managing market access

- 4.1.66 G A *firm* should periodically review its efforts to establish and maintain relationships with liability providers, to maintain adequate diversification of liabilities, and to ensure adequate capacity to sell assets, or use them as *collateral* in secured funding. Where possible the *firm* should aim regularly to test its access to the individual markets in assets that it holds for liquidity purposes.

- 4.1.67 G Market access should be assessed under a variety of normal and stressed conditions.

- 4.1.68 G In some circumstances, the disclosure of information about a *firm* may be useful in managing the public perception of its organisation and soundness. A *firm* should consider the role of disclosure in managing the *liquidity risk* to which it is exposed.

Application of INSPRU 4.1 to Lloyd's

- 4.1.69 G *INSPRU* 4.1 applies to *managing agents* and to the *Society* in accordance with:

- (1) for *managing agents*, *INSPRU* 8.1.4R; and
- (2) for the *Society*, *INSPRU* 8.1.2R

- 4.1.70 G In accordance with *INSPRU* 8.6.2R, the *rules* and *guidance* in *INSPRU* 4.1 relating to the establishment and maintenance of a business plan do not apply to the *Society*.

5.1 Operational Risk Management

Application

5.1.1 G *INSPRU* 5.1 applies to an *insurer* unless it is:

- (1) a *non-directive friendly society*; or
- (2) an *incoming EEA firm*; or
- (3) an *incoming Treaty firm*.

5.1.2 G *INSPRU* 5.1 applies to:

- (1) an *EEA-deposit insurer*; and
- (2) a *Swiss general insurer*;

only in respect of the activities of the *firm* carried on from a *branch* in the *United Kingdom*.

Purpose

5.1.3 G This section provides *guidance* on how to interpret *SYSC* 14.1.18R and *SYSC* 14.1.19R(2) (which relate to the design and documentation of risk management systems) in so far as they relate to the management of operational risk in a *prudential context*. Operational risk has been described by the Basel Committee on Banking Supervision as "the risk of loss, resulting from inadequate or failed internal processes, people and systems, or from external events". Thus this section covers management of risks concerning any of the *firm's* operations, whether caused by internal or external matters. However, it does not cover management of credit, market, liquidity and insurance risk. Examples of operational risk exposures that this section is meant to address include internal and external fraud; failure to comply with employment law or meet workplace safety standards; damage to physical assets; business disruptions and system failures; and transaction processing failures.

5.1.4 G Operational risk concerns the *FSA* in a *prudential context* because inappropriate management of operational risk can adversely affect the solvency or business continuity of a *firm*, threatening the *regulatory objectives* of market confidence and consumer protection.

5.1.5 G This section contains *guidance* on how a *firm* should determine, in a *prudential context*, its policy for operational risk management and its processes for the identification, assessment, monitoring and control of operational risk. In addition, *guidance* is provided on record keeping in relation to operational risk.

5.1.6 G The *guidance* contained within this section is not designed to be exhaustive. When establishing and maintaining its systems and controls for operational risk, a *firm* should have regard to other parts of the *Handbook* as well as the material that is issued by other industry or regulatory bodies. In particular, a *firm* should read this section in conjunction with SYSC 3A (Operational Risk Systems and Controls) which contains high level *guidance* on the management of people, processes and systems, and external events in relation to operational risk. SYSC 3A also outlines some *guidance* on the areas that are covered by operational risk systems and controls (including the *FSA's* interpretation of some frequently used risk management terms in relation to operational risk), business continuity management, outsourcing, and the role of insurance in financing operational risk. In addition, a *firm* should read SYSC 14, which contains the *FSA's* general policy on prudential systems and controls. SYSC 14 contains some *rules* and *guidance* on which this section offers additional *guidance*.

5.1.7 G *Guidance* on the application of this section to a *firm* that is a member of a *group* is provided in SYSC 12 (Group Risk Systems and Controls).

5.1.8 G Appropriate management of operational risk will vary with the scale, nature and complexity of a *firm's* activities. Therefore the material in this section is *guidance*. A *firm* should assess the appropriateness of any particular item of *guidance* in the light of the scale, nature and complexity of its activities as well as its obligations as set out in *Principle 3* to organise and control its affairs responsibly and effectively.

Operational risk policy

5.1.9 G Much of the management of operational risk is about identifying, assessing, monitoring and controlling failures or inadequacies in a *firm's* systems and controls. As such, a *firm* may often find that there is no clear boundary between its risk management systems for operational risk and all its other systems and controls. When drafting its operational risk policy, a *firm* should try to distinguish between its systems and controls for credit, market, liquidity and insurance risk, and its systems and controls for operational risk. Where such a distinction is not possible a *firm* should still try to identify those systems and controls that are used in the management of operational risk, even when they have other purposes as well.

5.1.10 G A *firm* should document its policy for managing operational risk. This policy should outline a *firm's* strategy and objectives for operational risk management and the processes that it intends to adopt to achieve these objectives. In complying with SYSC 14.1.19R(2), the documented operational risk policy of a *firm* should include:

(1) an analysis of the *firm's* operational risk profile (see the *FSA's* interpretation of this term in SYSC 3A.5.1G(3)), including where relevant some consideration of the effects that operational risk may have on the firm, including consideration of those operational risks within a *firm* that may

have an adverse impact upon the quality of service afforded to its *clients*;

(2) the operational risks that the *firm* is prepared to accept and those that it is not prepared to accept, including where relevant some consideration of its appetite or tolerance (see *INSPRU* 5.1.12G) for specific operational risks;

(3) how the *firm* intends to identify, assess, monitor, and control its operational risks, including an overview of the people, processes and systems that are used; and

(4) where assessments of the *firm's* risk exposures are used for internal capital allocation purposes, a description of how operational risk is incorporated into this methodology.

5.1.11 G A *firm* may also wish to set threshold levels in its operational risk policy for particular types of operational risk (based on its risk appetite or tolerance for risk), which when exceeded trigger a response (such as the allocation of more resources to control the risk or a reappraisal of business plans).

5.1.12 G Given its association with a willingness to take risk, a *firm* may wish to replace the term appetite for tolerance when drafting its operational risk policy. Tolerance describes the types and degree of operational risk that a *firm* is prepared to incur (based on factors such as the adequacy of its resources and the nature of its operating environment). Tolerance may be described in terms of the maximum budgeted (that is, expected) costs of an operational risk that a *firm* is prepared to bear, or by reference to risk indicators such as the cost or number of system failures, available spare capacity and the number of failed trades.

5.1.13 G The term risk assessment can be used to represent both the qualitative and quantitative evaluation or measurement of operational exposures.

Risk identification

5.1.14 G In order to understand its operational risk profile, a *firm* should identify the types of operational risk that it is exposed to as far as reasonably possible. This might include, but is not limited to, consideration of:

(1) the nature of a *firm's customers*, products and activities, including sources of business, distribution mechanisms, and the complexity and volumes of transactions;

(2) the design, implementation, and operation of the processes and systems used in the end-to-end operating cycle for a *firm's* products and activities;

(3) the risk culture and human resource management practices at a *firm*; and

(4) the business operating environment, including political, legal, socio-demographic, technological, and economic factors as well as the competitive environment and market structure.

5.1.15 G A *firm* should recognise that it may face significant operational exposures from a product or activity that may not be material to its business strategy.

A *firm* should consider the appropriate level of detail at which risk identification is to take place, and may wish to manage the operational risks that it faces in risk categories that are appropriate to its organisational and legal structures.

- 5.1.16 G The *FSA's* interpretation of the term operational exposure is provided in *SYSC 3A.5.1G(2)*.
- Risk assessment
- 5.1.17 G The *FSA* recognises that risk management systems for operational risk are still developing, and that it may be neither feasible nor appropriate to measure certain types of operational risk in a quantitative way. A *firm* may wish to take a qualitative approach to the assessment of its operational risks using, for example, relative estimates (such as high, medium, low) to understand its exposure to them.
- 5.1.18 G In order to understand the effects of its operational exposures a *firm* should continually assess its operational risks. This might include, but is not limited to, consideration of:
- (1) actual operational losses that have occurred within a *firm*, or events that could have resulted in significant operational losses, but were avoided (for example, the waiving of financial penalties by a third party as a gesture of goodwill or where by chance the *firm* realised profits);
 - (2) internal assessment of risks inherent in its operations and the effectiveness of controls implemented to reduce these risks (through activities such as self-assessment or stress testing and scenario analysis);
 - (3) other risk indicators, such as *customer* complaints, processing volumes, *employee* turnover, large numbers of reconciling items, process or system failures, fragmented systems, systems subject to a high degree of manual intervention and transactions processed outside a *firm's* mainstream systems;
 - (4) reported external (peer) operational losses and exposures; and
 - (5) changes in its business operating environment.
- 5.1.19 G When assessing its operational risks, a *firm* may be able to differentiate between expected and unexpected operational losses. A *firm* should consider whether it is appropriate to adopt a more quantitative approach to the assessment of its expected operational losses, for example by defining tolerance, setting thresholds, and measuring and monitoring operational losses and exposures. In contrast, a *firm* may wish to take a more qualitative approach to assessing its unexpected losses.
- 5.1.20 G Although a *firm* may currently be unable to assess certain operational risks with a high degree of accuracy or consistency, it should, according to the nature, scale and complexity of its business, consider the use of more sophisticated qualitative and quantitative techniques as they become

available.

Risk monitoring

- 5.1.21 G In monitoring its operational risks, a *firm* should:
- (1) as appropriate, regularly report to the relevant level of management its operational exposures, loss experience (including if possible cumulative losses), and authorised deviations from the *firm's* operational risk policy;
 - (2) engage in exception-based escalation to management of:
 - (a) unauthorised deviations from the *firm's* operational risk policy;
 - (b) likely or actual breaches in predefined thresholds for operational exposures and losses, where set; and
 - (c) significant increases in the *firm's* exposure to operational risk or alterations to its operational risk profile.

Risk control

- 5.1.22 G A *firm* should control its operational risks, as appropriate, through activities for the avoidance, transfer, prevention or reduction of the likelihood of occurrence or potential impact of an operational exposure. This might include, but is not limited to, consideration of:
- (1) adjusting a *firm's* risk culture and creating appropriate incentives to facilitate the implementation of its risk control strategy (see SYSC 3A.6 People);
 - (2) adapting internal processes and systems (see SYSC 3A.7 Processes and systems);
 - (3) transferring or changing the operational exposure through mechanisms such as *outsourcing* (see SYSC 3A.9 Outsourcing) and insurance (see SYSC 3A.10 Insurance);
 - (4) the active acceptance of a given operational risk within the *firm's* stated risk appetite or tolerance; and
 - (5) providing for expected losses, and maintaining adequate financial resources against unexpected losses that may be encountered in the normal course of a *firm's* business activities.

Record keeping

- 5.1.23 G The *FSA's* high level *rules* and *guidance* for record keeping are outlined in SYSC 3.2.20R (Records). Additional *rules* and *guidance* in relation to the *prudential context* are set out in SYSC 14.1.51G to SYSC 14.1.64G (Record keeping). In complying with these *rules* and all associated *guidance*, a *firm* should retain an appropriate record of its operational risk management activities. This may, for example, include records of:
- (1) the results of risk identification, measurement, and monitoring activities;

- (2) actions taken to control identified risks;
- (3) where relevant, any exposure thresholds that have been set for identified operational risks;
- (4) an assessment of the effectiveness of the risk control tools that are used; and
- (5) actual exposures against stated risk appetite or tolerance.

Application of INSPRU 5.1 to Lloyd's

- 5.1.24 G *INSPRU* 5.1 applies to *managing agents* and to the *Society* in accordance with:
 - (1) for *managing agents*, *INSPRU* 8.1.4R; and
 - (2) for the *Society*, *INSPRU* 8.1.2R
- 5.1.25 G In accordance with *INSPRU* 8.5.2R, the *rules* and *guidance* in *INSPRU* 5.1 relating to the establishment and maintenance of a business plan do not apply to the *Society*.

6.1 Group Risk: Insurance Groups

Application

- 6.1.1 R *INSPRU* 6.1 applies to an *insurer* that is either:
- (1) a *participating insurance undertaking*; or
 - (2) a member of an *insurance group* which is not a *participating insurance undertaking* and which is not:
 - (a) a *non-EEA insurer*; or
 - (b) a *friendly society*.
- 6.1.2 R *INSPRU* 6.1 does not apply to:
- (1) a *non-directive friendly society*; or
 - (2) a *Swiss general insurer*; or
 - (3) an *EEA-deposit insurer*; or
 - (4) an *incoming EEA firm*; or
 - (5) an *incoming Treaty firm*.
- 6.1.3 G *INSPRU* 6.1 applies to a *firm*:
- (1) on a solo basis, as an adjusted solo calculation, where that *firm* is a *participating insurance undertaking*; and
 - (2) on a group basis where that *firm* is a member of an *insurance group*.
- 6.1.4 G For the purposes of *INSPRU* 6.1, an *insurer* includes a *friendly society* (other than a *non-directive friendly society*) and a *non-EEA insurer*.
- ### Purpose
- 6.1.5 G The purpose of this section is to implement the *Insurance Groups Directive* on supplementary supervision of *firms* in an *insurance group*, as amended by the *Financial Groups Directive* and the *Reinsurance Directive*. The *Financial Groups Directive* (by amending the *Insurance Directives* and the *Insurance Groups Directive*) introduces specific requirements for the treatment of *related undertakings* of an *insurance parent undertaking* or a *participating insurance undertaking* that are *credit institutions*, *investment firms* or *financial institutions*. The *Reinsurance Directive* (by amending the *Insurance Directives* and the *Insurance Groups Directive*) introduces supplementary supervision for *firms* that are *reinsurance undertakings* in an *insurance group*.
- 6.1.6 G *INSPRU* 6.1 sets out the *sectoral rules* for *insurers* for:
- (1) *firms* that are *participating insurance undertakings* carrying out an adjusted solo calculation as contemplated by *GENPRU* 2.1.13R(2);
 - (2) *insurance groups*; and
 - (3) *insurance conglomerates*.

- 6.1.6A G In accordance with the definition, an *insurance holding company* ceases to be an *insurance holding company* if:
- (1) it is a *mixed financial holding company*; and
 - (2) notice has been given in accordance with Article 4(2) of the *Financial Groups Directive* that the *financial conglomerate* of which it is a *mixed financial holding company* is a *financial conglomerate*;
- otherwise it remains an *insurance holding company* for the purposes of this chapter.
- 6.1.7 G For a *firm* that is a *participating insurance undertaking*, the rules in *INSPRU* 6.1 out the minimum capital adequacy requirements for the *firm* itself. A *firm* that satisfies the test in *INSPRU* 6.1.9R in relation to its *group capital resources* is deemed by *GENPRU* 2.1.13R(2) to be in compliance with the capital adequacy requirement set out in *GENPRU* 2.1.13R(1).
- Requirement to calculate GCR and GCRR
- 6.1.8 R A *firm* must on a regular basis calculate the *group capital resources (GCR)* and *group capital resources requirement (GCRR)* of each *undertaking* referred to in *INSPRU* 6.1.17R.
- Requirement to maintain group capital
- 6.1.9 R Where a *firm* is the *undertaking* referred to in *INSPRU* 6.1.17R(1)(c) or *INSPRU* 6.1.17R(2), it must maintain at all times *tier one capital resources* and *tier two capital resources* of such an amount that its *group capital resources* are equal to or exceed its *group capital resources requirement*.
- 6.1.10 R A *firm* that is both:
- (1) a *composite firm*; and
 - (2) an *undertaking* referred to in *INSPRU* 6.1.17R(1)(c) or *INSPRU* 6.1.17R(2);
- must comply with *INSPRU* 6.1.9R separately in respect of its *long-term insurance business* and its *general insurance business*.
- 6.1.11 R For the purposes of *INSPRU* 6.1.10R, a *firm* must include in the calculation of the *group capital resources* and *group capital resources requirement* of its *long-term insurance business* the *regulated related undertakings* and *ancillary services undertakings* that are *long-term insurance assets*.
- 6.1.12 G *INSPRU* 1.5 sets out the detailed requirements for the separation of *long-term* and *general insurance business*.
- 6.1.13 G In order to comply with *INSPRU* 6.1.10R, a *composite firm* will need to:
- (1) establish the *group capital resources requirement* of its *general insurance business* and its *long-term insurance business* separately; and
 - (2) allocate its *group capital resources* between its *general insurance business* and its *long-term insurance business* so that:

(a) the *group capital resources* allocated to its *general insurance business* are equal to or in excess of the *group capital resources requirement* of its *general insurance business*; and

(b) the *group capital resources* allocated to its *long-term insurance business* are equal to or in excess of the *group capital resources requirement* of its *long-term insurance business*.

6.1.14 G Surplus *group capital resources* in the *long-term insurance business* cannot be used towards meeting the requirements of the *general insurance business* (see *INSPRU* 6.1.41R) but surplus *group capital resources* in the *general insurance business* may be used towards meeting the amount of the *group capital resources requirement* that relates to the *long-term insurance business*.

6.1.15 R (1) Subject to *INSPRU* 6.1.27R, a *firm* must ensure that at all times its *capital resources* are of such an amount that the *group capital resources* of each *undertaking* referred to in *INSPRU* 6.1.17R (excluding those referred to in *INSPRU* 6.1.9R) are equal to or exceed that *undertaking's group capital resources requirement*.

(2) (1) does not apply to a *pure reinsurer* which became a *firm in run-off* before 10 December 2007 and whose *Part IV permission* has not subsequently been varied to add back the *regulated activity* of *effecting contracts of insurance*.

6.1.16 G *Principle 4* requires a *firm* to maintain adequate financial resources, taking into account any activity of other members of the *group* of which the *firm* is a member. *INSPRU* 6.1 sets out provisions that deal specifically with the way the activities of other members of the *group* should be taken into account. This results in the *firm* being required to hold sufficient capital resources so that the *group capital resources* are at least equal to the *group capital resources requirement*. However, the adequacy of the *group capital resources* needs to be assessed both by the *firm* and the *FSA*. *Firms* are required to carry out an assessment of the adequacy of their financial resources under the *overall financial adequacy rule*, the *overall Pillar 2 rule* and *GENPRU* 1.2.39R, and the *FSA* will review this and may provide individual guidance on the amount and quality of *capital resources* the *FSA* considers adequate. As part of such reviews, the *FSA* may also form a view on the appropriateness of the *group capital resources requirement* and *group capital resources*. Where necessary, the *FSA* may also give individual guidance on the *capital resources* a *firm* should hold in order to comply with *Principle 4* expressed by reference to *INSPRU* 6.1.9R and *INSPRU* 6.1.15R.

Scope - undertakings whose group capital is to be calculated and maintained

6.1.17 R The *undertakings* referred to in *INSPRU* 6.1.8R, *INSPRU* 6.1.9R, *INSPRU* 6.1.10R and *INSPRU* 6.1.15R are:

(1) for any *firm* that is not within (2), each of the following:

(a) its *ultimate insurance parent undertaking*;

- (b) its *ultimate EEA insurance parent undertaking* (if different); and
- (c) the *firm* itself, if it is a *participating insurance undertaking*; and
- (2) the *firm* itself, where the *firm* is a *participating insurance undertaking* and is:
 - (a) a *non-EEA insurer*; or
 - (b) a *friendly society*.

- 6.1.18 G Article 3(3) of the *Insurance Groups Directive* allows an *undertaking* to be excluded from supplementary supervision if:
- (1) its head office is in a *non-EEA State* where there are legal impediments to the transfer of the necessary information; or
 - (2) in the opinion of the *competent authority* responsible for exercising supplementary supervision, having regard to the objectives of supplementary supervision:
 - (a) its inclusion would be inappropriate or misleading; or
 - (b) it is of negligible interest.
- 6.1.19 G If an application is made for a *waiver*, it is the policy of the *FSA* to consider the effect, in the circumstances described in *INSPRU* 6.1.18G, of granting a *waiver* allowing the exclusion of a *related undertaking* from the calculation of *group capital resources* and the *group capital resources requirement* required by *INSPRU* 6.1.8R.
- 6.1.20 G Examples of *related undertakings* which may be excluded from supplementary supervision by Article 3(3) of the *Insurance Groups Directive* include *insurance holding companies* in the *insurance group* that are not the *ultimate insurance parent undertaking* or, if different, the *ultimate EEA insurance parent undertaking* of a *firm*.
- 6.1.21 G If more than one member of the *insurance group* is to be excluded in the circumstances described in *INSPRU* 6.1.18G (2)(b), they may only be excluded if, considered together, they are of negligible interest in the context of the *insurance group*.
- 6.1.22 G When giving a *waiver* in the circumstances described in *INSPRU* 6.1.18G, the *FSA* may impose a condition requiring the *firm* to provide information about any member of the *insurance group* excluded pursuant to a *waiver* granted in the circumstances described in *INSPRU* 6.1.18G.
- Optional alternative method of calculation for firms subject to supplementary supervision by another EEA competent authority
- 6.1.23 R If the *competent authority* in an *EEA State* other than the *United Kingdom* has agreed to be the *competent authority* responsible for exercising supplementary supervision of an *insurance group* of which a *firm* is a member under Article 4(2) of the *Insurance Groups Directive*, the *firm* may prepare the calculations required under *INSPRU* 6.1.8R in relation to the *ultimate EEA insurance parent undertaking* in accordance with the requirements of supplementary supervision in that *EEA State*.

6.1.24 G The *FSA* will notify the *firm* if it has reached agreement with the *competent authority* in an *EEA State* other than the *United Kingdom* in accordance with Article 4(2) of the *Insurance Groups Directive*.

Non-EEA ultimate insurance parent undertakings

6.1.25 R Where the *ultimate insurance parent undertaking* of a *firm* has its head office in a non-*EEA State*, the *firm* may:

(1) calculate the *group capital resources* and the *group capital resources requirement* of its *ultimate insurance parent undertaking* in accordance with accounting practice applicable for the purposes of the regulation of *insurance undertakings* in the state or territory of the head office of the *ultimate insurance parent undertaking* adapted as necessary to apply the general principles set out in Annex I (1) paragraphs B, C and D of the *Insurance Groups Directive*; and

(2) elect (see *INSPRU* 6.1.26R) to carry out the calculation referred to in (1) in accordance with the accounting consolidation method set out in Annex I (3) of the *Insurance Groups Directive*.

6.1.26 R A *firm* may elect to use the calculation method referred to in *INSPRU* 6.1.25R(2) if it has made the election by written notice to the *FSA* in a way that complies with the requirements for written notice in SUP 15.7.

6.1.27 R *INSPRU* 6.1.15R does not apply in respect of the *group capital resources* of a *firm's ultimate insurance parent undertaking* if that *ultimate insurance parent undertaking* has its head office in a non-*EEA State*.

Proportional holdings

6.1.28 R Subject to *INSPRU* 6.1.30R and *INSPRU* 6.1.31R, when calculating *group capital resources* and the *group capital resources requirement* of an *undertaking* in *INSPRU* 6.1.17R, a *firm* must take only the relevant proportion of the following items ("calculation items") into account:

(1) the *solo capital resources* of a *regulated related undertaking*;

(2) the assets of a *regulated related undertaking* which are required to be deducted as part of the calculation of *group capital resources*; and

(3) the *individual capital resources requirement* of a *regulated related undertaking*.

6.1.29 R In *INSPRU* 6.1.28R, the relevant proportion is either:

(1) the proportion of the total number of issued *shares* in the *regulated related undertaking* held, directly or indirectly, by the *undertaking* in PRU 8.3.17 R; or

(2) where a *consolidation Article 12(1) relationship* exists between *related undertakings* within the *insurance group*, such proportion as the *FSA* determines in accordance with Article 28(5) of the *Financial Groups Directive* and Regulation 15 of the *Financial Groups Directive Regulations*.

6.1.30 R Where the *undertaking* in *INSPRU* 6.1.17R is a *firm*, if the *individual*

capital resources requirement of a *regulated related undertaking* that is a *subsidiary undertaking* and not an *insurer* exceeds the *solo capital resources* of that *undertaking* less the amount calculated in *INSPRU 6.1.74R (3)* (if any), the full amount of the calculation items of that *regulated related undertaking* less the amount in *INSPRU 6.1.74R (3)* must be taken into account in the calculation of *group capital resources* and the *group capital resources requirement*.

- 6.1.31 R Except where *INSPRU 6.1.30R* applies, if the *individual capital resources requirement* of a *regulated related undertaking* that is a *subsidiary undertaking* of the undertaking in *INSPRU 6.1.17R* exceeds its *solo capital resources*, the full amount of the calculation items of that *regulated related undertaking* must be taken into account in the calculation of *group capital resources* and the *group capital resources requirement*.
- 6.1.32 R For the purposes of *INSPRU 6.1.10R*, where a *composite firm* that is an *undertaking* in *INSPRU 6.1.17R (1)(c)* or (2):
- (1) holds directly or indirectly *shares* in a *regulated related undertaking*; and
 - (2) the *shares* in (1) are held partly by its *long-term insurance business* and partly by its *general insurance business*;
 - (3) the relevant proportion of the calculation items calculated in accordance with *INSPRU 6.1.29R*, subject to *INSPRU 6.1.30R* and *INSPRU 6.1.31R*, must be allocated between the *long-term* and *general insurance business* in proportion to their respective holdings, directly or indirectly, in the *shares* in that *regulated related undertaking*.

Calculation of the GCRR

- 6.1.33 R Subject to *INSPRU 6.1.23R* and *INSPRU 6.1.25R*, a *firm* must calculate the *group capital resources requirement* of an *undertaking* in *INSPRU 6.1.17R* as the sum of the *individual capital resources requirement* of that *undertaking* and the *individual capital resources requirement* of each of its *regulated related undertakings*.
- 6.1.34 R For the purposes of *INSPRU 6.1*, an *individual capital resources requirement* is:
- (1) in respect of any *insurer*:
 - (a) its *capital resources requirement* calculated in accordance with *GENPRU 2.1*; less
 - (b) where the *capital resources requirements* of both the *insurer* and its *insurance parent undertaking* that is an *insurer* include *with-profits insurance capital components*, any element of double-counting that may arise from the aggregation of the *individual capital resources requirements* for the purposes of *INSPRU 6.1.33R*;
 - (2) in respect of an *EEA insurer* (other than an *EEA pure reinsurer*), the equivalent of the *capital resources requirement* as calculated in accordance with the applicable requirements in its *Home State*;
 - (3) in respect of an *EEA pure reinsurer*, the equivalent of the *capital*

resources requirement as calculated in accordance with the applicable requirements in its *Home State*;

(4) in respect of an *insurance undertaking* that is not within (1), (2) or (3) and whose head office is in a *designated State or territory*, either:

(a) its *proxy capital resources requirement*; or

(b) the solo capital resources requirement that applies to it under the *sectoral rules* for the *insurance sector* of the *designated State or territory*;

(5) in respect of an *insurance undertaking* within (4) which is not subject to a solo capital resources requirement under the *sectoral rules* for the *insurance sector* of that *designated State or territory*, its *proxy capital resources requirement*;

(6) in respect of an *insurance undertaking* that is not within (1) to (5), its *proxy capital resources requirement*;

(7) in respect of an *insurance holding company*, zero;

(8) [intentionally blank]

(9) in respect of a *regulated entity* (excluding an *insurance undertaking*), its *solo capital resources requirement*;

(10) in respect of an *asset management company*, the *solo capital resources requirement* that would apply to it if, in connection with its activities, it were treated as being in the *investment services sector*;

(11) in respect of a *financial institution* that is not a *regulated entity* (including a *financial holding company*), the *solo capital resources requirement* that would apply to it if, in connection with its activities, it were treated as being within the *banking sector*; and

(12) in respect of an *EEA ISPV*, the solo capital resources requirement that applies to the *ISPV* under the *sectoral rules* for the *insurance sector* of the *Member State* of the *competent authority* that authorised the *ISPV*.

6.1.34A G For the purposes of *INSPRU* 6.1.34R(4)(b), where the solo capital resources requirement under the *sectoral rules* for the *insurance sector* in a *designated State or territory* is ascertained by reference to the trigger for regulatory intervention, the *FSA* considers that the solo capital resources requirement of the *insurance undertaking* in such a *designated State or territory* will generally correspond to the highest point at which any regulatory or corrective action is triggered or which is at least comparable to the *capital resources requirement* which would apply if the *insurance undertaking* were an *insurer*.

6.1.35 G [intentionally blank]

Calculation of GCR

6.1.36 R For the purposes of *INSPRU* 6.1.8R and subject to *INSPRU* 6.1.23R and *INSPRU* 6.1.25R, a *firm* must calculate the group capital resources of an *undertaking* in *INSPRU* 6.1.17R in accordance with the table in *INSPRU* 6.1.43R, subject to the limits in *INSPRU* 6.1.45R.

- 6.1.37 R For the purposes of *INSPRU* 6.1, the following expressions when used in relation to either an *undertaking* in *INSPRU* 6.1.17R or a *regulated related undertaking* which is not subject to the *capital resources table*, are to be construed as if that *undertaking* were required to calculate its capital resources in accordance with the *capital resources table*, but with such adjustments being made to secure that the *undertaking's* calculation of its *solo capital resources* complies with the relevant *sectoral rules* applicable to it:
- (1) *tier one capital resources*;
 - (2) *tier two capital resources*;
 - (3) *upper tier two capital resources*;
 - (4) *lower tier two capital resources*;
 - (5) *innovative tier one capital resources*; and
 - (6) *core tier one capital*.
- 6.1.38 R For the purposes of *INSPRU* 6.1.37R, the *sectoral rules* applicable to:
- (1) an *insurance holding company* whose main business is to acquire and hold participations in *subsidiary undertakings* which are either exclusively or mainly *reinsurance undertakings* are the *sectoral rules* that would apply to it if, in connection with its activities, it were treated as a *pure reinsurer*;
 - (2) an *insurance holding company* not within (1) are the *sectoral rules* that would apply to it if, in connection with its activities, it were treated as an *insurer*;
 - (3) an *asset management company* are the *sectoral rules* that would apply to it if, in connection with its activities, it were treated as an *investment firm*; and
 - (4) subject to *INSPRU* 6.1.39R, a *financial institution*, that is not a *regulated entity*, are the *sectoral rules* that would apply to it if, in connection with its activities, it were treated as being within the *banking sector*.
- 6.1.39 R Where a *financial institution*, that is not a *regulated entity*, has invested in *tier one capital* or *tier two capital* issued by a *parent undertaking* that is:
- (1) an *insurance holding company*; or
 - (2) an *insurer*;
- the *sectoral rules* that apply to that *financial institution* are the *sectoral rules* for the *insurance sector*.
- 6.1.40 R For the purposes of *INSPRU* 6.1.36R, the capital resources of a *financial institution* within *INSPRU* 6.1.39R that can be included in the calculations in *INSPRU* 6.1.48R(2), *INSPRU* 6.1.50R(2), *INSPRU* 6.1.53R(2), *INSPRU* 6.1.55R(2) and *INSPRU* 6.1.57R(2) are:
- (1) the issued *tier one capital* or *tier two capital* of that *financial institution* held, directly or indirectly, by its *parent undertaking* referred to in *INSPRU* 6.1.39R; and
 - (2) the lower of:

(a) the *tier one capital* or *tier two capital* issued by the *parent undertaking* referred to in *INSPRU 6.1.39R* pursuant to the investment by the *financial institution*; and

(b) the *tier one capital* or *tier two capital* issued by the *financial institution* to raise funds for its investment in the capital resources of the *parent undertaking* referred to in (a).

6.1.41 R (1) In calculating *group capital resources*, a *firm* must exclude the restricted assets of a *regulated related undertaking* except insofar as those assets are available to meet the *individual capital resources requirement* of that *regulated related undertaking*.

(2) In (1), "restricted assets" means assets of a *regulated related undertaking* which are subject to a legal restriction or other requirement having the effect that those assets cannot be transferred or otherwise made available to another *regulated related undertaking* for the purposes of meeting its *individual capital resources requirement* without causing a breach of that legal restriction or requirement.

6.1.42 G For the purposes of *INSPRU 6.1.41R*, in respect of an *insurance undertaking* that is a member of an *insurance group*, the assets of a *long-term insurance fund* are restricted assets within the meaning of *INSPRU 6.1.41R*. Any excess of assets over liabilities in the *long-term insurance business* may only be included in the calculation of the *group capital resources* up to the amount of the *capital resources requirement* related to that *long-term insurance business*.

6.1.42A R For the purposes of calculating *group capital resources*, a *firm* must exclude the book value of any investment by a *related undertaking* of the *undertaking* in *INSPRU 6.1.17R* in shares of, or loans to, an *undertaking* that is not a *related undertaking*, where that *undertaking* has invested in the *capital resources* of a *regulated related undertaking* of the *undertaking* in *INSPRU 6.1.17R*.

6.1.43 R Table: Group capital resources

	Stage	Related text
Total group tier one capital	A	<i>INSPRU 6.1.48R</i>
Total group tier two capital	B	<i>INSPRU 6.1.50R</i>
Group capital resources before deductions	$C=(A+B)$	
Total deductions of inadmissible assets	D	<i>INSPRU 6.1.59R</i>
Total deductions under the requirement deduction method from group capital resources	E	<i>INSPRU 6.1.62R</i>

Total deductions of ineligible surplus capital*	F	<i>INSPRU 6.1.65R</i>
Deduction of assets in excess of market risk and counterparty exposure limits*	G	<i>INSPRU 6.1.70R</i>
Group capital resources	H=(C-(D+E+F*+G*))	
* = section (F) of the table (the deductions for ineligible surplus capital) and section (G) of the table (assets in excess of market risk and counterparty exposure limits) only apply and are required to be calculated for the purposes of the adjusted solo calculation of an <i>undertaking</i> in <i>INSPRU 6.1.17R</i> that is a <i>participating insurance undertaking</i> .		

Calculation of GCR - Limits on the use of different forms of capital

- 6.1.44 G As the various components of capital differ in the degree of protection that they offer the *insurance group*, restrictions are placed on the extent to which certain types of capital are eligible for inclusion in the *group capital resources* of the *undertaking* in *INSPRU 6.1.17R*. These restrictions are set out in *INSPRU 6.1.45R*.
- 6.1.45 R (1) For the purposes of *INSPRU 6.1.9R*, *INSPRU 6.1.10R* and *INSPRU 6.1.15R*, a *firm* must ensure that at all times its *tier one capital resources* and *tier two capital resources* are of such an amount that the *group capital resources* of the *undertaking* in *INSPRU 6.1.17R* comply with the following limits:
- (a) $(P - Q) \geq \frac{1}{2} (R - S)$;
 - (b) $(P - Q + T - W) \geq \frac{3}{4} (R - S)$;
 - (c) $V \geq \frac{1}{2} P$;
 - (d) $Q \leq 15\%$ of P;
 - (e) $T \leq P$; and
 - (f) $W \leq \frac{1}{2} P$
- (2) For the purposes of *INSPRU 6.1.9R* and *INSPRU 6.1.10R*, a *firm* must ensure that at all times its *tier one capital resources* and *tier two capital resources* are of such an amount that its *group capital resources* comply with the following limit, subject to (4)
- $$(P - Q + T) \geq \frac{1}{3} X + (R - S - U - X).$$
- (3) For the purposes of (1) and (2):
- (a) P is the *total group tier one capital* of the *undertaking* in *INSPRU 6.1.17R*;
 - (b) Q is the sum of the *innovative tier one capital resources* calculated in accordance with *INSPRU 6.1.53R*;

(c) R is the *group capital resources requirement* of the *undertaking* in *INSPRU 6.1.17R*;

(d) S is the sum of all the *with-profits insurance capital components* of an *undertaking* in *INSPRU 6.1.17R* that is an *insurer* and each of its *regulated related undertakings* that is an *insurer*;

(e) T is the *total group tier two capital* of the *undertaking* in *INSPRU 6.1.17R*;

(f) U is the sum of all the *resilience capital requirements* of an *undertaking* in *INSPRU 6.1.17R* that is an *insurer* and each of its *regulated related undertakings* that is an *insurer*;

(g) V is the sum of all the *core tier one capital* calculated in accordance with *INSPRU 6.1.55R*;

(h) W is the sum of the *lower tier two capital resources* calculated in accordance with *INSPRU 6.1.57R*; and

(i) X is the *MCR* of the *firm* less its *resilience capital requirement*, if any.

(4) For the purposes of (2):

(a) *INSPRU 6.1.45R (1)(a)* does not apply;

(b) the *innovative tier one capital* of the *firm* or its *regulated related undertakings* that meets the conditions for it to be *upper tier two capital* may be included as *upper tier two capital* for the purpose of the calculation in *INSPRU 6.1.50R*; and

(c) the *firm* must exclude from the calculation of (P - Q + T) in (2) the higher of:

(i) any amount by which the *total group tier two capital* exceeds the *group capital resources* of the *firm* less any *innovative tier one capital* excluded by (b); and

(ii) any amount by which the sum of *lower tier two capital resources* calculated in accordance with *INSPRU 6.1.57R* exceeds one third of the *group capital resources* of the *firm* less any *innovative tier one capital* excluded by (b).²

6.1.46 G The amount of any capital item excluded from *group capital resources* under *INSPRU 6.1.45R (1)(d)* may form part of *total group tier two capital* calculated in accordance with *INSPRU 6.1.50R* subject to the limits in *INSPRU 6.1.45R (1)(e)* and (f).

6.1.47 R For the purposes of *INSPRU 6.1.10R*, a *firm* must ensure that the *tier one capital resources* and *tier two capital resources* of each of its *long-term insurance business* and its *general insurance business* are of such an amount that the *group capital resources* of each its *long-term insurance business* and its *general insurance business* comply with the limits in *INSPRU 6.1.45R* separately for each type of business.

Calculation of GCR - Total group tier one capital

6.1.48 R For the purposes of *INSPRU 6.1.43R*, the *total group tier one capital* of an

undertaking in *INSPRU* 6.1.17R is the sum of:

(1) the *tier one capital resources* of the *undertaking* in *INSPRU* 6.1.17R;
and

(2) subject to *INSPRU* 6.1.40R, the *tier one capital resources* of each of the *related undertakings* of that *undertaking* that is a *regulated related undertaking* after the deduction in *INSPRU* 6.1.49R.

- 6.1.49 R The deduction referred to in *INSPRU* 6.1.48R is the sum of:
- (1) the book value of the investment by the *undertaking* in *INSPRU* 6.1.17R in the *tier one capital resources* of each of its *related undertakings* that is a *regulated related undertaking*; and
- (2) the book value of the investments by *related undertakings* of the *undertaking* in *INSPRU* 6.1.17R in the *tier one capital resources* of the *undertaking* in *INSPRU* 6.1.17R and each of its *related undertakings* that is a *regulated related undertaking*.

Calculation of GCR - Total group tier two capital

- 6.1.50 R For the purposes of *INSPRU* 6.1.43R, the *total group tier two capital* of an *undertaking* in *INSPRU* 6.1.17R is the sum of:
- (1) the *upper tier two capital resources* and the *lower tier two capital resources* of that *undertaking*; and
- (2) subject to *INSPRU* 6.1.40R, the *upper tier two capital resources* and the *lower tier two capital resources* of each of the *related undertakings* of that *undertaking* that is a *regulated related undertaking* after the deduction in *INSPRU* 6.1.51R.

- 6.1.51 R The deduction referred to in *INSPRU* 6.1.50R is the sum of:
- (1) the book value of the investments by the *undertaking* in *INSPRU* 6.1.17R in the *upper tier two capital resources* and the *lower tier two capital resources* of each of its *related undertakings* that is a *regulated related undertaking*; and
- (2) the book value of the investments by *related undertakings* of the *undertaking* in *INSPRU* 6.1.17R in the *upper tier two capital resources* and the *lower tier two capital resources* of the *undertaking* in *INSPRU* 6.1.17R and each of its *related undertakings* that is a *regulated related undertaking*.

- 6.1.52 G For the purposes of *INSPRU* 6.1.50R(2), the limits in *GENPRU* 2.2.37R apply to the *upper tier two capital resources* and the *lower tier two capital resources* of any *regulated related undertaking* that is an *insurer*. Similar limits may apply to other *regulated related undertakings* under the relevant *sectoral rules*.

Calculation of GCR - Innovative tier one capital resources, lower tier two capital resources and core tier one capital

- 6.1.53 R For the purposes of *INSPRU* 6.1.45R(3)(b), the *innovative tier one capital resources* is the sum of:
- (1) the *innovative tier one capital resources* of the *undertaking* in *INSPRU*

6.1.17R; and

(2) subject to *INSPRU* 6.1.40R, the *innovative tier one capital resources* of each of the *related undertakings* of that *undertaking* that is a *regulated related undertaking* after the deduction in *INSPRU* 6.1.54R.

- 6.1.54 R The deduction referred to in *INSPRU* 6.1.53R is the sum of:
- (1) the book value of the investments by the *undertaking* in *INSPRU* 6.1.17R in the *innovative tier one capital resources* of each of its *related undertakings* that is a *regulated related undertaking*; and
 - (2) the book value of the investments by *related undertakings* of the *undertaking* in *INSPRU* 6.1.17R in the *innovative tier one capital resources* of the *undertaking* in *INSPRU* 6.1.17R and each of its *related undertakings* that is a *regulated related undertaking*.
- 6.1.55 R For the purposes of *INSPRU* 6.1.45R(3)(g), the *core tier one capital* is the sum of:
- (1) the *core tier one capital* of the *undertaking* of *INSPRU* 6.1.17R; and
 - (2) subject to *INSPRU* 6.1.40R, the *core tier one capital* of each of the *related undertakings* of that *undertaking* that is a *regulated related undertaking* after the deduction in *INSPRU* 6.1.56R.
- 6.1.56 R The deduction referred to in *INSPRU* 6.1.55R is the sum of:
- (1) the book value of the investments by the *undertaking* in *INSPRU* 6.1.17R in the *core tier one capital* of each of its *related undertakings* that is a *regulated related undertaking*; and
 - (2) the book value of the investments by *related undertakings* of the *undertaking* in *INSPRU* 6.1.17R in the *core tier one capital* of the *undertaking* in *INSPRU* 6.1.17R and each of its *related undertakings* that is a *regulated related undertaking*.
- 6.1.57 R For the purposes of *INSPRU* 6.1.45R(3)(h), the *lower tier two capital resources* is the sum of:
- (1) the *lower tier two capital resources* of the *undertaking* in *INSPRU* 6.1.17R; and
 - (2) subject to *INSPRU* 6.1.40R, the *lower tier two capital resources* of each of the *related undertakings* of that *undertaking* that is a *regulated related undertaking* after the deduction in *INSPRU* 6.1.58R.
- 6.1.58 R The deduction referred to in *INSPRU* 6.1.57R is the sum of:
- (1) the book value of the investments by the *undertaking* in *INSPRU* 6.1.17R in the *lower tier two capital resources* of each of its *related undertakings* that is a *regulated related undertaking*; and
 - (2) the book value of the investments by *related undertakings* of the *undertaking* in *INSPRU* 6.1.17R in the *lower tier two capital resources* of the *undertaking* in *INSPRU* 6.1.17R and each of its *related undertakings* that is a *regulated related undertaking*.

Calculation of GCR - Inadmissible assets

- 6.1.59 R For the purpose of *INSPRU* 6.1.43R, a *firm* must deduct from the group capital resources before deduction (calculated at stage C in the table in *INSPRU* 6.1.43R) of the *undertaking* in *INSPRU* 6.1.17R, the value of all assets of the *undertaking* in *INSPRU* 6.1.17R and each of its *regulated related undertakings* that are not admissible assets as set out in *INSPRU* 6.1.60R.
- 6.1.60 R For the purposes of *INSPRU* 6.1.59R, an asset is not an admissible asset if:
- (1) in respect of a *regulated related undertaking* or *undertaking* in *INSPRU* 6.1.17R that is an *insurer* (other than a *pure reinsurer*), it is not an *admissible asset* as listed in *GENPRU* 2 Annex 7R;
 - (2) in respect of a *regulated related undertaking* or *undertaking* in *INSPRU* 6.1.17R that is a *pure reinsurer*, the holding of the asset is inconsistent with compliance by that *undertaking* with *INSPRU* 3.1.61AR; or
 - (3) in respect of a *regulated related undertaking* or *undertaking* in *INSPRU* 6.1.17R that is not an *insurer*, it is an asset of the *undertaking* that is not admissible for the purpose of calculating that *undertaking's solo capital resources* in accordance with the *sectoral rules* applicable to it.
- 6.1.61 R For the purposes of *INSPRU* 6.1.60R(3), the *sectoral rules* applicable to:
- (1) an *asset management company* are the *sectoral rules* that would apply to it if, in connection with its activities, it were treated as an *investment firm*; and
 - (2) a *financial institution* that is not a *regulated entity* are the *sectoral rules* that would apply to it if, in connection with its activities, it were treated as being within the *banking sector*.

Calculation of GCR - Deductions under requirement deduction method from group capital resources

- 6.1.62 R For the purposes of *INSPRU* 6.1.43R, a *firm* must deduct from the group capital resources before deduction (calculated at stage C in the table in *INSPRU* 6.1.43R) of an *undertaking* in *INSPRU* 6.1.17R, the sum of the value of the direct or indirect investments by the *undertaking* in *INSPRU* 6.1.17R in each of its *related undertakings* which is an *ancillary services undertaking*, calculated in accordance with *INSPRU* 6.1.63R.
- 6.1.63 R The value of an investment in an *undertaking* referred to in *INSPRU* 6.1.62R is the higher of the book value of the direct or indirect investment by the *undertaking* in *INSPRU* 6.1.17R and the notional capital resources requirement of that *undertaking*.
- 6.1.64 R For the purposes of *INSPRU* 6.1.63R, the notional capital resources requirement is:
- (1) for an *ancillary insurance services undertaking*, zero;
 - (2) for any other *ancillary services undertaking*, the *capital resources requirement* that would apply to that *undertaking*, if it were a *regulated*

related undertaking, in accordance with the *sectoral rules* applicable to a *regulated related undertaking* whose activities are closest in nature and scope to the activities of that *undertaking*.

Calculation of GCR - Deductions of ineligible surplus capital

- 6.1.65 R Where the *undertaking* in *INSPRU 6.1.17R* is a *participating insurance undertaking*, the *firm* must, for the purposes of *INSPRU 6.1.43R*, deduct from its group capital resources before deduction (calculated at stage C in the table in *INSPRU 6.1.43R*) the sum of the ineligible surplus capital of each of its *regulated related undertakings* that is an *insurance undertaking*, calculated in accordance with *INSPRU 6.1.67R*.
- 6.1.66 G The purpose of *INSPRU 6.1.65R* is to ensure that, where the *undertaking* in *INSPRU 6.1.17R* is a *firm*, *group capital resources* are not overstated by the inclusion of capital that, although surplus to the requirements of the relevant *regulated related undertaking* that is an *insurance undertaking*, cannot practically be transferred to support requirements arising elsewhere in the group. Therefore, ineligible surplus capital in a *regulated related undertaking* that is an *insurance undertaking* is deducted in arriving at *group capital resources*. Surplus capital in such a *regulated related undertaking* is regarded as transferable only to the extent that:
- (1) it can be transferred without the *regulated related undertaking* breaching its own limits on the use of different forms of capital;
 - (2) it does not contain assets that are restricted within the meaning of *INSPRU 6.1.41R*; and
 - (3) in the case of a *regulated related undertaking* that has a *long-term insurance business*, it does not contain any assets allocated to the *capital resources* of that *undertaking* for the purposes of the *capital resources* of its *long-term insurance business* meeting the *capital resources requirement* of its *long-term insurance business*.
- 6.1.67 R (1) For the purposes of *INSPRU 6.1.65R*, the ineligible surplus capital of a *regulated related undertaking* that is an *insurance undertaking* is calculated by deducting B from A where:
- (a) A is the *regulatory surplus value* of that *insurance undertaking* less any restricted assets of the *insurance undertaking* that have been excluded under *INSPRU 6.1.41R*; and
 - (b) B is the transferable capital of that *undertaking*.
- (2) If A minus B is negative, the ineligible surplus capital is zero.
- 6.1.68 R For the purposes of *INSPRU 6.1.67R(1)(b)*, the transferable capital is calculated by deducting the sum of the following from the *tier one capital resources* of the *regulated related undertaking* that is an *insurance undertaking*:
- (1) any restricted assets of that *insurance undertaking* that have been excluded under *INSPRU 6.1.41R*;
 - (2) any *tier one capital resources* of that *insurance undertaking* that have been allocated towards meeting the *individual capital resources requirement*

of its *long-term insurance business*; and

(3) the higher of:

(a) 50% of the *individual capital resources requirement* of the *general insurance business* of that *insurance undertaking*; and

(b) the *individual capital resources requirement* of the *general insurance business* of that *insurance undertaking* less the difference between E and F where:

(i) E is its *tier two capital resources*; and

(ii) F is the amount of its *tier two capital resources* that have been allocated towards meeting the *individual capital resources requirement* of its *long-term insurance business*.

Examples of transferable and ineligible surplus capital:

6.1.69 G Example 1

Share capital	Audited reserves	FFA	Tier two	Requirement
30	20	0	40	50

(i) Under *INSPRU* 6.1.68R, transferable capital = *tier one capital resources* of 50, less the sum of:

(1) restricted assets excluded under *INSPRU* 6.1.41R = (none);

(2) *tier one capital resources* allocated to the *long-term insurance business* = (none); and

(3) higher of (50% of 50 = 25 and 50 - 40 = 10) = (25) = (50 - 25) = 25

(2) Under *INSPRU* 6.1.67R, ineligible surplus capital = *regulatory surplus value* (40) less restricted assets excluded under *INSPRU* 6.1.41R (0) less transferable capital (25) = 15.

Example 2

Share capital	Audited reserves	FFA (of which 5 is restricted)	Tier two	Requirement (of which 4 relates to the <i>long-term insurance business</i>)
30	20	10	40	50

(i) Under *INSPRU* 6.1.68R, transferable capital = *tier one capital resources* of 60, less the sum of:

- (1) restricted assets excluded under *INSPRU* 6.1.41R = (5);
- (2) *tier one capital resources* allocated to the *long-term insurance business* = (5); and
- (3) the higher of (50% of 45 = 22.5; and 45 - 40 = 5) = (22.5) = 60 - 32.5 = 27.5
- (ii) Under *INSPRU* 6.1.67R, ineligible surplus capital = *regulatory surplus value* (50) - restricted assets excluded under *INSPRU* 6.1.41R of (5) - transferable capital (27.5) = 17.5.

Example 3

Share capital	Audited reserves	FFA (of which 0 is restricted)	Tier two (40, of which 5 is excluded at the solo level - see below)	Requirement (of which 25 relates to the <i>long-term insurance business</i>)
20	10	20	35	50

The requirement relating to the *long-term insurance business* is met by the FFA of 20 and *tier two capital resources* of 5. Of the remaining *tier two capital resources* of 35, 5 is excluded at the solo level because the *tier one capital resources* allocated to the *general insurance business* are 30.

(i) Under *INSPRU* 6.1.68R, transferable capital = *tier one capital resources* of 50, less the sum of:

- (1) restricted assets excluded under *INSPRU* 6.1.41R = (none);
- (2) *tier one capital resources* allocated to the *long-term insurance business* = (20); and
- (3) the higher of (50% of 25 = 12.5; and 25 - (35 - 5) = -5) = (12.5) = 50 - 32.5 = 17.5.
- (ii) Under *INSPRU* 6.1.67R, ineligible surplus capital = *regulatory surplus value* (35) - restricted assets excluded under *INSPRU* 6.1.41R of (0) - transferable capital (17.5) = 17.5.

Calculation of GCR - Assets in excess of market risk and counterparty exposure limits

- 6.1.70 R Subject to *INSPRU* 6.1.70AR, where the *undertaking* in *INSPRU* 6.1.17R is a *participating insurance undertaking*, the *firm* must deduct from its group capital resources before deduction (calculated at stage C in the table in *INSPRU* 6.1.43R) the assets in excess of *market risk* and *counterparty* exposure limits calculated in accordance with *INSPRU* 6.1.74R.
- 6.1.70A R Where the *undertaking* in *INSPRU* 6.1.17R is a *pure reinsurer* that is a *participating insurance undertaking*, the *firm* must calculate assets in

accordance with *INSPRU* 6.1.74AR and deduct from its group capital resources before deduction (calculated at stage C in the table in *INSPRU* 6.1.43R) those assets the holding of which is inconsistent with compliance by that *undertaking* with *INSPRU* 3.1.61AR.

- 6.1.71 G For the purposes of *INSPRU* 6.1.43R, where the *undertaking* in *INSPRU* 6.1.17R is a *participating insurance undertaking*, the investments referred to in *INSPRU* 6.1.48R and *INSPRU* 6.1.50R are not subject to the *market risk* and *counterparty* exposure limits.
- 6.1.72 R The *firm* (A) must, subject to *INSPRU* 6.1.73R, include in the calculation in *INSPRU* 6.1.74R or, where A is a *pure reinsurer*, *INSPRU* 6.1.74AR each *related undertaking* (B) that is:
- (1) a *regulated related undertaking* that is a *subsidiary undertaking*; or
 - (2) a *related undertaking* where the *firm* has elected to value the *shares* held in that *undertaking* by the *firm* in accordance with *GENPRU* 1.3.47R for the purposes of calculating the *tier one capital resources* of the *firm*.
- 6.1.73 R The *related undertakings* in *INSPRU* 6.1.72R need only be included in the calculation in *INSPRU* 6.1.74R or *INSPRU* 6.1.74AR if:
- (1) where B is a *regulated related undertaking*, the *solo capital resources* of that *undertaking* exceed its *individual capital resources requirement*; or
 - (2) where B is an *undertaking* in *INSPRU* 6.1.72R (2), its assets that fall within one or more of the categories in *GENPRU* 2 Annex 7R exceed its accounting liabilities.
- 6.1.74 R A's assets in excess of the *market risk* and *counterparty* exposure limits are calculated as follows:
- (1) Subject to (2), a *firm* must apply the *market risk* and *counterparty* exposure limits in *INSPRU* 2.1.22R(3) to:
 - (a) where B is an *insurer*, the *admissible assets* of B;
 - (b) where B is a *pure reinsurer*, the assets of that *undertaking* less those assets identified in *INSPRU* 6.1.60R(2) as not being admissible; and
 - (c) where B is a *regulated related undertaking* that is not an *insurer*, the assets of that *undertaking* less those assets identified in *INSPRU* 6.1.60R(3) as not being admissible assets.
 - (2) The *market risk* and *counterparty* exposure limits do not need to be applied to an *undertaking* in *INSPRU* 6.1.72R(2).
 - (3) Where the assets of B in *INSPRU* 6.1.74R(1) exceed the limits in *INSPRU* 2.1.22R(3), the assets of B in excess of the limits must be deducted by the *firm* from B's *solo capital resources* for the purposes of *INSPRU* 6.1.30R.
 - (4) After the application of (1) and (2), the surplus assets of B are aggregated with the *admissible assets* of A, where the surplus assets of B are:
 - (a) where B is a *firm* (other than a *pure reinsurer*), the *admissible assets* of B that represent the amount by which the *capital resources* of B exceed its

capital resources requirement, subject to *INSPRU* 6.1.77R, and limited to the amount of transferable capital calculated in accordance with *INSPRU* 6.1.68R;

(b) where B is a *regulated related undertaking* that is not in (a), the assets of the *undertaking* in *INSPRU* 6.1.74R(1)(b) or (c) that represent the amount by which the *solo capital resources* of B exceed its *individual capital resources requirement* and, where B is an *insurance undertaking* that is not in (a), limited to the amount of transferable capital calculated in accordance with *INSPRU* 6.1.68R; and

(c) where B is an *undertaking* in *INSPRU* 6.1.72R(2), the assets of the *undertaking* which represent those assets that fall within one or more of the categories in *GENPRU* 2 Annex 7R which exceed its accounting liabilities.

(5) The *market risk* and *counterparty* exposure limits are then applied to the aggregate of A's *admissible assets* and the surplus assets in *INSPRU* 6.1.74R(4).

- 6.1.74A R A must apply *INSPRU* 3.1.61AR to the aggregate of:
- (1) the assets of A, less any assets already identified in *INSPRU* 6.1.60R(2) as not being admissible; and
 - (2) the surplus assets of B calculated in accordance with *INSPRU* 6.1.74R(1) to (4) as if that *rule* applied to B.
- 6.1.75 R (1) Subject to (2), A must then deduct the amount by which the *admissible assets* aggregated in accordance with *INSPRU* 6.1.74R(5) exceed the *market risk* and *counterparty* exposure limits from A's group capital resources before deduction (calculated at stage C in the table in *INSPRU* 6.1.43R) in accordance with *INSPRU* 6.1.70R.
- (2) Where A is a *pure reinsurer*, A must then deduct the amount of any assets identified by *INSPRU* 6.1.74AR as not complying with *INSPRU* 3.1.61AR in accordance with *INSPRU* 6.1.70AR.
- 6.1.76 R In relation to any of its *regulated related undertakings* that is not an *insurer*, A may modify the calculation in *INSPRU* 6.1.74R by:
- (1) omitting the calculation in *INSPRU* 6.1.74R (1) and (3); and
 - (2) aggregating all of the assets of B identified in *INSPRU* 6.1.74R(1)(b) as admissible assets with the *admissible assets* of A in *INSPRU* 6.1.74R (4).
- 6.1.77 R The *admissible assets* of either A or B that are part of a *long-term insurance fund* of A or B are excluded for the purposes of the calculation in *INSPRU* 6.1.74R and *INSPRU* 6.1.74AR except insofar as those assets are available to meet the liabilities and *capital resources requirement* of that *long-term insurance fund*.
- 6.1.78 R If B is itself either a *participating insurance undertaking* or an *insurance parent undertaking*, the *admissible assets* of B for the purposes of *INSPRU*

6.1.74R (1) must be calculated as in *INSPRU* 6.1.75R but as if B were A.

7.1 Individual Capital Assessment

Application

7.1.1 R *INSPRU* 7.1 applies to an *insurer* unless it is:

- (1) a *non-directive friendly society*; or
- (2) a *Swiss general insurer*; or
- (3) an *EEA-deposit insurer*; or
- (4) an *incoming EEA firm*; or
- (5) an *incoming Treaty firm*.

Purpose

7.1.2 G Principle 4 requires a *firm* to maintain adequate financial resources. *GENPRU* 2 sets out provisions that deal specifically with the adequacy of that part of a *firm's* financial resources that consists of *capital resources*. The adequacy of a *firm's capital resources* needs to be assessed both by the *firm* and the *FSA*. In *INSPRU* 7.1, the *FSA* sets minimum *capital resources requirements* for *firms*. It also reviews a *firm's* own assessment of its capital needs, and the processes and systems by which that assessment is made, in order to see if the minimum *capital resources requirements* are appropriate. *GENPRU* 1.2 contains *rules* requiring a *firm* to identify and assess risks to its being able to meet its liabilities as they fall due, to assess how it intends to deal with those risks and to quantify the financial resources it considers necessary to mitigate those risks. To meet these requirements, a *firm* should consider the extent to which capital is an appropriate mitigant for the risks identified and assess the amount and quality of capital required. In accordance with *GENPRU* 1.2.60R, these assessments must be documented so that they can be easily reviewed by the *FSA* as part of the *FSA's* assessment of the adequacy of the *firm's capital resources*.

7.1.3 G This section (*INSPRU* 7.1) sets out *guidance* on how *firms* should assess the adequacy of their *capital resources*, both to comply with the *rules* in *GENPRU* 1.2 and to enable the *FSA* better to assess whether the minimum *capital resources requirements* in *GENPRU* 2.1 are appropriate. This section also requires *firms* carrying on *general insurance business* to calculate their *ECR*. The *ECR* for *firms* carrying on *general insurance business* is an indicative measure of the *capital resources* that a *firm* may need to hold based on risk sensitive calculations applied to its business profile. For *realistic basis life firms*, the *ECR* forms part of the calculation of the *firm's capital resources requirement* (see *GENPRU* 2.1.18R). The *ECR* for such *firms* requires the calculation of a *with-profits insurance capital component* (see *INSPRU* 1.3) that supplements the *mathematical reserves* so as to ensure that a *firm* holds adequate financial resources for the

conduct of its *with-profits insurance business*. In the case of *firms* carrying on *general insurance business* and *realistic basis life firms*, the *FSA* will use the *ECR* as a benchmark for its consideration of the appropriateness of the *firm's* own capital assessment. For *firms* where an *ECR* is not calculated the *MCR* will provide a benchmark for the *firm's* own capital assessment. For *firms* generally, the more thorough, objective and prudent a *firm's* capital assessment is and can be demonstrated as being, the more reliance the *FSA* will be able to place on the results of that assessment. The *FSA* will consider the appropriateness of the *firm's* capital assessment to establish the level of *capital resources* the *firm* needs. This may result in the *FSA's* assessment of a *firm's capital resources* needs being lower or higher than would otherwise be the case.

- 7.1.4 G There are two main purposes of this section:
- (1) to enable *firms* to understand the issues which the *FSA* would expect to see assessed and the systems and processes which the *FSA* would expect to see in operation for capital adequacy assessments by the *firm* to be regarded as thorough, objective and prudent; and
 - (2) to enable *firms* to understand the *FSA's* approach to assessing whether the minimum *capital resources requirements* of *GENPRU 2.1* are appropriate and what action may be taken if the *FSA* concludes that those requirements are not appropriate to a *firm's* circumstances.

Main requirements and guidance

- 7.1.5 G In making an assessment of capital adequacy, the *FSA* requires *firms* to identify the major risks they face and, where capital is appropriate to mitigate those risks, to quantify how much (and what type) of capital is appropriate. To do this, the *FSA* expects *firms* to conduct stress tests and scenario analyses in respect of each risk. For each risk the *firm* will then be able to estimate a range of probable outcomes and hence capital required to absorb losses which might arise. A *firm* must document the results of each of the stress tests and scenario analyses undertaken and should also document, as part of the details of those tests and analyses, the key assumptions including the aggregation of the results.
- 7.1.6 G The assessment which a *firm* makes should be based upon its future business plans and projections. This is the main area where the *firm's* assessment may diverge from its prescribed *capital resources requirement* which, necessarily, is based upon historic data.
- 7.1.7 G In assessing the quality and the amount of *capital resources* projected to be available to meet its projected *capital resources requirement*, a *firm* should consider the timing of its liabilities to repay existing capital together with the prospects for raising new capital in the scenarios considered.
- 7.1.8 G The *FSA* may ask for the results of a *firm's* assessment to be provided to it together with a description of the processes by which the assessment has

been made, the range of results from each stress test or scenario analysis performed and the main assumptions made. The *FSA* may also carry out a more detailed examination of the details of the *firm's* processes and calculations.

- 7.1.9 G Based upon this information and other information available to the *FSA*, the *FSA* will consider whether the *capital resources requirement* applicable to the *firm* is appropriate. Where relevant, the *firm's ECR* will be a key input to the *FSA's* assessment of the adequacy of the *firm's capital resources*.
- 7.1.10 R A *firm* carrying on *general insurance business*, other than a *non-directive insurer*, must calculate the amount of its *ECR*.
- 7.1.11 R A *firm* to which *INSPRU 7.1.10R* applies must calculate its *ECR* in respect of its *general insurance business* as the sum of:
(1) the *asset-related capital requirement*; and
(2) the *insurance-related capital requirement*; less
(3) the *firm's equalisation provisions*.
- 7.1.12 G Details of the calculation of the *asset-related capital requirement* are set out in *INSPRU 2.2.10R* to *INSPRU 2.2.16R*. Details of the calculation of the *insurance-related capital requirement* are set out in *INSPRU 1.1.76R* to *INSPRU 1.1.79R*.
- 7.1.13 G Where the *FSA* considers that a *firm* will not comply with the *overall financial adequacy rule* by holding the *capital resources* required by *GENPRU 2.1*, the *FSA* may give the *firm* individual *guidance* advising it of the amount and quality of *capital resources* which the *FSA* considers it needs to hold in order to meet that *rule*.
- 7.1.14 G The individual *guidance* will be given taking into consideration *capital resources* consistent with a 99.5% confidence level over a one year timeframe or, if appropriate to the *firm's* business, an equivalent lower confidence level over a longer timeframe. *Firms* should therefore prepare an individual capital assessment on the same basis. Throughout whatever timeframe is adopted by *firms*, *firms* should ensure that their projected assets are, and will continue to be, sufficient, to enable their projected liabilities to be paid, and it would be reasonable for *firms* to test that this is the case at the end of each year of the timeframe. *Firms* may also wish to make estimates of capital adequacy using other assumptions for their own internal purposes and are free to do so if they so choose.
- 7.1.15 G If a *firm* considers that the individual *guidance* is inappropriate to its circumstances, then the *firm* should inform the *FSA* that it does not intend to follow that *guidance*. Informing the *FSA* of such an intention would be expected if a *firm* is to comply with *Principle 11* (relations with regulators).

7.1.16 G The *FSA* expects most disagreements about the adequacy of capital will be resolved through further analysis and discussion. The *FSA* may consider the use of its powers under section 166 of the *Act* (Reports by skilled persons) to assist in such circumstances. If the *FSA* and the *firm* still do not agree on an adequate level of capital, then the *FSA* may consider using its powers under section 45 of the *Act* to, on its own initiative, vary a *firm's Part IV permission* so as to require it to hold capital in accordance with the *FSA's* view of the capital necessary to comply with the *overall financial adequacy rule*. SUP 7 provides further information about the *FSA's* powers under section 45.

7.1.17 G Where a *firm* or the *FSA* considers that the *capital resources requirements* of *GENPRU 2.1* require the holding of more capital than is needed for the *firm* to comply with the *overall financial adequacy rule* then the *firm* may apply to the *FSA* for a *waiver* of the requirements in *GENPRU 2.1* under section 148 of the *Act*. This section sets out the factors which the *FSA* will consider in deciding whether to grant such a *waiver* request, and if so, the terms and extent of any modification to the *rules* in *GENPRU 2.1*. In addition to the statutory tests under section 148, these will include the thoroughness, objectivity, and prudence of a *firm's* own capital assessment and the extent to which the *guidance* in this section has been followed. The *FSA* will not grant a *waiver* that would cause a breach of the minimum capital requirements under the *Insurance Directives*.

Stress and scenario requirement

7.1.18 G The *overall stress and scenario testing rule* requires a *firm* to carry out stress tests and scenario analyses for each of the sources of risk identified in accordance with the *overall pillar 2 rule*. Using each of the risk categories set out in the *overall pillar 2 rule*, *INSPRU 7.1.19G* to *INSPRU 7.1.34G* set out the factors that a *firm* should consider. *INSPRU 7 Annex 1G G* provides a practical illustration of how a small *firm* carrying on *general insurance business* might undertake this analysis.

Factors to consider when assessing credit risk

7.1.19 G Credit risk refers to the risk of loss if another party fails to perform its obligations or fails to perform them in a timely fashion.

7.1.20 G In assessing potential credit risk events that may affect the *firm's* solvency, a *firm* should allow for:

(1) the financial effect of non-payment of *reinsurance*, considering the likelihood both of non-payment of outstanding *claims* and for the fact that *reinsurance* cover purchased for underwritten risks may not be effective (that is, offsetting potential liabilities); and

(2) the financial effect of non-payment of *premium* debtors such as

intermediaries and *policyholders*.

- 7.1.21 G Some further areas to consider in developing the credit risk stress tests and scenario analyses might include:
- (1) the adequacy of the *reinsurance* programme and whether it is appropriate for the risks selected by the *firm* and adequately takes account of the underwriting and business plans of the *firm* generally;
 - (2) the collapse of a *reinsurer* or several *reinsurers* on the *firm's reinsurance* programme and the subsequent impact this may have on the *firm's* outstanding *reinsurance* recoveries and *IBNR* recoveries;
 - (3) a deterioration in the creditworthiness of the *firm's reinsurers*, intermediaries or other *counterparties*;
 - (4) the degree of credit concentration. For example, the degree to which a *firm* is exposed to a single *counterparty* or *group*;
 - (5) the degree of concentration of exposure to *reinsurers* of particular rating grades;
 - (6) the prospect of *reinsurance* rates increasing substantially or *reinsurance* being unavailable;
 - (7) any existing or possible future disputes relating to *reinsurance* contracts on a pessimistic basis and the extent that they are not already reflected in the value attributed to the reinsurances;
 - (8) greater losses from bad debts than anticipated;
 - (9) deterioration in the extent and quality of *collateral*; and
 - (10) guarantees given by the *insurer* of the performance of others, whether under *contracts of insurance* or otherwise.

Factors to consider when assessing market risk

- 7.1.22 G *Market risk* includes the risks that arise from fluctuations in values of, or income from, assets or in interest or exchange rates.
- 7.1.23 G In assessing potential *market risk* events that may affect the *firm's* solvency, a *firm* should allow for:
- (1) reduced market values of *investments*;
 - (2) variation in interest rates and the effect on the market value of *investments*;
 - (3) a lower level of investment income than planned; and
 - (4) the possibility of *counterparty* defaults.
- 7.1.24 G Some further areas to consider in developing the *market risk* scenario might include:
- (1) the possibility of a severe economic or market downturn or upturn leading to adverse interest rate movements affecting the *firm's* investment

position;

- (2) unanticipated losses and defaults of issuers;
- (3) price shifts in asset classes, and their impact on the entire portfolio;
- (4) inadequate valuation of assets;
- (5) the direct impact on the portfolio of currency devaluation, as well as the effect on related markets and currencies;
- (6) extent of any mismatch of assets and liabilities, including reinvestment risk;
- (7) the impact on the portfolio value of a dramatic change in the spread between a market index of interest rates and the risk-free interest rates; and
- (8) the extent to which market moves could have non-linear effects on values, such as *derivatives*.

Factors to consider when assessing liquidity risk

- 7.1.25 G In accordance with the *overall pillar 2 rule* a *firm* should consider the major sources of risk, including *liquidity risks*, and assess its response should each risk materialise.
- 7.1.26 G *INSPRU* 4.1 (liquidity risk management) contains evidential provisions and *guidance* on how *firms* should meet the *overall financial adequacy rule* for liquidity purposes.
- (1) *INSPRU* 5.1.58E states that a scenario analysis in relation to *liquidity risk* required under the *general stress and scenario testing rule* should include a cash-flow projection for each scenario tested, based on reasonable estimates of the impact of that scenario on the *firm's* funding needs and sources.
- (2) *INSPRU* 4.1.70E states that a *firm* should have a *contingency funding plan* for taking action to ensure, so far as it can, that in each of the scenarios tested under the *general stress and scenario testing rule*, it would still have sufficient liquid financial resources to meet liabilities as they fall due.
- 7.1.27 G When assessing *liquidity risk*, the *firm* should consider the extent of mismatch between assets and liabilities and the amount of assets held in highly liquid, marketable forms should unexpected cashflows lead to a liquidity problem. The price concession of liquidating assets is a prime concern when assessing such *liquidity risk* and should be built into any assessment of capital adequacy.
- 7.1.28 G Some further areas to consider in developing the *liquidity risk* scenario might include:
- (1) any mismatching between expected asset and liability cash flows;
 - (2) the inability to sell assets quickly;
 - (3) the extent to which the *firm's* assets have been pledged;

(4) the cash-flow positions generally of the *firm* and its ability to withstand sharp, unexpected outflows of funds via *claims*, or an unexpected drop in the inflow of *premiums*; and

(5) the possible need to reduce large asset positions at different levels of market liquidity, and the related potential costs and timing constraints.

Factors to consider when assessing operational risk

- 7.1.29 G Operational risk refers to the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events.
- 7.1.30 G A *firm* may wish to refer to SYSC 3A and INSPRU 5.1 when carrying out its operational risk assessment.
- 7.1.31 G Examples of some issues that a *firm* might want to consider include:
- (1) the likelihood of fraudulent activity occurring that may impact upon the financial or operational aspects of the *firm*;
 - (2) the obligation a *firm* may have to fund a pension scheme for its employees;
 - (3) the technological risks that the *firm* may be exposed to regarding its operations. For example, risks relating to both the hardware systems and the software utilised to run those systems;
 - (4) the reputational risks to which the *firm* is exposed. For example, the impact on the *firm* if the *firm's* brand is damaged resulting in a loss of *policyholders* from the underwriting portfolio;
 - (5) the marketing and distribution risks that the *firm* may be exposed to. For example, the dependency on intermediary business or a *firm's* own sales force;
 - (6) the impact of legal risks. For example a non-insurance related legal action being pursued against the *firm*;
 - (7) the management of employees - for instance staff strikes, where dissatisfied staff may withdraw goodwill and may indulge in fraud or acts giving rise to reputational loss;
 - (8) the resourcing of key functions such as the risk management function by staff in appropriate numbers and with an appropriate mix of skills such as underwriting, claims handling, accounting, actuarial and legal expertise.
- 7.1.32 G A *firm* may consider that investigation of operational weaknesses and corrective action is a better response than holding capital and may consider that a certain degree of operational risk is within its pre-defined risk tolerance. However, until the *firm* corrects any identified deficiencies a *firm* should consider capital as a (interim) response to the risk.

Factors to consider when assessing insurance risk

- 7.1.33 G As a result of the differences between the nature of *general* and *long-term insurance business*, some aspects of the risk assessment vary depending on the type of business written. In assessing potential insurance risk events that may affect the *firm's* solvency, *general* and *long-term insurance business firms* should:
- (1) analyse the potential for catastrophic losses, including both risk and event losses, the cost of reinstatement *premiums* and any possible *reinsurance* exhaustion; and
 - (2) determine the likelihood of any other feature of insurance risk that may lead to a variation in projected outcomes.
 - (3) *Firms* carrying on *general insurance business* should in addition:
 - (a) analyse the potential for *claims* reserves to deteriorate beyond the current reserving level; and
 - (b) determine the effect of loss ratios being higher than planned by analysing historic loss ratio experience and volatility.
 - (4) *Firms* carrying on *long-term insurance business* should in addition:
 - (a) analyse the potential for *mathematical reserves* subsequently to prove inadequate compared with the current reserving level; and
 - (b) determine the effect of *claims* experience being more costly than planned by analysing historic *claims* experience, volatility and trends in experience.
- 7.1.34 G Some further areas to consider in developing the insurance risk scenario might include:
- (1) For underwriting risks, *general insurance business* and long-term *insurance business* firms:
 - (a) the adequacy of the *firm's* pricing. For example, the *firm* should be able to satisfy itself that it can charge adequate rates, taking into account the business and the risk profile of different products, the business environment (e.g. *premium* cycle-non-life) and its own internal profit targets;
 - (b) the uncertainty of *claims* experience;
 - (c) the dependence on intermediaries for a disproportionate share of the *insurer's* *premium* income; the effects of a high level of uncertainty in pricing in new or emerging underwriting markets due to a lack of information needed to enable the *insurer* to make a proper assessment of the price of the risk; the geographical mix of the portfolio or whether any geographical or jurisdictional concentrations exist;
 - (d) the appropriateness of *policy* wordings;
 - (e) the risk of mis-selling, for example, the number of complaints or disputed *claims*; and
 - (f) the tolerance for expense reserve variations or variations in expenses (including indirect costs).
 - (2) For *firms* carrying on *general insurance business*, in addition:

- (a) the length of tail of the *claims* development and latent *claims*; and
 - (b) the effects of rapid growth or decline in the volume of the underwriting portfolio.
- (3) For *firms* carrying on *long-term insurance business*, in addition:
- (a) the uncertainty of future investment returns;
 - (b) the effects of rapid growth or decline in the volume and nature of new business written; and
 - (c) the ability of *firms* to adjust *premium* rates or charges for some products.
- (4) For reserving and *claims* risks, both *general insurance business* and *long term insurance business firms*:
- (a) the frequency and size of large *claims*;
 - (b) possible outcomes relating to any disputed *claims*, particularly where the outcome is subject to legal proceedings;
 - (c) the ability of the *firm* to withstand catastrophic events, increases in unexpected exposures, latent *claims* or aggregation of *claims*;
 - (d) the possible exhaustion of *reinsurance* arrangements, both on a per risk and per event basis;
 - (e) social changes regarding an increase in the propensity to claim and to sue; and
 - (f) other social, economic and technological changes.
- (5) For *firms* carrying on *general insurance business*:
- (a) the adequacy and uncertainty of the technical *claims* provisions, such as outstanding *claims*, *IBNR* and *claims* handling expense reserves;
 - (b) the adequacy of other underwriting provisions, such as the provisions for *unearned premium* and unexpired risk reserves;
 - (c) the appropriateness of catastrophe models and underlying assumptions used, such as possible maximum loss (PML) factors used;
 - (d) unanticipated legal judgements and legal change with retrospective effect specifically with regard to the *claims* reserves; and
 - (e) the effects of inflation.
- (6) For *firms* carrying on *long-term insurance business*:
- (a) the adequacy and sensitivity of the *mathematical reserves* to variations in future experience, including:
 - (i) the risk that investment returns differ from those assumed in the reserving assumptions;
 - (ii) the risk of variations in mortality, morbidity and persistency experience and in the exercise of options under contracts;
 - (iii) the rates of taxation applied, in particular where there is uncertainty over the tax treatment; and
 - (b) unanticipated legal judgements and legal change with retrospective

effect specifically with regard to the impact on *mathematical reserves*.

Other assessments of the adequacy of capital resources

- 7.1.35 G *Firms* must assess the adequacy of their financial resources and this will entail an assessment of both *capital resources* and liquidity resources. The stress tests and scenario analyses which a *firm* must carry out will assist with both assessments. However, *firms* may also find it helpful to approach their assessment of capital in another way.
- 7.1.36 G *Firms* may also wish to carry out an additional assessment to inform their view as to whether their *capital resources* are adequate. The additional assessment is to consider the extent to which the *capital resources requirement (CRR)* produces adequate capital for a *firm's* particular circumstances. In considering this, *firms* that are required to calculate an *Enhanced Capital Requirement (ECR)* may wish to note that the *ECR* as calculated is based upon the assumptions that a *firm's* business is well diversified, well managed with assets matching its liabilities and good controls, and stable with no large, unusual, or high risk transactions. *Firms* may find it helpful to assess the extent to which their actual business differs from these assumptions and therefore what adjustments it might be reasonable to make to the *CRR* or *ECR* to arrive at an adequate level of *capital resources*.
- 7.1.37 G *Firms* may find it helpful for their own assessment process if they also consider divergences from the assumptions described in *INSPRU 7.1.36G* under the headings set out below. These are the areas which the *FSA* considers when forming its view of the adequacy of a *firm's capital resources*.
- Business risk factors:
- (1) *market risk*;
 - (2) securitisation risk;
 - (3) residual risk;
 - (4) concentration risk;
 - (5) high impact, low probability events; and
 - (6) cyclical and capital planning.
- Control risk factors:
- (1) systems and controls.
- 7.1.38 G *Market risk*: a *firm* should assess its exposure to those elements of *market risk* that are not captured by the *CRR*. In doing so, *firms* may wish to use stress tests to determine the impact on their balance sheets of an appropriate move in market conditions. The results of this test should then be used by the *firm* to determine its *market risk*.
- 7.1.39 G Securitisation risk: a *firm* should assess its exposure to risks transferred through the securitisation of assets should those transfers fail for whatever reason. For instance, *firms* may contemplate two broad types of

securitisation: 'embedded value securitisation' - the transfer of the value emerging from an existing block of business to bondholders; and 'risk transfer securitisation' - the purchase of protection against catastrophic risks to the *insurer* through the issuance of bonds whose repayment is contingent upon the non-occurrence of such risks. In either case, *firms* should consider the effect on their financial position of a failure of such complex arrangements to operate as anticipated or the values and risks transferred not emerging as expected.

- 7.1.40 G Residual risk: a *firm* should assess its exposure to the residual risks that may result from the partial performance or failure of risk mitigation techniques for reasons that are unconnected with their intrinsic value. This could result from (for example): ineffective documentation, a delay in payment or the inability to realise payment from a guarantor in a timely manner. Given that residual risks can always be present, *firms* should assess the appropriateness of their *capital resources requirement* against their assumptions for the risk mitigation measures that they may have in place.
- 7.1.41 G Concentration risk: a *firm* should assess and monitor its exposure to: sector, geographic, liability and asset concentrations, as well as granularity. The *FSA* considers that concentrations in these areas increase the *firm's* credit risk and where the *firm* identifies concentrations then they should consider the adequacy of the *capital resources requirement*. For instance, *firms* should monitor concentrations of exposure to particular *reinsurers* and ensure that they are aware of the implications of several of their *reinsurers* failing at the same time.
- 7.1.42 G High impact, low probability events: *firms* should consider stress tests and scenario analyses which are realistic - that is not too remote a possibility. However, should a *firm* decide to enter into a high impact, low probability transaction, the *firm* should satisfy itself that it has sufficient financial resources to meet its resulting financial obligation in the event the single risk materialises. For instance, a *firm* should not accept individual risks in circumstances where, if that single risk materialised, the *claim* arising would exceed the financial resources available to the *firm*.
- 7.1.43 G A *firm* should also consider the value of the financial obligation arising where the risks from a combination of high impact, low probability transactions that the *firm* has entered into materialise at the same time. A *firm* should ensure that in no circumstances would a combination of any consequent *claims* materially exceed the financial resources available to it.
- 7.1.44 G Cyclical and capital planning: a *firm's capital resources requirement* may vary as business cycles and economic conditions fluctuate over time. *Firms* should be aware that a deterioration in business or economic conditions could require them to raise capital or alternatively to contract their businesses at a time when market conditions are most unfavourable to raising capital. Such an effect is known as procyclicality.

- 7.1.45 G To reduce the impact of cyclical effects, *firms* should look to build-up capital levels through the course of an upturn in business and economic cycles to ensure that they have sufficient capital available to protect themselves against adverse conditions.
- 7.1.46 G To assess its expected capital requirements over the economic and business cycles, a *firm* may wish to project forward its financial position taking account of its business strategy and expected growth under a range of environmental assumptions. Projections over a three to five year period would be appropriate in most circumstances. *Firms* may then calculate their projected *capital resources requirement* and assess whether that requirement could be met from expected financial resources.
- 7.1.47 G Systems and controls: a *firm* may decide to hold additional *capital resources* to mitigate weaknesses in its overall control environment. Weaknesses might be indicated by the following:
- (1) a failure by the *firm* to complete an assessment of its systems and controls in line with SYSC 3.1 (Systems and Controls) and SYSC 14 (Prudential risk management and associated systems and controls);
 - (2) a failure by the *firm's* senior management to approve its financial results; and
 - (3) a failure by the *firm* to consider an analysis of relevant internal and external information on its business and control environment.
- 7.1.48 G In considering any systems and control weaknesses and their effect on the adequacy of the *capital resources requirement*, a *firm* may wish to be able to demonstrate to the *FSA* that all the issues identified in SYSC 3.2 (Areas covered by systems and controls) have been considered; and that appropriate plans and procedures exist to deal adequately with adverse scenarios.

Capital models

- 7.1.49 G A *firm* may approach its assessment of adequate *capital resources* by developing a model for some or all of its business risks. Where such a model captures some of the risks identified in accordance with the *overall pillar 2 rule* then this will usually satisfy the requirement to perform stress tests in respect of those risks. However, the assumptions required to aggregate risks modelled and the confidence levels adopted should be considered by the *firm's* senior management. A *firm* should also consider whether any risks are not captured by the model and also the extent to which systems and control risks are not incorporated in the model.
- 7.1.50 G A *firm* should not expect the *FSA* to accept as adequate any particular model that it develops or that the results from the model are automatically reflected in any individual *guidance* given to the *firm* for the purpose of determining adequate *capital resources*. However, the *FSA* will take into account the results of any sound and prudent model when giving individual *guidance* or

considering applications for a *waiver* under section 148 of the *Act* of the *capital resources requirement* in *GENPRU 2.1*. This section sets out the types of issues the *FSA* would consider before giving individual *guidance* or granting a *waiver* based on the results of a model.

- 7.1.51 G There is no prescribed modelling approach for how a *firm* develops its internal model. However, *firms* should be able to demonstrate:
- (1) the extent of use of the internal capital model within the *firm's* capital management policy;
 - (2) that sound and appropriate risk-management techniques are employed and are embedded in the daily operations and financial resources requirements of the firm;
 - (3) that all material risks to which the *firm* is exposed have been adequately addressed by quantitative and qualitative means as appropriate;
 - (4) the confidence levels set and whether these are linked to the *firm's* corporate strategy;
 - (5) the time horizons set for the different types of business that the *firm* undertakes;
 - (6) the extent of historic data used and back testing carried out; and
 - (7) whether sufficient accuracy and validation in the internal capital model has been undertaken.

Quantitative factors

- 7.1.52 G The *firm's* model should be based on an appropriate probability of insolvency over an appropriate time period. A *firm* should be able to demonstrate the selected probability of insolvency and time horizon it has derived and explain why these are appropriate for its business.
- 7.1.53 G Good models will have as inputs (in addition to the specific examples given under the stress and scenario guidance):
- For both *firms* carrying on *general insurance business* and *long-term insurance business*:
- (1) assumed future investment returns. In particular, assumptions for future interest rates (to the extent that they impact on interest income on funds on deposit, price of and yield on fixed stock that may be purchased in future and interest income on variable interest rate assets), equity prices, dividend income, property prices, property rental income and inflation. The assumptions should take account of likely volatility and historic volatility in interest rates and asset prices;
 - (2) five-year predictions as to *premium* rates in each homogeneous category of business taking account of the effect of underwriting cycles;
 - (3) predictions of exposures written in each homogeneous category of business in the next five years;
 - (4) predictions of *premium* volume and expected growth under a five year

business plan;

(5) expenses and commission;

(6) catastrophic events, aggregations of *claims* and *claims* affecting more than one *class* of business;

(7) inflation in terms of how it might affect future *claims*, non-settled *claims* that have occurred to date, future expenses, future *reinsurance* costs and future investment returns;

(8) *reinsurance* programmes in place, allowing for changing term conditions, reinstatements and loss experience features;

(9) estimates of non-recovery of *reinsurance* and other debtors taking account of the financial strength of each *reinsurance* or other *counterparty*; and

(10) foreign exchange movements.

For *firms* carrying on *general insurance business* in particular:

(11) frequency and severity of *claims* (including costs associated with *claims* such as professional fees) for each homogeneous category of business, allowing for any impact of future social, legal and inflationary effects (especially concerning price, earnings, medical and *claims*) on future *claims* costs;

(12) settlement patterns of *claims* and *reinsurance* recoveries for each homogeneous category of business (including occurred and future *claims*);

(13) unintended coverage of risks; and

(14) correlation between these risks.

For *firms* carrying on *long-term insurance business* in particular:

(15) projected *claims* experience for each homogeneous category of business allowing for trends in mortality/ morbidity experience;

(16) assumptions for future *policyholder* actions such as lapsing or surrendering a *policy*, ceasing to pay *premiums* or choosing to exercise an option under the contract; and

(17) for business where management has discretion over the level of benefits or charges, assumptions about management reactions to changes in economic conditions and consequent changes to the benefits or charges.

- 7.1.54 G The *FSA* places credence in approaches to financial models to aid the assessment of capital adequacy which involve the production of a Dynamic Financial Analysis ("DFA") model. These models transform each element in the financial projection into a statistical distribution with a range of possible outcomes, and are therefore stochastic. They would generally incorporate a suitable economic model integrated into the DFA model and linked into the generation of insurance related assumptions. The model would, as far as possible, cover all risks and all areas of business. The future time period over which projections are made should be determined with reference to the type of *insurance business* written, the asset profile and the insurance cycle.

It may be appropriate to consider several different time periods.

- 7.1.55 G Due regard should also be given to the historical experience of both the firm and the wider relevant industry and market when assigning values to the above inputs.
- 7.1.56 G The values assigned to each of the above inputs should be derived either stochastically, by assuming the value of an item can follow an appropriate probability distribution and by selecting appropriate values at the tail of the distribution, or deterministically, using appropriate prudent assumptions. For *long-term insurance business* which includes options or guarantees that change in value significantly in certain economic or demographic circumstances, a stochastic approach would normally be appropriate.

Application of INSPRU 7.1 to Lloyd's

- 7.1.57 R Subject to *INSPRU 7.1.58R*, *INSPRU 7.1* applies to *managing agents* and to the *Society* in accordance with:
- (1) for *managing agents*, *INSPRU 8.1.4R*; and
 - (2) for the *Society*, *INSPRU 8.1.2R*
- 7.1.58 R *Managing agents* must carry out assessments of capital adequacy for each *syndicate* they manage by reference to all *open syndicate years* taken together.

Assessment of adequacy of capital resources for *syndicates* and *members*

- 7.1.59 G Responsibility for:
- (1) managing the risks associated with the *insurance business*; and
 - (2) holding the *capital resources* that support those risks;
- is divided between *managing agents* and the *Society*. To clarify the respective responsibilities of *managing agents* and the *Society* for ensuring the adequacy of financial resources, the FSA distinguishes between the *managing agents'* responsibility to carry out capital adequacy assessments of the *capital resources* held at *syndicate* level for each *syndicate* that they manage, and the *Society's* responsibility to carry out an assessment for each *member*.
- 7.1.60 R In carrying out capital adequacy assessments in respect of the *insurance business* carried on through each *syndicate* (the *syndicate ICA*), *managing agents* must consider the risks, controls and the financial resources relevant to each *syndicate*.
- 7.1.61 R When carrying out the *syndicate ICA*, *managing agents* must not take into account risks to which a *member* may be exposed or controls from which a *member* may benefit:

(1) because that *member* carries on *insurance business* through another *syndicate* or more than one *syndicate year* (whether or not managed by the same *managing agent*); or

(2) because that *member's* financial resources include *funds at Lloyd's* or *central assets*.

7.1.62 R The *Society* must have regard to *syndicate ICAs* in arriving at its own capital assessment for each *member*.

7.1.63 G In assessing the adequacy of the *capital resources* supporting the *insurance business* of each *member*, the *Society* should consider the risks, controls and financial resources relevant to the totality of the *member's insurance business*, including:

(1) the adequacy of *syndicate ICAs*;

(2) the *member's* share of *syndicate ICAs*;

(3) adjustments in respect of risks and controls relating to *funds at Lloyd's*, *central assets* and the interaction of risks underwritten by the *member* through different *syndicates* and in respect of different *syndicate years*; and

(4) the ongoing validity of any relevant assumptions it makes.

7.1.64 G In taking account of a *syndicate ICA* under *INSPRU 7.1.62R*:

(1) if the *Society* considers a *syndicate ICA* to be adequate, it should use the *managing agent's* risk and capital assessments in carrying out its individual capital assessment in relation to any *member* of that *syndicate*, or it should be able to justify why it will not; and

(2) if the *Society* considers a *syndicate ICA* to be less than adequate, the *Society* should increase the *syndicate ICA* so that it is adequate for the purpose of carrying out its individual capital assessment in relation to the *members* of that *syndicate*.

7.1.65 G The assessment of capital adequacy for a *member* will rarely equal the proportionate share of a *syndicate ICA* (or sum of those shares, where the *member* participates on more than one *syndicate*) as attributed to that *member*, because, in determining the capital assessments for each *member*, the *Society* may make adjustments to take account of:

(1) risks and controls associated with *funds at Lloyd's* and *central assets*, which can increase the *member's* individual capital assessment;

(2) diversification effects, including as a result of *members'* participations on more than one *syndicate year*, which can reduce the *member's* individual capital assessment; and

(3) its own assessment of *syndicate* risks, which can be higher than the *managing agent's* and so increase the *member's* individual capital assessment.

The balancing amount

- 7.1.66 G *Capital resources* to meet each *syndicate ICA* could be:
- (1) held within a *syndicate* and managed by the *managing agent*; or
 - (2) held and managed by the *Society*; or
 - (3) not needed in full, because of effects such as diversification that the *Society* takes into account.
- 7.1.67 G The *balancing amount* is a function of the relationship between the *syndicate ICA* and the amount of assets held within the *syndicate*. As illustrations:
- (1) if the *syndicate* holds no *capital resources* (but its liabilities are fully covered by relevant assets), the *balancing amount* equals the *syndicate ICA* (as there are no *capital resources* at *syndicate* level, all the *capital resources* must be held as *funds at Lloyd's* or *central assets*);
 - (2) if *capital resources* held at *syndicate* level are negative (i.e. if relevant assets do not fully cover liabilities for the *syndicate*), the *balancing amount* should be higher than the *syndicate ICA* by an amount corresponding to the negative *capital resources* held by *managing agents* on behalf of the *syndicate*; and
 - (3) conversely, if a *syndicate* holds positive *capital resources* for the *syndicate*, the *balancing amount* should be lower than the *syndicate ICA* by a corresponding amount.
- 7.1.68 R *Managing agents* must periodically notify the *Society* of the *syndicate ICA* and the *balancing amount* in respect of each *syndicate*.
- 7.1.69 R For the purpose of assessing the adequacy of *capital resources* held as *funds at Lloyd's* and *central assets*, the *Society* must have regard to *balancing amounts* notified to it by *managing agents*.
- 7.1.70 R After notification of a *balancing amount* by a *managing agent*, the *Society* must:
- (1) confirm to the *managing agent* that *capital resources* held as *funds at Lloyd's* and *central assets* are adequate to support the *balancing amount*; or
 - (2) notify the *managing agent* that it cannot give that confirmation.
- 7.1.71 G *Managing agents* should submit *syndicate ICAs* and notify *balancing amounts* to the *Society* as part of the annual capital-setting process at *Lloyd's*. The submission of the *syndicate ICA* and notification of the *balancing amount* should be made in good time for the *Society* to review them and place appropriate reliance on them when it determines the capital assessments for each *member*.
- 7.1.72 G When communicating the *syndicate ICA* and *balancing amount* for each *syndicate* to the *Society*, *managing agents* should agree with the *Society* an allocation of the *syndicate ICA* between *syndicate years*. The purpose of the allocation is to ensure that there is an appropriate matching of assets to risk and liabilities and an equitable treatment between the *members* reflecting the

provision of capital in each *syndicate year*.

Monitoring of capital resources

- 7.1.73 G For the purposes of complying with their obligations under *INSPRU*, *managing agents* may assume that any *balancing amount* confirmed by the *Society* under *INSPRU* 7.1.70R is supported by *capital resources* held as *funds at Lloyd's* and *central assets*.
- 7.1.74 R If a *managing agent* has, at any time, a significant doubt about the adequacy of a *syndicate ICA* or *balancing amount* with respect to *syndicate* risks and controls, it must notify the *Society* immediately.
- 7.1.75 R If the *Society* has, at any time, a significant doubt about the adequacy of any *member's* capital resources held by it in support of any *balancing amount*, it must notify the relevant *managing agent* immediately.

	Annex 1G
A1	This annex provides an illustrative qualitative example of how a small <i>firm</i> could undertake its stress and scenario analysis without this being disproportionate to the size and complexity of its business so as to comply with the <i>general stress and scenario testing rule</i> . For these reasons, the example does not provide any quantitative guidance as we believe this would be impractical given the diverse nature of each <i>firm's</i> individual circumstances.
A2	This example is based on <i>guidance</i> contained in <i>INSPRU 7.1</i> . The areas discussed are not exhaustive and it is likely that in practice a <i>firm</i> will need to consider a range of other issues.
A3	The scenarios that the <i>firm</i> generates as part of its analysis should aim to reflect the degree of risk in a variety of areas. How extreme these scenarios are will influence the ultimate level of capital required by the <i>firm</i> . The <i>firm</i> should not necessarily develop scenarios based on the current trading or economic conditions, but on possible trading or economic conditions that could occur during the next three to five years.
A4	In addition to examining its event scenarios, a <i>firm</i> should also be able to meet any individual risk (however unlikely) that it has accepted (or proposes to accept through its business plan) from <i>policyholders</i> . It therefore should analyse its exposures and ensure that it has sufficient capital or available <i>reinsurance</i> to cover its largest individual risks and accumulations.
	Worked example
	Background
A5	The <i>firm</i> used for this example is an <i>insurer</i> carrying on <i>general insurance business</i> within a large <i>group</i> , writing predominantly personal lines, household and motor policies of approximately £25m <i>gross written premium</i> . This business has a reasonable geographical spread, sourced significantly from within the <i>United Kingdom</i> . The <i>firm</i> has purchased appropriate <i>reinsurance</i> cover from a variety of <i>reinsurers</i> and has a demonstrated record of utilising this cover. Its settlement pattern for <i>claims</i> averages three years, however, there is a small element of the account with longer tail liability <i>claims</i> . The <i>firm's</i> investments and IT support are outsourced.

	Insurance risk	
A6	The risk of incorrect or inaccurate pricing of business over the scenario period can be addressed by examining typical uncertainties within the pricing basis and the volatility of <i>claims</i> experience.	
A7	In examining the adequacy of its pricing, the <i>firm</i> establishes its underwriting and <i>claims</i> trend over a ten-year base period by reviewing profit and loss accounts (particularly underwriting profit). In particular it examines the following:	
	(i)	the volatility of losses in a particular line of business;
	(ii)	whether the loss ratio exceeded 100% in any line of business; and
	(iii)	whether the <i>deferred acquisition cost</i> (DAC) amount had been written down; e.g. whether an unexpired risk provision (URP) was necessary.
A8	The <i>firm</i> also examines whether its <i>premiums</i> over the last ten years have been:	
	(i)	reasonably stable;
	(ii)	responsive enough to changes in <i>claim</i> exposures (so that profitability is maintained);
	(iii)	providing adequately for contingencies (such as major losses e.g. hail, earthquake etc);
	(iv)	encouraged loss control (through the use of deductibles, no claim bonuses etc);
A9	The <i>firm</i> also reviews its method of pricing. The <i>firm</i> considers and performs the following:	
	(i)	a review of acceptable rates, e.g. <i>premiums</i> being charged by competitors for similar products;
	(ii)	an examination of whether there have been any difficulties in the past with delegated authorities in relation to pricing including the ability and experience of staff members setting or recommending <i>premium</i> prices;

	(iii)	an examination of whether the <i>firm</i> has the appropriate mechanisms in place regarding <i>premium</i> rate changes (that is, who makes these decisions, frequency, and on what basis?); and
	(iv)	a benchmark price assessment (e.g. the ability to provide adequate competitive <i>premium</i> rates). For example, indicative rates being determined through the use of industry statistics, competitor statistics and the <i>firm's</i> own analysis for all classes.
A10	Other factors the <i>firm</i> considers are:	
	(i)	changes in environment (e.g. legislation, social, economic etc);
	(ii)	changes in <i>policy</i> conditions and deductibles; and
	(iii)	impact of market segments (e.g. the effects of different <i>claim</i> frequencies and costs impacting the price charged).
A11	Having completed its analysis, the <i>firm</i> makes the following assumptions to define its underwriting risk:	
	(i)	<i>claims</i> costs. The <i>firm</i> assumes these are X% higher than in the <i>premium</i> basis;
	(ii)	<i>claims</i> inflation. The <i>firm</i> assumes a X% <i>claims</i> inflation over the scenario period, compared to Y% in the pricing basis;
	(iii)	<i>policy</i> expenses (fixed and variable) are X% higher than anticipated in the pricing basis;
	(iv)	<i>reinsurance</i> charges are X% higher than anticipated in the pricing basis; and
	(v)	investment income is X% lower than anticipated in the pricing basis.
As a result of the above analysis on a per risk basis, the <i>firm</i> considers that capital of between £X and £Y would cover the possibility of material deviations to projected results.		
	Allowing for catastrophes	

A12	The allowance for catastrophic events within the insurance risk scenario should reflect both the severity and the frequency of these events.
A13	After considering the catastrophe <i>reinsurance</i> programme it may be clear that the upper limit is set at a level unlikely to be breached e.g. a 1 in 200 year event. Thus, for the purposes of the capital assessment, it would not be necessary to assume losses in excess of this retention.
A14	However, it may be determined that there is possible exhaustion of free reinstatements or of horizontal cover in total. For example, if there were a significant chance of three catastrophic losses in any one period but the <i>reinsurance</i> allowed only one free reinstatement, then the assessment may be to hold two retentions and the entire gross loss for the third event.
As a result of the above analysis, the <i>firm</i> considers it appropriate to hold capital sufficient to absorb three catastrophic losses: one European windstorm of £X, one UK flood of £Y, and one large man made explosion of £Z.	
The <i>reinsurance</i> structure in place allows for X number of reinstatements at full <i>premium</i> .	
	Deterioration of reserves
A15	The <i>firm</i> considers the adequacy of its <i>claims</i> reserves by focussing on the liability valuation.
A16	The liability valuation may contain a range of answers that might indicate possible reserve variability. Also, the valuation will contain areas where judgement has been applied and assumptions formulated which are subjective. These areas are considered and stressed as appropriate.
A17	The <i>firm</i> also reviews the historic level of <i>claims</i> reserves and subsequent level of settlements to help determine the size of any historic levels of under and over reserving.
A18	<i>Reinsurance</i> arrangements are considered and the extent to which these arrangements protect against reserve deterioration is assessed.
A19	For <i>unearned premium</i> , where losses have yet to occur, the <i>firm</i> considers that the level of uncertainty is greater and considers similar factors to those relating to underwriting risk in addition to those discussed above.
As a result of the above analysis, the <i>firm</i> considers it appropriate to apply a X% loading to the outstanding <i>claims</i> provision, a Y% loading to the <i>unearned premium</i> provision and Z% to all other liability values. The <i>firm</i> considers that capital of between £X and £Y would adequately cover reserve deterioration.	

	Credit risk
A20	Credit risk relates to the risk of default by <i>counterparties</i> . The <i>firm</i> believes its exposure to credit risk results from financial transactions with <i>counterparties</i> including issuers, debtors, borrowers, brokers, <i>policyholders</i> , <i>reinsurers</i> and guarantors.
A21	When assessing credit risk the <i>firm</i> makes an assessment of the creditworthiness of <i>counterparties</i> to the assets of the <i>firm</i> .
A22	The assessment includes an evaluation of the credit risk associated with loans and investment portfolios; the quality of on and off balance sheet assets; the ongoing management of the loans and investment portfolios; as well as loss provisions and reserves.
A23	The <i>firm</i> believes its exposure to credit risk also arises due to its exposure to its <i>reinsurers</i> . In this regard, the <i>firm</i> uses the credit ratings assigned to particular <i>counterparties</i> as a measure of credit risk, most notably Standard & Poor's, Moody's Investors Service and AM Best's (particularly for <i>reinsurers</i>).
A24	When forming an opinion on credit risk the <i>firm</i> considers:
	Reinsurance
A25	The <i>firm's</i> strategy is to lessen exposure to a single lead <i>reinsurer</i> to less than 30%, with other participants holding no more than 15%. In all cases, the panel of <i>reinsurers</i> all have a specified rating. The <i>firm</i> has no prior experience of disputes, and their working relationship with the panel may be excellent, and thus the <i>firm</i> does not envisage any future difficulties arising in this regard.
A26	Bond default rates could then be used to assess a likely credit risk figure for <i>reinsurance</i> recoveries (including <i>IBNR</i> recoveries).
The <i>firm</i> considers that capital of between £X and £Y would cover <i>reinsurance</i> defaults, with no additional allowance for disputes.	
	Overseas financial institutions and banks
A27	The <i>firm</i> investigates its business relationships with overseas financial institution <i>counterparties</i> including <i>banks</i> , and decides no additional allowance is required.
	Quality of counterparties and trends in counterparty risk
A28	The <i>firm</i> assesses the level and age of debtors, focussing particularly upon unpaid <i>premiums</i> , especially those greater than three months old, and reviews the level and trend of contingent liabilities. For example, the <i>firm</i> estimates that the credit risk scenario equates to taking a 10% reduction in the asset value of debtors, based on bond default rates and

	age of debt.
The <i>firm</i> considers that capital of between £X and £Y would cover credit risk to counterparties.	
	Off-balance sheet transactions
A29	The <i>firm</i> investigates any unfunded commitments, credit <i>derivatives</i> , commercial or standby letters of credit. Where these exist the possibility of a loss on these instruments is considered in relation to the requirement of the credit risk scenario.
The <i>firm</i> considers that no additional capital is necessary.	
	Market risk
A30	<i>Market risk</i> encompasses an adverse movement in the value of the assets as a consequence of market movements such as interest rates, foreign exchange rates, equity prices, etc. which is not matched by a corresponding movement in the value of the liabilities.
A31	In examining possible market risks, the <i>firm</i> considers its sensitivity to <i>market risk</i> by evaluating the degree to which changes in interest rates, foreign exchange rates, equity prices, or other areas can adversely affect the <i>firm's</i> earnings or capital.
A32	The <i>firm</i> believes its assets and liabilities are approximately matched e.g. there is no existence of large unmatched or unhedged currency positions; short tail business is backed by cash/fixed interest assets of suitable term and long tail business with real assets e.g. shares/property. If mismatching does exist this should be allowed for within the estimate.
A33	In developing the scenario the <i>firm</i> estimates the effect of a X% increase in interest rates on bond values.
A34	Similarly, the <i>firm</i> estimates the effect on equity values of a major recession to estimate the possible reduction in the value of equity capital. Also, it uses a suitable equity index to determine the size of historical falls in equity values and indicate possible future falls.
A35	<i>Counterparty</i> risk might be allowed for by assuming one or several major corporate bond holding defaults.
A36	For all investments, the stability of trading revenues should be examined to determine the volatility of investment.
From the above analysis, the <i>firm</i> considers that capital of between £X and £Y would be appropriate to protect it against adverse movement in <i>market risk</i> .	
	Liquidity risk

A37	<i>Liquidity risk</i> is the potential that the <i>firm</i> may be unable to meet its obligations as they fall due as a consequence of having a timing mismatch. The <i>firm</i> considers <i>liquidity risk</i> relates to the risk associated with the processes of managing timing relationship between asset and liability cash flow patterns.
A38	When assessing <i>liquidity risk</i> , the <i>firm</i> considers the extent of mismatch between assets and liabilities and the amount of assets held in a highly liquid, marketable form should unexpected cashflows lead to a liquidity crunch.
A39	The price concession of liquidating assets is a prime concern when assessing <i>liquidity risk</i> and is built into the scenario.
A40	In examining the <i>liquidity risk</i> , the <i>firm</i> examines the following:
	Marketability, quality and liquidity of assets
A41	The <i>firm</i> considers the assets held and makes an assessment regarding the quality and liquidity of these assets. Even though the assets matched the liabilities, residual risk remains given that timings are uncertain and there is a possibility that assets will be realised at unfavourable times. This is allowed for by assuming a 2.5% reduction in the market value of assets at realisation compared to the current market value.
The <i>firm</i> considers that capital of between £X and £Y would cover timing risk to <i>counterparties</i> .	
	Reliance on new business income
A42	The <i>firm</i> relies partially upon new business cash flows to meet current liabilities as they fall due. The <i>firm</i> analyses the sensitivity of future cash flow projections and new business assumptions and considers the effect of a reduced level of new business.
A43	The <i>firm</i> finds that it did not have immediate alternatives in place in case these expected new business cash flows were reduced. In this regard, it considers that these sources should be stressed by X%.
The <i>firm</i> considers that capital of between £X and £Y would cover possible effects of adjusting the asset portfolio to switch to more liquid assets.	
A44	The <i>firm</i> also examines the volatility and cost of on- and off-balance sheet funding sources. The <i>firm</i> is satisfied that no concerns need to be raised and that there should not be any impact on its liquidity position.
A45	The <i>firm</i> believes it is well placed to manage unplanned changes in funding sources as well as react to changes in market conditions that affect its ability to quickly liquidate assets with minimal loss. The <i>firm</i> assesses that it has reasonable access to money markets and other

	sources of funding such as lines of credit.
A46	The <i>firm</i> has no previous problems or delays in meeting obligations (or accessing external funding).
Overall, from the above analysis, the <i>firm</i> considers that capital of between £X and £Y would be necessary to withstand the effects of deterioration in liquidity.	
	Governance Risk
A47	Governance risk relates to the risk associated with the board and/or senior management of the <i>firm</i> not effectively performing their respective roles.
A48	The existence and level of directors and officers insurance in place is investigated compared to known incidence of <i>claims</i> of this type.
A49	The <i>firm</i> assesses whether the current level of governance is appropriate for the <i>firm</i> , and the likelihood that the <i>firm's</i> practices may result in the board and/or senior management not adequately undertaking their roles. The cost of altering and strengthening the current board structure is considered.
A50	In this regard, the <i>firm</i> makes an assessment that it may be reliant on only a few senior executives, and may be exposed if they experience any misadventure.
The <i>firm</i> considers that capital of between £X and £Y would cover governance risk.	
	Strategic Risk
A51	Strategic risk arises from an inability to implement appropriate business plans and strategies, make decisions, allocate resources or adapt to changes in the business environment.
A52	The <i>firm</i> therefore assesses the prudence and appropriateness of its business strategy in the context of the <i>firm's</i> competitive and economic environment. In particular the assumptions, forecasting and projections are assessed considering the possibility of a fundamental market change due, for example, to higher numbers of competitors, changes in sales channels, new forms of insurance or changes in legislation. This review includes whether the <i>reinsurance</i> programme is appropriate for the risks selected by the <i>firm</i> and whether it adequately takes account of the underwriting and business plans of the <i>firm</i> generally.
A53	The <i>firm</i> considers the likelihood of a fundamental strategic shift too remote to include within the scenario given the maturity of the market in which they operate.
	Operational risks

A54	In reviewing the operational risk exposures, the <i>firm</i> has examined its administration, compliance, event, fraud, governance, strategic and technological risks.
	Administration
A55	The <i>firm</i> considers the risk of error or failure associated with the administrative aspects of the operation of its business. In this regard, the <i>firm</i> considers likelihood of financial loss and reputation harm due to failure or errors occurring and the likely size of these losses.
A56	None of the <i>firm's</i> administration is out-sourced to service providers.
A57	In undertaking the assessment, the <i>firm</i> considers the history of failure or error from transaction processing or control within the <i>firm</i> . Exception reports are produced on a quarterly basis. Past reports highlighted past administrative deficiencies. The biggest event in the past 10 years related to a situation where <i>claim</i> -handling staff shared access codes to the <i>claims</i> administration system. This resulted in an overpayment to some clients.
A58	The <i>firm</i> also examines the nature and extent of centralised and decentralised functions within the <i>firm</i> . Three branches report regularly to the central office and an appropriate system is in place to record financial information, handle complaints etc.
A59	The <i>firm</i> also reviews the segregation of duties between staff. It is satisfied that an adequate segregation of duties between underwriting <i>claims</i> and payments divisions exist in terms of acceptance, authorisation and payments. It is also satisfied that sufficient interaction between the front, middle and back offices exist in terms of financial control and risk management. For example, it is confident that its guidelines for accepting risks are adequate and that any breach would be picked up by exception reporting.
A60	The <i>firm</i> also investigates the level of staff expertise and training to administer its product range/services.
The <i>firm</i> considers that capital of between £X and £Y would cover the risk of future administration issues.	
	Compliance Risk
A61	The <i>firm</i> believes its main compliance risk relates to the risk of non-adherence to legislative and internal <i>firm</i> requirements.
A62	An investigation into compliance over the last 10 years finds no history of non-compliance with <i>firm</i> policy and control systems nor have there been any reported areas of non-compliance with legislation or other requirements.

A63	Regulatory reforms including corporate and consumer law are considered and it is assumed that expenses costs will rise as a result of developments in the next 5 years. As a result an additional X% of <i>premium</i> income was assumed for the expense ratio.
The <i>firm</i> considers that capital of between £X and £Y would cover the risk of future compliance issues.	
	Event risk
A64	Event risk relates to risks associated with the potential impact of significant events (e.g., financial system crisis, major change in fiscal system, natural disaster) on the operations of the <i>firm</i> .
A65	The definition of event risk is not intended to cover events that are directly associated with products and services offered, for example, events which may directly impact on the <i>general insurance business</i> .
A66	The <i>firm</i> concludes that no additional specific allocation is required.
	Fraud Risk
A67	Fraud risk relates to the risk associated with intentional misappropriation of funds, undertaken with the objective of personal benefit at the expense of the <i>firm</i> .
A68	In assessing fraud risk, the <i>firm</i> considers the possibility of fraudulent acts occurring within the <i>firm</i> and the extent of controls which management has established to mitigate such acts.
A69	The <i>firm</i> examines fraud issues over a period of 10 years and finds one major incident where it was subject to a fraudulent activity. This involved fraudulent payments being made by a member of staff which resulted in a loss for the <i>firm</i> of £Xm. Based on this previous incident and allowing for improvements in controls, the company assessed a financial figure that it believes is consistent with the probability for this scenario.
The <i>firm</i> considers that capital of between £X and £Y would cover the risk of future fraud.	
	Technology Risk
A70	The <i>firm</i> considers the risk of error or failure associated with the technological aspects (IT systems) of its operations. Specifically, technology risk refers to both the hardware systems and the software utilised to run those systems.
A71	In relation to the <i>firm's</i> information systems, the <i>firm</i> assesses the past reliability and future functionality and believes them to be adequate. It does not have any future plans to either replace its systems or make

	major systems modifications.
A72	Concerning business continuity management and disaster recovery planning (and testing of plans), the <i>firm</i> reviews these plans regularly and tests them quarterly. A full back-up site exists with full recovery capabilities. Costs associated with utilising the site and associated business interruption insurance was estimated.
The <i>firm</i> considers that capital of between £X and £Y would cover technology risk.	
	Group risk
A73	The size of the group risk element within operational risk will depend on the ownership structure of the <i>firm</i> and how it is funded by the parent.
A74	The <i>firm</i> considers the likelihood and financial consequences of both insolvency and credit downgrading of its parent. Given the <i>firm</i> shares the parent's name there is a large risk of association.
A75	The <i>firm</i> considers it within the scope of the scenario to allow for a single downgrade of the parent's credit rating from AA to A. It does not believe the chance of insolvency great enough to allow for directly.
A76	The <i>firm</i> estimates the effect on its business plan and profit margins of the downgrade. It estimates the amount of business lost and the increase in marketing costs required to maintain the client base. It also allows for a change in the pricing basis to incorporate a reduced profit margin (with knock on impacts on the business volume and loss ratios).
From the above analysis, the <i>firm</i> considers that capital of between £X and £Y would be required to cover group risks.	
	Overall assessment
A77	After individually assessing each risk area, the <i>firm</i> considers the capital that it has estimated might be absorbed under each scenario. In aggregate the range of capital absorbed is between £X and £Y. It considers how many of these scenarios might reasonably occur within a period and the extent to which it could replace capital within that period. It takes into account scenarios which might reasonably be linked, the difficulty with which capital might be replaced if the scenarios occurred, and the changes in strategy which might need to be adopted if the scenarios occurred.
A78	The <i>firm</i> decides that the worst realistic combination of circumstances that might arise would absorb capital of between £A and £B.

- 8.1 General provisions applying INSPRU and GENPRU to Lloyd's
- Application
- 8.1.1 R *INSPRU* 8.1 applies to:
- (1) the *Society*;
 - (2) *managing agents*.
- 8.1.2 R If a provision in *INSPRU* or *GENPRU* applies to the *Society* "in accordance with" this *rule*, the *Society* must:
- (1) manage each *member's funds at Lloyd's*;
 - (2) manage its *central assets*; and
 - (3) supervise the *insurance business* carried on by each *member* at Lloyd's; so as to achieve in relation to those assets and that *insurance business* the same effect as the relevant *INSPRU* or *GENPRU* provision would have (that is, conforming with the requirements of any *rule* and taking appropriate account of any applicable *guidance*,) when applied to a *firm* or to the *insurance business* of a *firm*.
- 8.1.3 G The *Society* is subject to *INSPRU* and *GENPRU rules* in respect of the *insurance business* of each Lloyd's *member*. These include *rules* in respect of:
- (1) the calculation of the *capital resources requirements* for each *member*;
 - (2) the financial resources it manages on behalf of *members*; and
 - (3) the *Society's* own financial resources.
- 8.1.4 R If a provision in *INSPRU* or *GENPRU* applies to a *managing agents* "in accordance with" this *rule*, the *managing agent* must, in relation to each *syndicate* managed by it and for each *syndicate* year, manage:
- (1) the *syndicate assets*; and
 - (2) the *insurance business* carried on by the *members* of the *syndicate* through that *syndicate*;
- so as to achieve in relation to those assets and that *insurance business* the same effect as the relevant *INSPRU* or *GENPRU* provision would have (that is, conforming with the requirements of any *rule* and taking appropriate account of any applicable *guidance*,) when applied to a *firm* or to the *insurance business* of a *firm*.
- 8.1.5 G *Syndicate membership* may change from year to year or it may remain constant. *Managing agents* are required to apply *INSPRU* and *GENPRU* to the *insurance business* carried on through each *syndicate* for each *syndicate*

year. This should ensure that *INSPRU* and *GENPRU* are applied to Lloyd's in a way that is consistent with the provision of capital to support the *insurance business* underwritten.

- 8.1.6 G Where common systems and controls or processes are appropriate for all the *insurance business* carried on through more than one *syndicate* year, a single response may be adequate for all *syndicate* years. However, in some cases it will be important to consider the business of each open *syndicate* year separately, particularly for quantitative *rules*. For example, it is important that *managing agents* separately assess the financial resources (including capital) that are required and are available to support the *insurance business* carried on through each *syndicate* year, where the *syndicate membership* changes from year to year. This is because each *member's* assets are only available to support its own business, so the assets supporting one year of account may not be available to support another. For example, if a *managing agent* were to assess the financial requirements of two or more *syndicate* years together where the capital structure had changed, there would be a risk that the *managing agent* might take account of diversification effects that were not reflected in the capital supporting the *insurance business*.

- 8.1.7 G There is no requirement on *managing agents* to carry out separate individual capital assessments for *syndicates* for each *syndicate* year. *Managing agents* are required to carry out individual capital assessments for each *syndicate* as if that *syndicate* were a *firm*; this would normally be on the basis of a going concern but, just as in a *firm*, account needs to be taken of any restrictions on the availability of assets (e.g. deposits with cedants), and some account needs to be taken of changes in the capital participation in the *syndicate*. The *Society* is responsible for the individual capital assessment for each *member*, which must take into account the assessments made by *managing agents* of any *syndicates* on which the *member* participates. *INSPRU* 7.1 contains *rules* and guidance on the assessment of capital adequacy for *firms* and *INSPRU* 7.1.57R to *INSPRU* 7.1.70R provide for the application of *INSPRU* 7.1 to the *Society* and *managing agents*.

- 8.1.8 G The assessment which a *firm* makes should be based upon its future business plans and projections. This is the main area where the *firm's* assessment may diverge from its prescribed *capital resources requirement* which, necessarily, is based upon historic data.

- 8.1.9 G Key *INSPRU* and *GENPRU* requirements for Lloyd's

Key <i>INSPRU</i> and <i>GENPRU</i> requirements	<i>INSPRU</i>	<i>GENPRU</i>
Risk management, systems and controls		

The <i>Society</i> to establish and maintain systems and controls to address risks affecting the Lloyd's market	<i>INSPRU</i> 8.2	
The <i>Society</i> to manage prudential, credit, market, liquidity and operational risks affecting <i>funds at Lloyd's</i> and <i>central assets</i>	<i>INSPRU</i> 4.1, <i>INSPRU</i> 5.1, <i>INSPRU</i> 8.2 & <i>INSPRU</i> 8.5	
<i>Managing agents</i> to establish and maintain systems and controls for the management of prudential, credit, market, liquidity, operational, and insurance risks affecting each <i>syndicate</i>	<i>INSPRU</i> 4.1, <i>INSPRU</i> 5.1, <i>INSPRU</i> 8.2 & <i>INSPRU</i> 8.5	
Adequacy of financial resources		
The <i>Society</i> to ensure that <i>members'</i> financial resources are adequate		<i>GENPRU</i> 1.2 & <i>GENPRU</i> 1.5
<i>Members</i> taken together to maintain adequate financial resources in respect of the <i>insurance business</i> conducted at Lloyd's		<i>GENPRU</i> 1.5
<i>Managing agents</i> to ensure that financial resources are adequate for each <i>syndicate</i>		<i>GENPRU</i> 1.2 & <i>GENPRU</i> 1.5
Valuation		
The <i>Society</i> and <i>managing agents</i> to apply generally accepted accounting principles to valuing assets, liabilities, equity and income statement items for the purposes of the <i>rules</i> and <i>guidance</i> in <i>GENPRU</i> , <i>INSPRU</i> and <i>IPRU (INS)</i> unless the contrary is expressly stated	<i>INSPRU</i> 3.1 & <i>INSPRU</i> 3.2	<i>GENPRU</i> 1.3 & <i>GENPRU</i> 1.5

Capital resources requirements		
The <i>Society</i> to calculate the <i>MCR</i> in respect of the <i>general insurance business</i> of each <i>member</i>		GENPRU 2.1 & GENPRU 2.3
The <i>Society</i> to calculate the <i>CRR</i> (higher of <i>MCR</i> and <i>ECR</i>) in respect of the <i>long-term insurance business</i> of each <i>member</i>		GENPRU 2.1 & GENPRU 2.3
Capital resources		
The <i>Society</i> and <i>managing agents</i> to calculate <i>capital resources</i> in accordance with the <i>rules</i> and <i>guidance</i> in <i>GENPRU</i>		GENPRU 2.2 & GENPRU 2.3
Adequacy of capital resources		
<i>Managing agents</i> to assess the adequacy of <i>capital resources</i> held at <i>syndicate</i> level in respect of <i>insurance business</i> carried on through each <i>syndicate</i> (annual <i>ICA</i> for each <i>syndicate</i>)	<i>INSPRU</i> 7.1	
The <i>Society</i> to assess the adequacy of <i>capital resources</i> available to support each <i>member's insurance business</i> (<i>ICA</i> for each <i>member</i>), both at <i>syndicate</i> level (taking account of <i>syndicate ICAs</i>), and as <i>funds at Lloyd's</i>	<i>INSPRU</i> 7.1	

8.2 Special provisions for Lloyd's

Management of insurance business

- 8.2.1 R Neither the *Society* nor *managing agents* may permit a *member* to carry on any *insurance business* except as a participant on one or more *syndicates*.

Obligations under INSPRU and GENPRU

- 8.2.2 R The *Society* must ensure that all participants in the Lloyd's market are made aware of their obligations under *INSPRU* and *GENPRU*.

Management of risk

- 8.2.3 R The *Society* must establish and maintain systems and controls to enable it appropriately to address the risks to which the Lloyd's market is exposed.

- 8.2.4 R The systems and controls in *INSPRU* 8.2.3 must include systems and controls to enable the *Society* to ensure that any assumptions made in calculating a *member's capital resources* or in determining the individual capital assessment for each *member* are regularly reviewed and that appropriate action is taken if any assumption is no longer valid.

- 8.2.5 R The *Society* must take all reasonable steps, including establishing and maintaining adequate systems and controls to enable it:
- (1) to manage the risks to which *funds at Lloyd's* and *central assets* are exposed; and
 - (2) to ensure that *funds at Lloyd's* and *central assets* are adequate to support all *balancing amounts*.

- 8.2.6 R A *managing agent* must establish and maintain adequate systems and controls to manage the risks to which the *insurance business* carried on through each *syndicate* it manages is exposed.

- 8.2.7 G In complying with *INSPRU* 8.2.6R, *managing agents* should have particular regard to:

(1) transactions which may give rise to a conflict of interest, such as those to which the *counterparties* are:

- (a) other members of the *managing agent's own group*;
- (b) any *members* of any *syndicates* managed by the *managing agent*; or
- (c) any entity that is part of a *group* to which one or more *members* of any *syndicates* managed by the *managing agent* belong; and

(2) transactions involving:

- (a) the provision of capital;

- (b) the provision of *reinsurance*; or
 - (c) the provision of other services.
- 8.2.8 R In complying with *INSPRU* 8.2.6R a *managing agent* need not take account of risks associated with assets that are not *syndicate assets*.
- 8.2.9 R The *Society* must take reasonable steps to ensure that systems and controls established and maintained by *managing agents* are adequate to ensure that risks to which the *insurance business* carried on through each *syndicate* is exposed do not have a detrimental effect on *funds at Lloyd's* or *central assets*.
- 8.2.10 G *Managing agents* and the *Society* each hold and manage some of the financial resources held to support the *insurance business* carried on through *syndicates*. In particular:
- (1) the *Society* holds and manages *funds at Lloyd's* and *central assets* which must be held to support *balancing amounts*. The *Society* is required to manage the risks that affect *funds at Lloyd's* and *central assets* directly, once the effects of any aggregation and diversification have been taken into account;
 - (2) *managing agents* hold and manage some of the financial resources in respect of the *insurance business* carried on through each *syndicate* that they manage. *Managing agents* are required to manage all risks affecting a *syndicate* except for the risk that *funds at Lloyd's* and *central assets* are not available to support the *balancing amount*.
- 8.2.11 R The *Society* must establish and maintain effective arrangements to monitor and manage risk arising from:
- (1) conflicts of interest (including in relation to (2) to (4));
 - (2) inter-*syndicate* transactions, including *reinsurance to close* and *approved reinsurance to close*;
 - (3) related party transactions; and
 - (4) transactions between *members* and itself.
- 8.2.12 R The arrangements in *INSPRU* 8.2.11R must enable the *Society* to identify any significant overstatement of financial resources resulting from any transaction falling within *INSPRU* 8.2.11R(2) to *INSPRU* 8.2.11R(4), including as a result of:
- (1) any differences in the amounts recorded as due or payable by each party to any such transaction; or
 - (2) any actual or likely disputes between the parties to any such transaction.
- 8.2.13 R If the *Society* identifies a significant overstatement of the kind referred to in *INSPRU* 8.2.12R, it must ensure that an appropriate adjustment is made, including if appropriate by a deduction from or reduction in the value attributed to:

- (1) the *capital resources* of any *member* concerned; or
- (2) the *Society's capital resources*.

Approved reinsurance to close

- 8.2.14 G As defined in the *Glossary*, "approved reinsurance to close" excludes:
- (1) *reinsurance* between parties other than *members*; and
 - (2) balance transfers between *syndicate years* of *syndicates* having only one *member*, which have no effect on the overall liabilities of that *member*.
- 8.2.15 G The "approved" status of an *approved reinsurance to close* does not alter the legal status or effect of the original *contract of insurance*, or the liability of a reinsured *member* to the *policyholder* under or in respect of the original *contract of insurance*.
- 8.2.16 R Notwithstanding that the liability of a reinsured *member* to a *policyholder* is unaffected by an *approved reinsurance to close* as described in *INSPRU* 8.2.15G, for the purposes of *INSPRU* and *GENPRU* only:
- (1) a *contract of insurance* reinsured under an *approved reinsurance to close* must be treated as if the reinsuring *member* and not the reinsured *member* had effected the original *contract of insurance*; and
 - (2) any payment received by a *member* as consideration for or in connection with an *approved reinsurance to close* must be treated as a *Lloyd's member's contribution* and not as *premium* or as a reinsurance recovery.

Provision of information by managing agents

- 8.2.17 R A *managing agent* must, as soon as possible, give the *Society* any information the *managing agent* has concerning material risks to *funds at Lloyd's* or *central assets*.
- 8.2.18 R A *managing agent* need not comply with *INSPRU* 8.2.17R if the *managing agent* knows that the *Society* already has the relevant information.

Insurance receivables to be carried to trust funds

- 8.2.19 R The *Society* must take all reasonable steps to ensure that each *member*:
- (1) executes the appropriate *Lloyd's trust deeds*; and
 - (2) carries to the appropriate *Lloyd's trust fund* all amounts received or receivable by the *member*, or on its behalf, in respect of any *insurance business* carried on by it.
- 8.2.20 R The *Society* must carry all amounts it receives on behalf of any *member* in respect of that *member's insurance business* to the appropriate *Lloyd's trust fund*.
- 8.2.21 R A *managing agent* must carry all amounts it receives on behalf of any

member in respect of that *member's insurance business* to the appropriate *Lloyd's trust fund*.

- 8.2.22 R In complying with *INSPRU* 8.2.19R to *INSPRU* 8.2.21R, the *Society* and *managing agents* must take all reasonable steps to ensure that amounts received or receivable by a *member* in respect of *general insurance business* and *long-term insurance business* are carried to separate *Lloyd's trust funds*.
- Amendments to byelaws, trust deeds and standard form letters of credit and guarantees
- 8.2.23 R The *Society* must, as soon as it is practical to do so, notify the *FSA* of its intention to approve the form of any new *Lloyd's trust deed*.
- 8.2.24 R The *Society* must, as soon as it is practical to do so, notify the *FSA* of its intention to make any amendment which may alter the meaning or effect of any *byelaw*, including:
- (1) any *Lloyd's trust deed*;
 - (2) any standard form letter of credit prescribed by the *Society* from time to time; or
 - (3) any standard form guarantee agreement prescribed by the *Society* from time to time.
- 8.2.25 R The *Society* must provide the *FSA* with full details of:
- (1) the form of any new *Lloyd's trust deed* it intends to approve, as described in *INSPRU* 8.2.23R and
 - (2) any amendments falling within *INSPRU* 8.2.24R.
- 8.2.26 R The *Society* must consult interested parties in relation to any new *Lloyd's trust deed* and in relation to any amendment falling within *INSPRU* 8.2.24R.
- 8.2.27 G Except in urgent cases, the *Society* should consult in relation to any new *Lloyd's trust deed* or amendments before the new deed or amendments take effect.
- 8.2.28 R The information provided to the *FSA* by the *Society* under *INSPRU* 8.2.25R must include:
- (1) a statement of the purpose of any proposed amendment or new *Lloyd's trust deed* and the expected impact, if any, on *policyholders*, *managing agents*, *members*, and potential *members*; and
 - (2) a description of the consultation undertaken under *INSPRU* 8.2.26R including a summary of any significant responses to that consultation.
- 8.2.29 G The *FSA* would normally expect to receive the information required under *INSPRU* 8.2.25R and *INSPRU* 8.2.28R not less than three months in advance of the proposed change.

8.3 The Central Fund

Application

8.3.1 R This chapter applies to the *Society*.

Purpose

8.3.2 G The *rules* and *guidance* in this chapter are intended to promote confidence in the market at Lloyd's, and to protect certain *consumers* of services provided by the *Society* in carrying on, or in connection with or for the purposes of, its *regulated activities*. They do this by:

(1) giving guidance to the *Society* about the protection that the *Central Fund* should provide for policyholders; and

(2) enabling the *FSA* to keep under review the protection the *Central Fund* provides for policyholders.

Enabling Provision

8.3.3 D The directions in this chapter are given under section 318 of the *Act* (Exercise of powers through Council) for the purpose of achieving the objective specified, as required by section 318(2) of the *Act*.

8.3.4 D The directions given in this chapter are given in relation to the exercise of the powers by the *Society* in respect of the *Central Fund* and are given with a view to achieving the objective of ensuring that the *Society* in making payments or in providing any other financial assistance from the *Central Fund* does so on a basis which takes no account of amounts of compensation which policyholders may receive under the provisions of the *compensation scheme* in respect of *protected claims* against *members*.

8.3.5 G The *Society* should seek to ensure that the *Central Fund* provides protection for policyholders so as to minimise the need for Lloyd's policyholders to have recourse to the *compensation scheme*.

8.3.6 G The *Society* should seek, and take appropriate account of, the *FSA's* views on all proposed changes in its arrangements relating to the *Central Fund*.

8.3.7 D The *Society* must, in the exercise of its powers to make payments from the *Central Fund* or to provide other forms of financial assistance from the *Central Fund*, ensure that in calculating and determining the amount of any such payment or the amount of any other financial assistance, it takes no account of the amounts of compensation which policyholders may receive under the provisions of the *compensation scheme* in respect of *protected claims* against *members*.

8.4 Capacity Transfer Market

Application

8.4.1 R This chapter applies to the *Society*.

Purpose

8.4.2 G The *rules* and *guidance* in this chapter are intended to promote confidence in the market at Lloyd's, and to protect certain *consumers* of services provided by the *Society* in carrying on, or in connection with or for the purposes of, its *regulated activities*. They do this by ensuring that the *Society* appropriately and effectively regulates the *capacity transfer market* so that it operates in a fair and transparent manner.

Requirement to make byelaws governing conduct in the capacity transfer market

8.4.3 R The *Society* must make appropriate *byelaws* governing conduct in the *capacity transfer market*.

8.4.4 G The *byelaws* referred to in *INSPRU* 8.4.3R should:

(1) ensure that adequate and effective arrangements are in place to enable *members* and *persons* applying to be admitted as *members* to enter into transactions to transfer *syndicate* capacity and settle these transactions in a timely manner;

(2) give clear and comprehensive guidance about the dissemination of information that is, or may be, relevant to the price of *syndicate* capacity and the transparency of the *capacity transfer market*; and

(3) prohibit unfair and abusive practices (including market manipulation), the misuse of information not generally available, and the dissemination of false or misleading information.

8.4.5 G The *Society* should have adequate and effective arrangements to:

(1) record and monitor transactions in the *capacity transfer market*, and maintain adequate audit trails; and

(2) suspend or annul transactions where appropriate.

8.4.6 G The *Society* should regularly review the *byelaws* referred to in *INSPRU* 8.4.3R, taking account of the standards of conduct required in other *UK* financial markets.

8.4.7 G The *Society* should consult *members* and *underwriting agents* before it finalises material changes in the *byelaws* referred to in *INSPRU* 8.4.3R, and should have timely and effective arrangements for notifying them of changes in these *byelaws*.

8.5 Former underwriting members

Application

8.5.1 R This chapter applies to the *Society*.

8.5.2 G The *rules* and *guidance* in this chapter are intended to promote confidence in the market at Lloyd's and to protect certain *consumers* of services provided by the *Society* in carrying on or in connection with or for the purposes of its *regulated activities* by:

(1) protecting policyholders against the risk that *former underwriting members* may not be able to meet any liabilities to carry out *contracts of insurance* that they underwrote at Lloyd's; and

(2) enabling the *FSA* to impose requirements under section 320(3) of the *Act* (Former underwriting members) if it considers this appropriate to protect policyholders.

Requirements relating to former underwriting members

8.5.3 R The *Society* must draw sections 320 to 322 of the *Act* (Former underwriting members, Requirements imposed under section 320, Rules applicable to former underwriting members) to the attention of any *person* ceasing to be an *underwriting member* on or after *commencement*.

8.5.4 R The *Society* must require any *person*, other than a *body corporate*, ceasing to be an *underwriting member* on or after *commencement* to:

(1) notify the *Society* of any change in his address within one month of the change;

(2) in the case of a natural person, to make arrangements for the *Society* to be notified in the event of his death.

8.6 Prudential risk management and associated systems and controls

Application of SYSC 14

8.6.1 R Subject to *INSPRU* 8.6.2R, *SYSC* 14 (Prudential risk management and associated systems and controls) applies to *managing agents* and to the *Society* in accordance with:

(1) for *managing agents*, *INSPRU* 8.1.4R; and

(2) for the *Society*, *INSPRU* 8.1.2R.

8.6.2 R The requirement in *SYSC* 14.1.18R to take reasonable steps to ensure the establishment and maintenance of a business plan does not apply to the *Society*.

Application of SYSC 11, 15 and 16

8.6.3 R Subject to *INSPRU* 8.6.5R, *SYSC* 11 (Liquidity risk management systems and controls), *SYSC* 15 (Credit risk management systems and controls) and *SYSC* 16 (Market risk management systems and controls) apply to *managing agents* and to the *Society* in accordance with:

(1) for *managing agents*, *INSPRU* 8.1.4R; and

(2) for the *Society*, *INSPRU* 8.1.2R.

Application of SYSC 17

8.6.4 R Subject to *INSPRU* 8.6.5R, *SYSC* 17 (Insurance risk systems and controls) applies to *managing agents* in accordance with *INSPRU* 8.1.4R.

8.6.5 R In accordance with *INSPRU* 8.6.2 R, the *rules* and *guidance* in *SYSC* 11, *SYSC* 15, *SYSC* 16 and *SYSC* 17 relating to the establishment and maintenance of a business plan do not apply to the *Society*.

9.1 Actions for damages

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

INSPRU TP

Transitional provisions

1 IPRU waivers

Application

1.1 R *INSPRU* TP 1 applies to an *insurer* unless it is:

- (1) a *non-directive friendly society*; or
- (2) an *incoming EEA firm*; or
- (3) an *incoming Treaty firm*.

Version of IPRU to be used

1.2 R Any reference in *INSPRU* TP to *IPRU (INS)* is to the version in force on 30 December 2004.

Duration of transitional

1.3 R *INSPRU* TP 1 applies until the relevant *rule* is revoked.

Continuing effect of waivers

1.4 R A *rule* in *INSPRU* listed in the Table at *INSPRU* TP Table 2 is disapplied, or is modified in its application, to a *firm*:

- (1) in order to produce the same effect, including any conditions, as a *waiver* had on the corresponding *rule* in *IPRU (INS)*;
- (2) for the same period as the *waiver* would have lasted, if shorter than the period in *INSPRU* TP 1.3;

provided the conditions set out in *INSPRU* TP 1.5 are satisfied.

1.5 R The conditions referred to in *INSPRU* TP 1.4 are:

- (1) the *rule* is shown in the Table at *INSPRU* TP Table 2 as corresponding with the *rule* in *IPRU (INS)* in relation to which the *waiver* was granted to the *firm*;
- (2) the *waiver* was current as respects the *firm* immediately before 31 December 2004; and
- (3) there is no specific transitional *rule* relating to the *waiver*.

- 1.6 R *INSPRU* TP 1.4 does not have effect if, and to the extent that, it would be inconsistent with any community obligation of the *United Kingdom*.
- 1.7 R A *firm* which has the benefit of a *waiver* to which *INSPRU* TP 1.4 applies must:
- (1) notify the *FSA* immediately if it becomes aware of any matter which is material to the relevance or appropriateness of the *waiver*;
 - (2) maintain a written record of the *rule* in *INSPRU* to which it considers the *waiver* applies; and
 - (3) make the record available to the *FSA* on request.

INSPRU TP Table 2

Rules in INSPRU	Corresponding rules in IPRU (INS)
2.1.22	4.14(1)
3.1.34	5.11
3.1.39	5.11 5.11(4) 5.11(5) 5.11(9) 5.11(11)
3.1.58	2.3(2)
1.1.51	2.4(6)
1.1.56	2.4(1)
1.1.66	Appendix 2.1 2.4(1)(b) Appendix 2.2 2.4(1)(b) 5.9(1)
1.2.40	5.9(2)
1.2.41	5.9(2)
1.2.43	5.10
1.2.74	5.16
6.1.17	10.1 10.2 10.2(1) 10.2(2) 10.2(3)
6.1.23	10.2 10.2(1) 10.2(2) 10.2(3)

3 PRU waivers

Application

3.1 R *INSPRU* TP 3 applies to an *insurer* unless it is:

- (1) a *non-directive friendly society*; or
- (2) an *incoming EEA firm*; or
- (3) an *incoming Treaty firm*.

Version of PRU to be used

3.2 R A reference in *INSPRU* TP 3 to *PRU* is to the version in force on 30 December 2006.

Duration of transitional

3.3 R *INSPRU* TP 3 applies until the relevant *INSPRU rule* is revoked.

Continuing effect of waivers

3.4 R A *rule* in *INSPRU* is disapplied, or is modified in its application, to a *firm*:

- (1) in order to produce the same effect, including any conditions, as a *waiver* had on the *rule* in *PRU*;
- (2) for the same period as the *waiver* would have lasted, if shorter than the period in *INSPRU* TP 3.3;

provided the conditions set out in *INSPRU* TP 3.5 are satisfied.

3.5 R The conditions referred to in *INSPRU* TP 3.4 are:

- (1) the *rule* in *PRU* in relation to which the *waiver* was granted to the *firm* was redesignated as the relevant *rule* in *INSPRU* by the Prudential Sourcebook for Insurers Instrument 2006;
- (2) the *waiver* was current as respects the *firm* immediately before 31 December 2006; and
- (3) there is no specific transitional *rule* relating to the *waiver*.

3.6 R *INSPRU* TP 3.4 does not have effect if, and to the extent that, it would be inconsistent with any community obligation of the *United Kingdom*.

- 3.7 R A *firm* which has the benefit of a *waiver* to which *INSPRU* TP 3.4 applies must:
- (1) notify the *FSA* immediately if it becomes aware of any matter which is material to the relevance or appropriateness of the *waiver*;
 - (2) maintain a written record of the *rule* in *INSPRU* to which it considers the *waiver* applies; and
 - (3) make the record available to the *FSA* on request.

4 EEA pure reinsurers

Application

4.1 R *INSPRU* TP 4 applies to a *pure reinsurer*:

- (1) whose head office is in an *EEA State* other than the *United Kingdom*; and
- (2) which is not an *incoming Treaty firm*.

Duration of transitional

4.2 R *INSPRU* TP 4 has effect in relation to a *firm* until 10 December 2008 or, if earlier, the date on which it becomes:

- (1) an *incoming EEA firm* by reason of having exercised its right to carry on the *regulated activity* of *effecting or carrying out contracts of insurance* in the *United Kingdom* in accordance with Schedule 3 to the *Act* (EEA Passport Rights); or
- (2) an *incoming Treaty firm* by reason of having exercised its right to carry on the *regulated activity* of *effecting or carrying out contracts of insurance* in the *United Kingdom* in accordance with Schedule 4 to the *Act* (Treaty Rights).

50% premiums and claims uplift for classes 11, 12 and 13; credit equalisation provision

4.3 R The following *rules* or paragraphs of a *rule* do not apply to a *firm*:

- (1) *INSPRU* 1.1.56R(1);
- (2) *INSPRU* 1.1.60R(1); and
- (3) *INSPRU* 1.4.39R to *INSPRU* 1.4.46R.

5 Pure reinsurance groups

Application

- 5.1 R *INSPRU* TP 5 applies to a *pure reinsurer* whose *ultimate EEA insurance parent undertaking* is the *parent undertaking* of a *group* comprised solely of *reinsurance undertakings*.

Duration of transitional

- 5.2 R *INSPRU* TP 5 applies until 10 December 2007.

Group capital resources requirement

- 5.3 R A *firm* need not comply with *INSPRU* 6.1.15R.

Insurance Prudential sourcebook (*INSPRU*)

Schedule 1

Record keeping requirements

G

1 The aim of the *guidance* in the following table is to give the reader a quick overall view of the relevant record keeping requirements.

2 It is not a complete statement of those requirements and should not be relied on as if it were.

3 Table

Handbook reference	Subject of Record	Contents of Record	When record must be made	Retention Period
<i>INSPRU</i> 1.2.20R	<i>Mathematical reserves</i>	(1) The methods and assumptions used in establishing the <i>firm's mathematical reserves</i> , including the margins for adverse deviation, and the reasons for their use (2) The nature of, reasons for, and effect of, any change in approach, including the amount by which the change in approach increases or decreases its <i>mathematical reserves</i>	Not specified	An appropriate period
<i>INSPRU</i> 1.3.17R, <i>INSPRU</i> 1.3.19R	Calculation of <i>with-profits insurance capital component</i>	(1) The methods and assumptions used in making any calculation required for the purposes of <i>INSPRU</i> 1.3 (and any subsequent changes) and the reasons for their use (2) Any change in practice (in particular	Not specified	An appropriate period

Handbook reference	Subject of Record	Contents of Record	When record must be made	Retention Period
		changes in those items which will or may be significant in relation to the eventual <i>claim</i> values) and the nature of, reasons for, and effect of, any change in approach with respect to those methods and assumptions		
<i>INSPRU</i> 1.5.23R	<i>Long-term insurance funds</i>	A separate accounting record in respect of each of a <i>firm's long-term insurance funds</i>	Not specified	Not specified
<i>INSPRU</i> 1.5.56R, <i>INSPRU</i> 1.5.57R	<i>Branch accounting records in the United Kingdom</i>	A record of the activities carried on from a <i>non-EEA direct insurer's United Kingdom branch</i> and, if it is an <i>EEA-deposit insurer</i> , from its <i>branches</i> in other <i>EEA states</i> including a record of: (1) the income, expenditure and liabilities arising from activities of the <i>branch</i> or <i>branches</i> (2) the assets identified under <i>INSPRU</i> 1.1.20R as available to meet those liabilities	Not specified	Not specified

Insurance Prudential sourcebook (*INSPRU*)

Schedule 2

Notification and reporting requirements

G

1 The aim of the *guidance* in the following table is to give the reader a quick overall view of the relevant notification requirements.

2 It is not a complete statement of those requirements and should not be relied on as if it were.

3 Table

Handbook reference	Matter to be notified	Contents of notification	Trigger event	Time allowed
<i>INSPRU</i> 2.1.23R	That a <i>reinsurance</i> exposure to a <i>reinsurer</i> or group of closely related <i>reinsurers</i> is reasonably likely to exceed, or has exceeded, 100% of the <i>firm's capital resources</i> excluding <i>capital resources</i> held to cover <i>property-linked liabilities</i>	Fact that the limit is reasonably likely to be, or has been, exceeded Note: upon notification under <i>INSPRU</i> 2.1.23R the <i>firm</i> must: (1) demonstrate that prudent provision has been made for the <i>reinsurance</i> exposure in excess of the 100% limit, or explain why in the opinion if the <i>firm</i> no provision is required, and (2) explain how the <i>reinsurance</i> exposure is being safely managed (see <i>INSPRU</i> 2.1.24R)	(1) A reasonable likelihood that the limit will be exceeded, or (2) if (1) does not apply, the limit being exceeded	As soon as the <i>firm</i> first becomes aware of the matter required to be notified
<i>INSPRU</i> 2.1.29R	That the <i>firm</i> has exceeded, or anticipates exceeding, the	Fact that the limit has been	The limit being	Immediately

Handbook reference	Matter to be notified	Contents of notification	Trigger event	Time allowed
	limit expressed in <i>INSPRU</i> 2.1.28E (in each <i>financial year</i> a <i>firm</i> should restrict the <i>gross earned premiums</i> which it pays to a <i>reinsurer</i> or group of closely related <i>reinsurers</i> to the higher of (a) 20% of the <i>firm's</i> projected <i>gross earned premiums</i> for that <i>financial year</i> and (b) £4 million)	exceeded, or that the <i>firm</i> anticipates exceeding the limit Note: upon notification under <i>INSPRU</i> 2.1.29R the <i>firm</i> must explain to the <i>FSA</i> how, despite the excess <i>reinsurance</i> concentration, the credit risk is being safely managed (see <i>INSPRU</i> 2.1.30R)	exceeded, or an anticipation that the limit will be exceeded	
<i>INSPRU</i> 3.1.65R	<i>Syndicate</i> liabilities not covered by matching <i>syndicate assets</i> as required by <i>INSPRU</i> 3.1.53R	Nature and extent of <i>syndicate</i> liabilities not covered by matching <i>syndicate assets</i> as required by <i>INSPRU</i> 3.1.53R	<i>Syndicate</i> liabilities are no longer covered by matching <i>syndicate assets</i> as required by <i>INSPRU</i> 3.1.53R	Immediately
<i>INSPRU</i> 7.1.68R	<i>Syndicate ICA</i> and <i>balancing amount</i> in respect of each <i>syndicate</i>	<i>Syndicate ICA</i> and <i>balancing amount</i> in respect of each <i>syndicate</i>	Notification should be made periodically	As part of the annual capital-setting process, in good time for the <i>Society</i> to review and place appropriate reliance on them when determining capital assessments for each

Handbook reference	Matter to be notified	Contents of notification	Trigger event	Time allowed
				<i>member</i>
<i>INSPRU</i> 7.1.74R	Significant doubt about the adequacy of a <i>syndicate ICA</i> or <i>balancing amount</i> with respect to <i>syndicate</i> risks and controls	Revised <i>syndicate ICA</i> and <i>balancing amount</i>	The <i>managing agent</i> considers that <i>syndicate ICA</i> and <i>balancing amount</i> communicated in the capital setting process are no longer adequate in the light of the risks to which the <i>syndicate</i> business is exposed	Immediately
<i>INSPRU</i> 8.2.17R	Information the <i>managing agent</i> has concerning material risks to <i>funds at Lloyd's</i> or <i>central assets</i>	All information concerning relevant risk	Receipt of information	As soon as possible
<i>INSPRU</i> 8.2.23R	Intention to approve the form of any new <i>Lloyd's trust deed</i>	Fact of intention	Intention to approve	As soon as practical
<i>INSPRU</i> 8.2.24R	Intention to make any amendment which may alter the meaning or effect of any <i>byelaw</i> (including <i>Lloyd's trust deeds</i> , standard form letters of credit and guarantees)	Fact of intention	Intention to amend	As soon as practical
<i>INSPRU</i> 8.2.25R	Full details of form of new <i>Lloyd's trust deed</i> or amendments to <i>byelaw</i> (including <i>Lloyd's trust deeds</i> , standard form letters of credit and guarantees)	(1) Statement of purpose of amendment or new form and expected impact, if any, on <i>policyholders</i> , <i>managing agents</i> , <i>members</i> and potential <i>members</i> , and	Not specified	Normally not less than three months in advance of proposed change

Handbook reference	Matter to be notified	Contents of notification	Trigger event	Time allowed
		(2) Description of the consultation undertaken and summary of significant responses to consultation		

Insurance Prudential sourcebook (*INSPRU*)

Schedule 3

Fees and other requirement payments

G

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

Insurance Prudential sourcebook (*INSPRU*)

Schedule 4

Powers exercised

G

1 The following powers and related provisions in the *Act* have been exercised by the *FSA* to make the rules in *INSPRU*:

- (1) section 138 (General rule-making power);
- (2) section 141 (Insurance business rules);
- (3) section 149 (Evidential provisions);
- (4) section 150(2) (Actions for damages);
- (5) section 156 (General supplementary powers; and
- (6) section 318(1) (Exercise of powers through Council)

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

- (1) section 157(1) (Guidance).

Insurance Prudential sourcebook (*INSPRU*)

Schedule 5

Rights of action for damages

G

1. The table below sets out the *rules* in *INSPRU* contravention of which by an *authorised person* may be actionable under section 150 of the *Act* (Actions for damages) by a *person* who suffers loss as a result of the contravention.

2. If a "Yes" appears in the column headed "For *private person*", the *rule* may be actionable by a *private person* under section 150 (or, in certain circumstances, his fiduciary or representative; see article 6(2) and (3)(c) of the Financial Services and Markets Act 2000 (Rights of Action) Regulations 2001 (SI 2001/2256)). A "Yes" in the column headed "Removed" indicates that the *FSA* has removed the right of action under section 150(2) of the *Act*. If so, a reference to the *rule* in which it is removed is also given.

3. The column headed "For other *person*" indicates whether the *rule* may be actionable by a *person* other than a *private person* (or his fiduciary or representative) under article 6(2) and (3) of those Regulations. If so, an indication of the type of *person* by whom the *rule* may be actionable is given.

Chapter/ Appendix	Section/ Annex	Right of action under section 150		
		For <i>private person</i>	Removed	For other <i>person</i>
All <i>rules</i> in <i>INSPRU</i>		No	Yes (<i>INSPRU</i> 9.1.1R)	No

Prudential sourcebook for insurers, the Society of Lloyd's and managing agents (*INSPRU*)

Schedule 6

Rules that can be waived

G

The rules in *INSPRU* can be waived by the *FSA* under section 148 of the *Act* (Modification or waiver of rules), except for *INSPRU* 9.1.1R (Actions for damages). However, if the *rules* incorporate requirements laid down in European directives, it will not be possible for the *FSA* to grant a *waiver* that would be incompatible with the *United Kingdom's* responsibilities under those directives. It therefore follows that if a *rule* in *INSPRU* contains provisions which derive partly from a directive, and partly not, the *FSA* will be able to consider a *waiver* of the latter requirements only, unless the directive provisions are optional rather than mandatory.

**PRUDENTIAL SOURCEBOOK FOR MORTGAGE AND HOME FINANCE
FIRMS, AND INSURANCE INTERMEDIARIES INSTRUMENT 2006**

Powers exercised

- A. The Financial Services Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 ("the Act"):
- (1) section 138 (General rule-making powers);
 - (2) section 149 (Evidential provisions);
 - (3) section 156 (General supplementary powers); and
 - (4) section 157(1) (Guidance).
- B. The rule-making powers listed above are specified for the purpose of section 153(2) of the Act (Rule-making instruments).

Commencement

- C. This instrument comes into force on 1 January 2007.

Amendments to the Handbook

- D. The FSA makes the rules and gives the guidance set out in Annexes A to C to this instrument.
- D. The Glossary of Definitions is amended in accordance with Annex D to this instrument.
- E. Other provisions in the FSA's Handbook of rules and guidance are amended in accordance with Annex E to this instrument.

Citation

- G. This instrument may be cited as the Prudential sourcebook for Mortgage and Home Finance Firms, and Insurance Intermediaries Instrument 2006.
- H. The sourcebook in Annexes A to C to this instrument may be cited as the Prudential sourcebook for Mortgage and Home Finance Firms, and Insurance Intermediaries (or MIPRU).

By order of the Board
25 October 2006

Annex A

Prudential sourcebook for Mortgage and Home Finance Firms, and Insurance Intermediaries

In this annex, all text is new and is not underlined.

Prudential sourcebook for Mortgage and Home Finance Firms, and Insurance Intermediaries

- 1** **Application and general provisions**
- 1.1 Application
- 1.2 Actions for damages

- 2** **Insurance mediation activity: responsibility, knowledge, ability and good repute**
- 2.1 Application and purpose
- 2.2 Allocation of the responsibility for insurance mediation activity
- 2.3 Knowledge, ability and good repute

- 3** **Professional indemnity insurance**
- 3.1 Application and purpose
- 3.2 Professional indemnity insurance requirements

- 4** **Capital resources**
- 4.1 Application and purpose
- 4.2 Capital resources requirements
- 4.3 Calculation of annual income
- 4.4 Calculation of capital resources

- 5** **Insurance undertakings and mortgage lenders using insurance or mortgage mediation services**
- 5.1 Application and purpose
- 5.2 Use of intermediaries

Transitional Provisions and Schedules

1 Application and general provisions

1.1 Application

1.1.1 G This sourcebook applies to a *firm* with *Part IV permission* to carry on:

- (1) *insurance mediation activity*;
- (2) *mortgage mediation activity*;
- (3) *mortgage lending*;
- (4) *mortgage administration*; and
- (5) *insurance business*;

as specified in the beginning of each of the remaining chapters.

1.2 Actions for damages

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

- 2 Insurance mediation activity: responsibility, knowledge, ability and good repute
- 2.1 Application and purpose
- Application
- 2.1.1 R This chapter applies to a *firm* with *Part IV permission* to carry on *insurance mediation activity*.
- Purpose
- 2.1.2 G The main purpose of this chapter is to implement, in part, the provisions of the *Insurance Mediation Directive* as these apply to *firms* regulated by the *FSA*.
- 2.2 Allocation of the responsibility for insurance mediation activity
- Responsibility for insurance mediation activity
- 2.2.1 R An insurance intermediary, other than a sole trader, must allocate the responsibility for the *firm's insurance mediation activity* to a director or senior manager.
- [**Note:** Article 3(1), fourth paragraph, of the *IMD*]
- 2.2.2 R The *firm* may allocate the responsibility for its *insurance mediation activity* to an *approved person* (or *persons*) performing:
- (1) a *governing function* (other than the *non-executive director function*);
or
 - (2) the *apportionment and oversight function*; or
 - (3) the *significant management (other business operations) function*.
- 2.2.3 G (1) Typically an *insurance intermediary* will appoint a *person* performing a *governing function* (other than the *non-executive director function*) to direct its *insurance mediation activity*. Where this responsibility is allocated to a *person* performing another function, the *person* performing the *apportionment and oversight function* with responsibility for the apportionment of responsibilities must ensure that responsibility for the *firm's insurance mediation activity* is appropriately allocated.
- (2) The descriptions of *significant influence functions*, other than the *required functions*, do not extend to activities carried on by an *insurance intermediary* with *permission* only to carry on *insurance mediation activity* and whose principal purpose is to carry on activities other than *regulated activities* (see *SUP 10.1.21R*). In this case, the *firm* may allocate the responsibility for the *firm's insurance*

mediation activity to one or more of the *persons* performing the *apportionment and oversight function* who will be required to be an *approved person*.

- (3) In the case of a *sole trader*, the *sole trader* will be responsible for the *firm's insurance mediation activity*, whether or not he is himself a *person* approved to perform the *sole trader function*.

2.2.4 G Where a *firm* has appointed an *appointed representative* to carry on *insurance mediation activity* on its behalf, the *person* responsible for the *firm's insurance mediation activity* will also be responsible for the *insurance mediation activity* carried on by an *appointed representative*.

2.2.5 G The *FSA* will specify in the *FSA Register* the name of the *persons* to whom the responsibility for the *firm's insurance mediation activity* has been allocated by inserting after the relevant *controlled function* the words "(insurance mediation)". In the case of a *sole trader*, the *FSA* will specify in the *FSA Register* the name of the *sole trader* as the 'contact person' in the *firm*.

2.3 Knowledge, ability and good repute

2.3.1 R An *insurance intermediary* must establish on reasonable grounds that:

- (1) a reasonable proportion of the *persons* within its management structure who are responsible for *insurance mediation activity*; and

- (2) all other *persons* directly involved in its *insurance mediation activity*;

demonstrate the knowledge and ability necessary for the performance of their duties; and

- (3) all the *persons* in its management structure and any staff directly involved in *insurance mediation activity* are of good repute.

[**Note:** Article 4(1) and (2) of the *IMD*]

2.3.2 G In determining a *person's* knowledge and ability, the *firm* should have regard to matters including, but not limited to, whether the *person*:

- (1) has demonstrated by experience and training to be able, or that he will be able, to perform his duties related to the *firm's insurance mediation activity*; and

- (2) satisfies the relevant requirements of the *FSA's* Training and Competence sourcebook.

2.3.3 R In considering a *person's* repute, the *firm* must ensure that the *person*:

- (1) has not been convicted of any serious criminal offences linked to crimes against property or other crimes related to financial activities

(other than spent convictions under the Rehabilitation of Offenders Act 1974 or any other national equivalent); and

- (2) has not been adjudged bankrupt (unless the bankruptcy has been discharged);

under the law of any part of the *United Kingdom* or under the law of a country or territory outside the *United Kingdom*.

[**Note:** Article 4(2) of the *IMD*]

- 2.3.4 G The *firm* should give particular consideration to offences of dishonesty, fraud, financial crime or other offences under legislation relating to banking and financial services, companies, insurance and consumer protection.
- 2.3.5 G *Firms* are reminded that *Principle 3* requires *firms* to take reasonable care to organise and control their affairs responsibly and effectively. *Principle 3* is amplified by the *rule* which requires *firms* to take reasonable care to establish and maintain such systems and controls as are appropriate to its business (*SYSC 3.1.1R*). A *firm's* systems and controls should enable it to satisfy itself of the suitability of anyone who acts for it (*SYSC 3.2.13G*). This includes the assessment of an individual's honesty and competence. In addition, the Training and Competence sourcebook lists some general, high level commitments to training and competence which every *firm* should make and fulfil.

3 Professional indemnity insurance

3.1 Application and purpose

Application

3.1.1 R This chapter applies to a *firm* with *Part IV permission* to carry on any of the following activities:

(1) *insurance mediation activity*;

(2) *mortgage mediation activity*;

unless any of the following exemptions apply:

(3) in relation to *insurance mediation activity*, this chapter does not apply to a *firm* if another *authorised person* which has net tangible assets of more than £10 million provides a comparable guarantee; for this purpose:

(a) if the *firm* is a member of a *group* in which there is an *authorised person* with net tangible assets of more than £10 million, the comparable guarantee must be from that *person*;

(b) a 'comparable guarantee' means a written agreement on terms at least equal to those in a contract of professional indemnity insurance (see *MIPRU* 3.2.4R) to finance the claims that might arise as a result of a breach by the *firm* of its duties under the *regulatory system* or civil law;

(4) in relation to *mortgage mediation activity*, this chapter does not apply to a *firm* if:

(a) it has net tangible assets of more than £1 million; or

(b) the comparable guarantee provisions of (3) apply (as if the *firm* was carrying on *insurance mediation activity*) but substituting £1 million for £10 million in (3)(a) and (b);

(5) this chapter does not apply to:

(a) an *insurer*; or

(b) a *managing agent*; or

(c) a *personal investment firm* that is required by another *rule* to hold professional indemnity insurance (see *IPRU(INV)* 13.1.4(1)R);

(6) in relation to *mortgage mediation activity*, this chapter does not

apply to an *authorised professional firm*:

- (a) that is required by another *rule* to hold professional indemnity insurance (see *IPRU(INV)* 2.3.1R); and
- (b) whose *mortgage mediation activity* is incidental to its main business.

3.1.2 G The definition of *insurance mediation activity* is any of several activities 'in relation to a *contract of insurance*' which includes a contract of reinsurance. This chapter, therefore, applies to a reinsurance intermediary in the same way as it applies to any other *insurance intermediary*.

Purpose

3.1.3 G The purposes of this chapter are to:

- (1) implement article 4.3 of the *Insurance Mediation Directive* in so far as it requires *insurance intermediaries* to hold professional indemnity insurance, or some other comparable guarantee, against any liability that might arise from professional negligence; and
- (2) meet the *regulatory objectives* of consumer protection and maintaining market confidence by ensuring that *firms* have adequate resources to protect themselves, and their *customers*, against losses arising from breaches in its duties under the *regulatory system* or civil law.

3.1.4 G Any breach in the duty of a *firm* or of its agents under the *regulatory system* or civil law can give rise to claims being made against the *firm*. Professional indemnity insurance has an important role to play in helping to finance such claims. In so doing, this chapter amplifies *threshold condition 4* (Adequate resources). This *threshold condition* provides that a *firm* must have, on a continuing basis, resources that are, in the opinion of the *FSA*, adequate in relation to the *regulated activities* that the *firm* carries on.

3.1.5 G Under *Principles 3* and *4* a *firm* is required to take reasonable care to organise and control its affairs responsibly and effectively with adequate risk management systems and to maintain adequate financial resources. Under *Principle 9* a *firm* is obliged to take reasonable care to ensure the suitability of its *advice on investments* and discretionary decisions for any *customer* who is entitled to rely upon its judgement.

3.1.6 G Although financial resources and appropriate systems and controls can generally mitigate operational risk, professional indemnity insurance has a role in mitigating the risks a *firm* faces in its day to day operations, including those arising from not meeting the legally required standard of care when *advising on investments*. The purpose of this chapter is to ensure that a *firm* has in place the type, and level, of professional indemnity insurance necessary to mitigate these risks.

3.2 Professional indemnity insurance requirements

- 3.2.1 R A *firm* must take out and maintain professional indemnity insurance that is at least equal to the requirements of this section from:
- (1) an *insurance undertaking* authorised to transact professional indemnity insurance in the *EEA*; or
 - (2) a *person* of equivalent status in:
 - (i) a *Zone A country*; or
 - (ii) the Channel Islands, Gibraltar, Bermuda or the Isle of Man.

[**Note:** Article 4(3) of the *IMD*]

- 3.2.2 G The minimum *limits of indemnity* for a *firm* whose *Part IV permission* covers both *insurance mediation activity* and *mortgage mediation activity* is the higher of the *limits of indemnity* for these activities. If the *firm* opts for a single comparable guarantee to finance the claims which might arise as a result of both activities, the requirements for *insurance mediation activity* apply.

- 3.2.3 G A non-*EEA firm* (such as a captive insurance company outside the *EEA*) will be able to provide professional indemnity insurance only if it is authorised to do so in one of the specified countries or territories. The purpose of this provision is to balance the level of protection required for the *policyholder* against a reasonable level of flexibility for the *firm*.

Terms to be incorporated in the insurance

- 3.2.4 R The contract of professional indemnity insurance must incorporate terms which make provision for:
- (1) cover in respect of claims for which a *firm* may be liable as a result of the conduct of itself, its *employees* and its *appointed representatives* (acting within the scope of their appointment);
 - (2) the minimum *limits of indemnity* per year set out in this section;
 - (3) an excess as set out in this section;
 - (4) appropriate cover in respect of legal defence costs;
 - (5) continuous cover in respect of claims arising from work carried out from the date on which the *firm* was given *Part IV permission* for the *insurance mediation activity* or *mortgage mediation activity* concerned; and
 - (6) cover in respect of *Ombudsman* awards made against the *firm*.

- 3.2.5 G A *firm* is responsible for the conduct of all of its *employees*. The *firm's employees* include, but are not limited to, its *partners, directors*, individuals that are self-employed or operating under a contract hire agreement and any other individual that is employed in connection with its business.
- 3.2.6 G A *firm* is responsible for the conduct of all of its *appointed representatives*.
Minimum limits of indemnity: insurance intermediary
- 3.2.7 R If the *firm* is an *insurance intermediary*, then the minimum *limits of indemnity* are:
- (1) for a single claim, €1 million; and
 - (2) in aggregate, €1.5 million or, if higher, 10% of *annual income* up to £30 million.
- [Note: Article 4(3) of the *IMD*]
- 3.2.8 R If a *policy* is denominated in any currency other than euros, a *firm* must take reasonable steps to ensure that the *limits of indemnity* are, when the *policy* is effected and at *renewal*, at least equivalent to those required.
Minimum limits of indemnity: mortgage intermediary
- 3.2.9 R If the *firm* is a *mortgage intermediary*, then the minimum *limit of indemnity* is the higher of 10% of *annual income* up to £1 million, and:
- (1) for a single claim, £100,000; or
 - (2) in aggregate, £500,000.
- Excess
- 3.2.10 R In this chapter, "*client assets*" includes a *document* only if it has value, or is capable of having value, in itself (such as a bearer instrument).
- 3.2.11 R For a *firm* which does not hold *client money* or other *client assets*, the excess must not be more than the higher of:
- (1) £2,500; and
 - (2) 1.5% of *annual income*.
- 3.2.12 R For a *firm* which holds *client money* or other *client assets*, the excess must not be more than the higher of:
- (1) £5,000; and
 - (2) 3% of *annual income*.

Policies covering more than one firm

- 3.2.13 R If a *policy* provides cover to more than one *firm*, then:
- (1) the *limits of indemnity* must be calculated on the combined *annual income* of all the *firms* named in the *policy*; and
 - (2) each *firm* named in the *policy* must have the benefit of the relevant minimum *limits of indemnity*.

Additional capital

- 3.2.14 R If a *firm* seeks to have an excess which is higher than the relevant limit, it must hold additional capital calculated in accordance with the appropriate table below:

Table: Calculation of additional capital for firm not holding client money or other client assets (£000's)

Income		Excess obtained up to and including:													
More than	Up to	2.5	5	10	15	20	25	30	40	50	75	100	150	200+	
0	100	0	5	9	12	14	17	19	23	26	33	39	50	59	
100	200	0	7	12	16	19	22	25	30	34	43	51	64	75	
200	300	0	7	12	16	20	24	27	32	37	47	56	71	84	
300	400	0	0	12	16	21	24	28	34	39	50	60	77	91	
400	500	0	0	11	16	21	24	28	34	40	53	63	81	96	
500	600	0	0	10	16	20	24	28	35	41	54	65	84	100	
600	700	0	0	0	15	20	24	28	35	41	55	67	87	104	
700	800	0	0	0	14	19	24	28	35	42	56	68	89	107	
800	900	0	0	0	13	18	23	27	35	42	56	69	91	109	
900	1,000	0	0	0	0	17	22	27	34	41	57	70	92	111	
1,000	1,500	0	0	0	0	0	21	26	34	41	57	71	97	118	

1,500	2,000	0	0	0	0	0	0	0	0	30	38	56	71	98	121
2,000	2,500	0	0	0	0	0	0	0	0	24	33	53	69	99	126
2,500	3,000	0	0	0	0	0	0	0	0	0	28	50	68	101	130
3,000	3,500	0	0	0	0	0	0	0	0	0	0	47	67	101	132
3,500	4,000	0	0	0	0	0	0	0	0	0	0	43	65	101	133
4,000	4,500	0	0	0	0	0	0	0	0	0	0	39	62	101	134
4,500	5,000	0	0	0	0	0	0	0	0	0	0	0	58	99	134
5,000	6,000	0	0	0	0	0	0	0	0	0	0	0	54	97	133
6,000	7,000	0	0	0	0	0	0	0	0	0	0	0	0	91	131
7,000	8,000	0	0	0	0	0	0	0	0	0	0	0	0	84	126
8,000	9,000	0	0	0	0	0	0	0	0	0	0	0	0	75	120
9,000	10,000	0	0	0	0	0	0	0	0	0	0	0	0	0	113
10,000	100,000	0	0	0	0	0	0	0	0	0	0	0	0	0	0
100,000	n/a	0	0	0	0	0	0	0	0	0	0	0	0	0	0

Table: Calculation of additional capital for firm holding client money or other client assets (£000's)

Income	Excess obtained up to and including:													
	Up to	5	10	15	20	25	30	40	50	75	100	150	200+	
More than 0	100	0	4	7	9	12	14	18	21	28	34	45	54	
100	200	0	7	11	14	17	20	25	29	38	46	59	70	
200	300	0	7	11	14	17	20	25	30	40	49	64	77	
300	400	0	0	9	13	16	19	25	30	40	50	67	81	
400	500	0	0	0	11	14	18	24	29	40	51	68	83	

500	600	0	0	0	8	12	15	22	28	40	51	69	85
600	700	0	0	0	0	9	13	20	26	39	50	69	86
700	800	0	0	0	0	6	10	17	24	38	49	69	87
800	900	0	0	0	0	0	7	15	22	36	48	69	87
900	1,000	0	0	0	0	0	0	12	19	34	47	68	87
1,000	1,500	0	0	0	0	0	0	0	16	32	45	67	86
1,500	2,000	0	0	0	0	0	0	0	0	18	34	59	81
2,000	2,500	0	0	0	0	0	0	0	0	0	19	48	71
2,500	3,000	0	0	0	0	0	0	0	0	0	6	37	64
3,000	3,500	0	0	0	0	0	0	0	0	0	0	26	55
3,500	4,000	0	0	0	0	0	0	0	0	0	0	14	45
4,000	4,500	0	0	0	0	0	0	0	0	0	0	1	33
4,500	5,000	0	0	0	0	0	0	0	0	0	0	0	21
5,000	6,000	0	0	0	0	0	0	0	0	0	0	0	8
6,000	7,000	0	0	0	0	0	0	0	0	0	0	0	0
7,000	8,000	0	0	0	0	0	0	0	0	0	0	0	0
8,000	9,000	0	0	0	0	0	0	0	0	0	0	0	0
9,000	10,000	0	0	0	0	0	0	0	0	0	0	0	0
10,000	100,000	0	0	0	0	0	0	0	0	0	0	0	0
100,000	n/a	0	0	0	0	0	0	0	0	0	0	0	0

3.2.15 G The *rule* on the items which are eligible to contribute to the capital resources of a *firm* applies (see *MIPRU* 4.4.2R).

- 4 Capital resources
- 4.1 Application and purpose
- Application
- 4.1.1 R This chapter applies to a *firm* with *Part IV permission* to carry on any of the following activities, unless an exemption in this section applies:
- (1) *insurance mediation activity*;
 - (2) *mortgage mediation activity*;
 - (3) *entering into a regulated mortgage contract* (that is, *mortgage lending*);
 - (4) *administering a regulated mortgage contract* (that is, *mortgage administration*).
- 4.1.2 G As this chapter applies only to a *firm* with *Part IV permission*, it does not apply to an *incoming EEA firm* (unless it has a *top-up permission*). An *incoming EEA firm* includes a *firm* which is passporting into the *United Kingdom* under the *IMD*.
- 4.1.3 G The definition of *insurance mediation activity* refers to several activities 'in relation to a *contract of insurance*' which includes a contract of reinsurance. This chapter, therefore, applies to a reinsurance intermediary in the same way as it applies to any other *insurance intermediary*.
- Application: banks, building societies, insurers and friendly societies
- 4.1.4 R This chapter does not apply to:
- (1) a *bank*; or
 - (2) a *building society*; or
 - (3) a solo consolidated *subsidiary* of a *bank* or a *building society* ; or
 - (4) an *insurer*; or
 - (5) a *friendly society*.
- 4.1.5 G The capital resources of the *firms* above are calculated in accordance with the appropriate prudential sourcebook.
- Application: firms carrying on designated investment business only
- 4.1.6 R This chapter does not apply to a *firm* whose *Part IV permission* is limited to *regulated activities* which are *designated investment business*.

- 4.1.7 G A *firm* which carries on *designated investment business*, and no other *regulated activity*, may disregard this chapter. For example, a *firm* with *permission* limited to *dealing in investments as agent* in relation to *securities* is only carrying on *designated investment business* and the Interim Prudential sourcebook for investment businesses or the Prudential sourcebook for Banks, Building Societies and Investment Firms, as appropriate, will apply. However, if its *permission* is varied to enable it to arrange motor insurance as well, this activity is not *designated investment business* so the *firm* will be subject to the higher of the requirements in this chapter and those sourcebooks (see *MIPRU 4.2.5R*).

Application: credit unions

- 4.1.8 R This chapter does not apply to:
- (1) a 'small *credit union*', that is one with:
 - (a) assets of £5 million or less; and
 - (b) a total number of members of 5,000 or less (see *CRED 8.3.14R*); or
 - (2) a *credit union* whose *Part IV permission* includes *mortgage lending* or *mortgage administration* (or both) but not *insurance mediation activity* or *mortgage mediation activity*.

- 4.1.9 G
- (1) For *credit unions* to which this chapter applies and which are not *CTF providers*, the capital requirements will be the higher of the requirements in this chapter and in the Credit Unions sourcebook (see *MIPRU 4.2.6R*).
 - (2) For *credit unions* to which this chapter applies and which are *CTF providers* with permission to carry on *designated investment business*, the capital requirements will be the highest of the requirements in this chapter, those in the Credit Unions sourcebook and in the Interim Prudential sourcebook for investment businesses (see *MIPRU 4.2.6R*).

Application: professional firms

- 4.1.10 R
- (1) This chapter does not apply to an *authorised professional firm*:
 - (a) whose main business is the practice of its profession; and
 - (b) whose *regulated activities* covered by this chapter are incidental to its main business.
 - (2) A *firm's* main business is the practice of its profession if the proportion of income it derives from professional fees is, during its annual accounting period, at least 50% of the *firm's* total income (a temporary variation of not more than 5% may be disregarded for this

purpose).

- (3) Professional fees are fees, commissions and other receipts receivable in respect of legal, accountancy, actuarial, conveyancing and surveying services provided to clients but excluding any items receivable in respect of *regulated activities*.

Application: Lloyd's managing agents

- 4.1.11 R This chapter does not apply to a *managing agent*.
- 4.1.12 G The reason for excluding *managing agents* from the provisions of this chapter is twofold: first, a *member* will have accepted full responsibility for those activities under the *Society's managing agent* agreement. Secondly, the *member* is itself subject to capital requirements which are equivalent to those applying to an *insurer* (to which this chapter is also disappplied).

Application: social housing firms

- 4.1.13 G There are special provisions for a *social housing firm* when it is carrying on *mortgage lending* or *mortgage administration* (see *MIPRU 4.2.7R*).

Purpose

- 4.1.14 G This chapter amplifies *threshold condition 4* (Adequate resources) by providing that a *firm* must meet, on a continuing basis, a basic solvency requirement and a minimum capital resources requirement. This chapter also amplifies *Principle 4* which requires a *firm* to maintain adequate financial resources by setting out capital requirements for a *firm* according to the *regulated activity* or activities it carries on.
- 4.1.15 G Capital has an important role to play in protecting consumers and complements the roles played by professional indemnity insurance and *client money* protection (see the *client money rules*). Capital provides a form of protection for situations not covered by a *firm's* professional indemnity insurance and it provides the funds for the *firm's* PII excess, which it has to pay out of its own finances (see *MIPRU 3.2.11R* and *MIPRU 3.2.12R* for the relationship between the *firm's* capital and its excess).
- 4.1.16 G More generally, having adequate capital gives the *firm* a degree of resilience and some indication to consumers of creditworthiness, substance and the commitment of its owners. It reduces the possibility of a shortfall of funds and provides a cushion against disruption if the *firm* ceases to trade.
- 4.1.17 G There is a greater risk to consumers, and a greater adverse impact on market confidence, if a *firm* holding *client money* or other *client* assets fails. For this reason, the capital resources *rules* in this chapter clearly distinguish between *firms* holding *client* assets and those that do not.

Purpose: social housing firms

- 4.1.18 G *Social housing firms* undertake small amounts of mortgage business even though their main business consists of activities other than *regulated activities*. Their *mortgage lending* is only done as an adjunct to their primary purpose (usually the provision of housing) and is substantially different in character to that done by commercial lenders. Furthermore, they are *subsidiaries* of local authorities or registered social landlords which are already subject to separate regulation. The *FSA* does not consider that it would be proportionate to the risks involved with such business to impose significant capital requirements for these *firms*. The capital resources requirement for *social housing firms* therefore simply provides that, where their *Part IV permission* is limited to *mortgage lending* and *mortgage administration*, their net tangible assets must be greater than zero.
- 4.1.19 G A registered social landlord is a non-profit organisation which provides and manages homes for rent and sale for people who might not otherwise be able to rent or buy on the open market. It can be a housing association, a housing society or a non-profit making housing company. The Housing Corporation, which was set up by Parliament in 1964, funds homes built by registered social landlords from money received from central government.
- 4.2 Capital resources requirements
- General solvency requirement
- 4.2.1 R A *firm* must at all times ensure that it is able to meet its liabilities as they fall due.
- General capital resource requirement
- 4.2.2 R A *firm* must at all times maintain capital resources equal to or in excess of its relevant capital resources requirement.
- Capital resources: relevant accounting principles
- 4.2.3 R A *firm* must recognise an asset or liability, and measure its amount, in accordance with the relevant accounting principles applicable to it for the purpose of preparing its annual financial statements unless a *rule* requires otherwise.
- Capital resources: client assets
- 4.2.4 R In this chapter, "*client assets*" includes a *document* only if it has value, or is capable of having value, in itself (such as a bearer instrument).
- Capital resources requirement: firms carrying on regulated activities including designated investment business
- 4.2.5 R The capital resources requirement for a *firm* (other than a *credit union*) carrying on *regulated activities*, including *designated investment business*, is the higher of:

- (1) the requirement which is applied by this chapter according to the activity or activities of the *firm* (treating the relevant *rules* as applying to the *firm* by disregarding its *designated investment business*); and
- (2) the financial resource requirement which is applied by the Interim Prudential sourcebook for investment businesses or the Prudential sourcebook for Banks, Building Societies and Investment Firms.

Capital resources requirement: credit unions

4.2.6 R The capital resources requirement for a *credit union* to which this chapter applies is the highest of:

- (1) the requirement which is applied to *firms* carrying on mediation activities only (see *MIPRU* 4.2.11R) treating that *rule* as applying to the *credit union* by disregarding activities which are not *insurance mediation activity* or *mortgage mediation activity*;
- (2) the amount which is applied by the Credit Unions sourcebook; and
- (3) if the *credit union* is a *CTF provider* that has a *permission* to carry on *designated investment business*, the amount which is applied by Chapter 8 of the Interim Prudential sourcebook for investment businesses.

Capital resources requirement: social housing firms

4.2.7 R The capital resources requirement for a *social housing firm* whose *Part IV permission* is limited to carrying on the *regulated activities* of:

- (1) *mortgage lender*; or
- (2) *mortgage administration* (or both);

is that the *firm's* net tangible assets must be greater than zero.

4.2.8 G If a *social housing firm* is carrying on *mortgage lending* or *mortgage administration* (and no other *regulated activity*), its net tangible assets must be greater than zero. However, if it carries on *insurance mediation activity* or *mortgage mediation activity*, there is no special provision and the capital resources requirement for *firms* carrying on *designated investment business* or mediation activities only applies to it as appropriate.

Capital resources requirement: application according to regulated activities

4.2.9 R Unless any of the *rules* on capital resources for *firms* carrying on *designated investment business*, for *credit unions* or for *social housing firms* apply, the capital resources requirement for a *firm* varies according to the *regulated activity* or activities it carries on.

4.2.10 R Table: Application of capital resources requirements

	Regulated activities	Provisions
1.	(a) <i>insurance mediation activity</i> ; or (b) <i>mortgage mediation activity</i> (or both); and no other <i>regulated activity</i> .	MIPRU 4.2.11R
2.	(a) <i>mortgage lending</i> ; or (b) <i>mortgage lending and mortgage administration</i> ; and no other <i>regulated activity</i> .	MIPRU 4.2.12R to MIPRU 4.2.17E
3.	<i>mortgage administration</i> ; and no other <i>regulated activity</i> .	MIPRU 4.2.18R to MIPRU 4.2.19R
4.	<i>insurance mediation activity</i> ; and (a) <i>mortgage lending</i> ; or (b) <i>mortgage administration</i> (or both).	MIPRU 4.2.20R
5.	<i>mortgage mediation activity</i> ; and (a) <i>mortgage lending</i> , or (b) <i>mortgage administration</i> (or both).	MIPRU 4.2.21R
6.	Any combination of <i>regulated activities</i> not within rows 1 to 5.	MIPRU 4.2.22R

Capital resources requirement: mediation activity only

- 4.2.11 R
- (1) If a *firm* carrying on *insurance mediation activity* or *mortgage mediation activity* (and no other *regulated activity*) does not hold *client money* or other *client* assets in relation to these activities, its capital resources requirement is the higher of:
- (a) £5,000; and
 - (b) 2.5% of the *annual income* from its *insurance mediation activity* or *mortgage mediation activity* (or both).
- (2) If a *firm* carrying on *insurance mediation activity* or *mortgage mediation activity* (and no other *regulated activity*) holds *client money* or other *client* assets in relation to these activities, its capital resources requirement is the higher of:
- (a) £10,000; and

- (b) 5% of the *annual income* from its *insurance mediation activity* or *mortgage mediation activity* (or both).

Capital resources requirement: mortgage lending and administration (but not mortgage administration only)

- 4.2.12 R (1) The capital resources requirement for a *firm* carrying on *mortgage lending* or *mortgage lending and mortgage administration* (and no other *regulated activity*) is the higher of:
- (a) £100,000; and
 - (b) 1% of:
 - (i) its total assets plus total undrawn commitments; less:
 - (ii) excluded loans plus intangible assets (see Note 1 in the table in *MIPRU* 4.4.4R).
- (2) Undrawn commitments means the total of those amounts which a borrower has the right to draw down from the *firm* but which have not yet been drawn down, excluding those under an agreement:
- (a) which has an original maturity of up to one year; or
 - (b) which can be unconditionally cancelled at any time by the lender.
- 4.2.13 G When considering what is an undrawn commitment, the *FSA* takes into account an amount which a borrower has the right to draw down, but which has not yet been drawn down, whether the commitment is revocable or irrevocable, conditional or unconditional.
- 4.2.14 R When calculating total assets, the *firm* may exclude a loan which has been transferred to a third party only if it meets the following conditions:
- (1) the first condition is that the loan has been transferred in a legally effective manner by:
 - (a) novation; or
 - (b) legal or equitable assignment; or
 - (c) sub-participation; or
 - (d) declaration of trust; and
 - (2) the second condition is that the lender:
 - (a) retains no material economic interest in the loan; and

(b) has no material exposure to losses arising from it.

4.2.15 E (1) When seeking to rely on the second condition, a *firm* should ensure that the loan qualifies for the 'linked presentation' accounting treatment under Financial Reporting Standard 5 (Reporting the substance of transactions) issued in April 1994, and amended in December 1994 and September 1998 (if applicable to the *firm*).

(2) Compliance with (1) may be relied upon as tending to establish compliance with the second condition.

4.2.16 G The requirement that the loan qualifies for the 'linked presentation' accounting treatment under FRS 5 is aimed at those *firms* which report according to FRS 5. Other *firms* which report under other standards, including International Accounting Standards, need not adopt FRS 5 in order to meet the second condition.

4.2.17 E (1) When seeking to rely on the second condition, a *firm* should not provide material credit enhancement in respect of the loan unless it deducts the amount of the credit enhancement from its capital resources before meeting its capital resources requirement.

(2) Credit enhancement includes:

(a) any holding of subordinated loans or notes in a transferee that is a special purpose vehicle; or

(b) over collateralisation by transferring loans to a larger aggregate value than the *securities* to be issued; or

(c) any other arrangement with the transferee to cover a part of any subsequent losses arising from the transferred loan.

(3) Contravention of (1) may be relied upon as tending to establish contravention the second condition.

Capital resources requirement: mortgage administration only

4.2.18 R The capital resources requirement for a *firm* carrying on *mortgage administration* only, which has all or part of the *regulated mortgage contracts* that it administers on its balance sheet, is the amount which is applied to a *firm* carrying on *mortgage lending* or *mortgage lending and mortgage administration* (and no other *regulated activity*) (see MIPRU 4.2.12R).

4.2.19 R The capital resources requirement for a *firm* carrying on *mortgage administration* only, which has all the *regulated mortgage contracts* that it administers off its balance sheet, is the higher of:

(1) £100,000; and

- (2) 10% of its *annual income*.

Capital resources requirement: insurance mediation activity and mortgage lending or mortgage administration

4.2.20 R The capital resources requirement for a *firm* carrying on *insurance mediation activity* and *mortgage lending* or *mortgage administration* is the sum of the requirements which are applied to the *firm* by:

- (1) the capital resources *rule* for a *firm* carrying on *insurance mediation activity* or *mortgage mediation activity* (and no other *regulated activity*) (see MIPRU 4.2.11R); and
- (2) (a) the capital resources *rule* for a *firm* carrying on *mortgage lending* or *mortgage lending* and *mortgage administration* (and no other *regulated activity*) (see MIPRU 4.2.12R); or
- (b) if, in addition to its *insurance mediation activity*, the *firm* carries on *mortgage administration* with all the assets that it administers off balance sheet, the capital resources *rule* for such a *firm* (see MIPRU 4.2.19R).

Capital resources requirement: mortgage mediation activity and mortgage lending or mortgage administration

4.2.21 R (1) If a *firm* carrying on *mortgage mediation activity* and *mortgage lending* or *mortgage administration* does not hold *client money* or other *client assets* in relation to its *mortgage mediation activity*, the capital requirement is the amount applied to a *firm*, according to the activities carried on by the *firm*, by:

- (a) the capital resources *rule* for a *firm* carrying on *mortgage lending* or *mortgage lending* and *mortgage administration* (and no other *regulated activity*) (see MIPRU 4.2.12R); or
- (b) if, in addition to its *mortgage mediation activity*, the *firm* carries on *mortgage administration* with all the assets that it administers off balance sheet, the capital resources *rule* for such a *firm* (see MIPRU 4.2.19R).
- (2) If the *firm* holds *client money* or other *client assets* in relation to its *mortgage mediation activity*, the capital resources requirement is:
- (a) the amount calculated under (1); plus
- (b) the amount which is applied to a *firm* carrying on *insurance mediation activity* or *mortgage mediation activity* (and no other *regulated activity*) that holds *client money* or other *client assets* in relation to these activities (see MIPRU 4.2.11R(2)).

Capital resources requirement: other combinations of activities

4.2.22 R The capital resources requirement for a *firm* carrying any other combination of *regulated activities* is the amount which is applied to a *firm* carrying on *insurance mediation activity* and *mortgage lending* or *mortgage administration* (see MIPRU 4.2.20R).

4.3 Calculation of annual income

Annual income

4.3.1 R This section contains provisions relating to the calculation of *annual income* for the purposes of:

- (1) the *limits of indemnity* for professional indemnity insurance; and
- (2) the capital resources requirements.

4.3.2 R 'Annual income' is the annual income given in the *firm's* most recent annual financial statement from the relevant *regulated activity* or activities.

4.3.3 R For a *firm* which carries on *insurance mediation activity* or *mortgage mediation activity*, *annual income* is the amount of all brokerage, fees, *commissions* and other related income (for example, administration charges, overrides, profit shares) due to the *firm* in respect of or in relation to those activities.

4.3.4 G (1) The purpose of the *rule* on *annual income* that applies to *insurance intermediaries* and *mortgage intermediaries* is to ensure that the capital resources requirement is calculated on the basis only of brokerage and other amounts earned by a *firm* which are its own income.

(2) *Annual income* includes *commissions* and other amounts the *firm* may have agreed to pay to other *persons* involved in a transaction, such as sub-agents or other intermediaries.

(3) A *firm's annual income* does not, however, include any amounts due to another *person* (for example, the product provider) which the *firm* has collected on behalf of that other *person*.

4.3.5 R If a *firm* is a *principal*, its *annual income* includes amounts due to its *appointed representative* in respect of activities for which the *firm* has accepted responsibility.

4.3.6 G If a *firm* is a *network*, it should include the relevant income due to all of its *appointed representatives* in its *annual income*.

Annual income for mortgage administration

- 4.3.7 R For the purposes of the calculation of the capital resources of a *firm* carrying on *mortgage administration* only with all the assets it administers off balance sheet, *annual income* is the sum of:
- (1) revenue (that is, *commissions*, fees, net interest income, dividends, royalties and rent); and
 - (2) gains;
 - (3) arising in the course of the ordinary activities of the *firm*, less profit:
 - (a) on the sale or termination of an operation;
 - (b) arising from a fundamental reorganisation or restructuring having a material effect on the nature and focus of the *firm's* operation; and
 - (c) on the disposal of fixed assets, including *investments* held in a long-term portfolio.

Annual income: periods of less than 12 months

- 4.3.8 R If the *firm's* most recent annual financial statement does not cover a 12 *month* period, the *annual income* is taken to be the amount in the statement converted, proportionally, to a 12 *month* period.

Annual income: no financial statements

- 4.3.9 R If the *firm* does not have annual financial statements, the *annual income* is to be taken from the forecast or other appropriate accounts which the *firm* has submitted to the *FSA*.

4.4 Calculation of capital resources

The calculation of a firm's capital resources

- 4.4.1 R (1) A *firm* must calculate its capital resources only from the items which are eligible to contribute to a *firm's* capital resources from which it must deduct certain items (see *MIPRU* 4.4.4R).
- (2) If the *firm* is subject to the Interim Prudential sourcebook for investment businesses, the Prudential sourcebook for Banks, Building Societies and Investment Firms or the Credit Unions sourcebook, the capital resources are the higher of:
- (a) the amount calculated under (1); and
 - (b) the financial resources calculated under those sourcebooks.

- 4.4.2 R Table: Items which are eligible to contribute to the capital resources of a firm

	Item	Additional explanation																		
1.	<i>Share capital</i>	<p>This must be fully paid and may include:</p> <table border="1" data-bbox="743 344 1417 568"> <tr> <td data-bbox="743 344 927 418">(1)</td> <td data-bbox="927 344 1417 418">ordinary <i>share capital</i>; or</td> </tr> <tr> <td data-bbox="743 418 927 568">(2)</td> <td data-bbox="927 418 1417 568">preference <i>share capital</i> (excluding preference <i>shares</i> redeemable by shareholders within two years).</td> </tr> </table>	(1)	ordinary <i>share capital</i> ; or	(2)	preference <i>share capital</i> (excluding preference <i>shares</i> redeemable by shareholders within two years).														
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(2)	preference <i>share capital</i> (excluding preference <i>shares</i> redeemable by shareholders within two years).																			
2.	Capital other than <i>share capital</i> (for example, the capital of a <i>sole trader</i> , <i>partnership</i> or <i>limited liability partnership</i>)	<p>The capital of a <i>sole trader</i> is the net balance on the <i>firm's</i> capital account and current account. The capital of a <i>partnership</i> is the capital made up of the <i>partners'</i>:</p> <table border="1" data-bbox="743 754 1417 2004"> <tr> <td data-bbox="743 754 810 1420">(1)</td> <td data-bbox="810 754 1417 1420"> <p>capital account, that is the account:</p> <table border="1" data-bbox="810 826 1417 1420"> <tr> <td data-bbox="810 826 868 938">(a)</td> <td data-bbox="868 826 1417 938">into which capital contributed by the <i>partners</i> is paid; and</td> </tr> <tr> <td data-bbox="810 938 868 1420">(b)</td> <td data-bbox="868 938 1417 1420"> <p>from which, under the terms of the <i>partnership</i> agreement, an amount representing capital may be withdrawn by a <i>partner</i> only if:</p> <table border="1" data-bbox="868 1126 1417 1420"> <tr> <td data-bbox="868 1126 1417 1308">(i)</td> <td data-bbox="868 1126 1417 1308">he ceases to be a <i>partner</i> and an equal amount is transferred to another such account by his former <i>partners</i> or any <i>person</i> replacing him as their <i>partner</i>; or</td> </tr> <tr> <td data-bbox="868 1308 1417 1420">(ii)</td> <td data-bbox="868 1308 1417 1420">the <i>partnership</i> is otherwise dissolved or wound up; and</td> </tr> </table> </td> </tr> </table> </td> </tr> <tr> <td data-bbox="743 1420 810 1532">(2)</td> <td data-bbox="810 1420 1417 1532">current accounts according to the most recent financial statement.</td> </tr> <tr> <td colspan="2" data-bbox="743 1532 1417 1677">For the purpose of the calculation of capital resources, in respect of a <i>defined benefit occupational pension scheme</i>:</td> </tr> <tr> <td data-bbox="743 1677 810 1789">(1)</td> <td data-bbox="810 1677 1417 1789">a <i>firm</i> must derecognise any <i>defined benefit asset</i>;</td> </tr> <tr> <td data-bbox="743 1789 810 2004">(2)</td> <td data-bbox="810 1789 1417 2004">a <i>firm</i> may substitute for a <i>defined benefit liability</i> the <i>firm's deficit reduction amount</i>, provided that the election is applied consistently in respect of any one financial year.</td> </tr> </table>	(1)	<p>capital account, that is the account:</p> <table border="1" data-bbox="810 826 1417 1420"> <tr> <td data-bbox="810 826 868 938">(a)</td> <td data-bbox="868 826 1417 938">into which capital contributed by the <i>partners</i> is paid; and</td> </tr> <tr> <td data-bbox="810 938 868 1420">(b)</td> <td data-bbox="868 938 1417 1420"> <p>from which, under the terms of the <i>partnership</i> agreement, an amount representing capital may be withdrawn by a <i>partner</i> only if:</p> <table border="1" data-bbox="868 1126 1417 1420"> <tr> <td data-bbox="868 1126 1417 1308">(i)</td> <td data-bbox="868 1126 1417 1308">he ceases to be a <i>partner</i> and an equal amount is transferred to another such account by his former <i>partners</i> or any <i>person</i> replacing him as their <i>partner</i>; or</td> </tr> <tr> <td data-bbox="868 1308 1417 1420">(ii)</td> <td data-bbox="868 1308 1417 1420">the <i>partnership</i> is otherwise dissolved or wound up; and</td> </tr> </table> </td> </tr> </table>	(a)	into which capital contributed by the <i>partners</i> is paid; and	(b)	<p>from which, under the terms of the <i>partnership</i> agreement, an amount representing capital may be withdrawn by a <i>partner</i> only if:</p> <table border="1" data-bbox="868 1126 1417 1420"> <tr> <td data-bbox="868 1126 1417 1308">(i)</td> <td data-bbox="868 1126 1417 1308">he ceases to be a <i>partner</i> and an equal amount is transferred to another such account by his former <i>partners</i> or any <i>person</i> replacing him as their <i>partner</i>; or</td> </tr> <tr> <td data-bbox="868 1308 1417 1420">(ii)</td> <td data-bbox="868 1308 1417 1420">the <i>partnership</i> is otherwise dissolved or wound up; and</td> </tr> </table>	(i)	he ceases to be a <i>partner</i> and an equal amount is transferred to another such account by his former <i>partners</i> or any <i>person</i> replacing him as their <i>partner</i> ; or	(ii)	the <i>partnership</i> is otherwise dissolved or wound up; and	(2)	current accounts according to the most recent financial statement.	For the purpose of the calculation of capital resources, in respect of a <i>defined benefit occupational pension scheme</i> :		(1)	a <i>firm</i> must derecognise any <i>defined benefit asset</i> ;	(2)	a <i>firm</i> may substitute for a <i>defined benefit liability</i> the <i>firm's deficit reduction amount</i> , provided that the election is applied consistently in respect of any one financial year.
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3.	Reserves (Note 1)	<p>These are, subject to Note 1, the audited accumulated profits retained by the <i>firm</i> (after deduction of tax, dividends and proprietors' or <i>partners'</i> drawings) and other reserves created by appropriations of share premiums and similar realised appropriations. Reserves also include gifts of capital, for example, from a <i>parent undertaking</i>.</p>
<p>For the purposes of calculating capital resources, a <i>firm</i> must make the following adjustments to its reserves, where appropriate:</p>		<p>(1) a <i>firm</i> must deduct any unrealised gains or, where applicable, add back in any unrealised losses on debt instruments held in the available-for-sale financial assets category;</p>
<p>(2) a <i>firm</i> must deduct any unrealised gains or, where applicable, add back in any unrealised losses on cash flow hedges of financial instruments measured at cost or amortised cost;</p>		<p>(3) in respect of a <i>defined benefit occupational pension scheme</i>:</p>
<p>(a) a <i>firm</i> must derecognise any <i>defined benefit asset</i>;</p>		<p>(b) a <i>firm</i> may substitute for a <i>defined benefit liability</i> the <i>firm's deficit reduction amount</i>, provided that the election is applied consistently in respect of any one financial year.</p>
4.	Interim net profits (Note 1)	<p>If a <i>firm</i> seeks to include interim net profits in the calculation of its capital resources, the profits have, subject to Note 1, to be verified by the <i>firm's</i> external auditor, net of tax, anticipated dividends or proprietors' drawings and other appropriations.</p>
5.	Revaluation reserves	
6.	General/collective provisions (Note 1)	<p>These are provisions that a <i>firm</i> carrying on <i>mortgage lending</i> or <i>mortgage administration</i> holds against potential losses that have not yet been identified but which experience indicates are</p>

		present in the <i>firm's</i> portfolio of assets. Such provisions must be freely available to meet these unidentified losses wherever they arise. Subject to Note 1, general/collective provisions must be verified by external auditors and disclosed in the <i>firm's</i> annual report and accounts.
7.	Subordinated loans	Subordinated loans must be included in capital on the basis of the provisions in this chapter that apply to subordinated loans.
Note:		
1	Reserves must be audited and interim net profits, general and collective provisions must be verified by the <i>firm's</i> external auditor unless the <i>firm</i> is exempt from the provisions of Part VII of the Companies Act 1985 relating to the audit of accounts (section 249A (Exemptions from audit)).	

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

- 4.4.4 R Table: Items which must be deducted from capital resources

1	<i>Investments</i> in own <i>shares</i>
2	Intangible assets (Note 1)
3	Interim net losses (Note 2)
4	Excess of drawings over profits for a <i>sole trader</i> or a <i>partnership</i> (Note 2)
<p>Notes</p> <p>1. Intangible assets are the full balance sheet value of goodwill (but not until 14 January 2008 - see transitional provision 1), capitalised development costs, brand names, trademarks and similar rights and licences.</p> <p>2. The interim net losses in row 3, and the excess of drawings in row 4, are in relation to the period following the date as at which the capital resources are being computed.</p>	

Personal assets

- 4.4.5 R In relation to a *sole trader's firm* or a *firm* which is a *partnership*, the *sole trader* or a *partner* in the *firm* may use personal assets to meet the general

solvency requirement and the general capital resource requirement, to the extent necessary to make up any shortfall in meeting those requirements, unless:

- (1) those assets are needed to meet other liabilities arising from:
 - (a) personal activities; or
 - (b) another business activity not regulated by the *FSA*; or
- (2) the *firm* holds *client money* or other *client* assets.

4.4.6 G A *sole trader* or a *partner* may use any personal assets, including property, to meet the capital requirements of this chapter, but only to the extent necessary to make up a shortfall.

Subordinated loans

4.4.7 R A subordinated debt must not form part of the capital resources of the *firm* unless it meets the following conditions:

- (1) (for a *firm* which carries on *insurance mediation activity* or *mortgage mediation activity* (or both) but not *mortgage lending* or *mortgage administration*) it has an original maturity of:
 - (a) at least two years; or
 - (b) it is subject to two years' notice of repayment;
- (2) (for all other *firms*) it has an original maturity of:
 - (a) at least five years; or
 - (b) it is subject to five years' notice of repayment;
- (3) the claims of the subordinated creditors must rank behind those of all unsubordinated creditors;
- (4) the only events of default must be non-payment of any interest or principal under the debt agreement or the winding up of the *firm*;
- (5) the remedies available to the subordinated creditor in the event of non-payment or other default in respect of the subordinated debt must be limited to petitioning for the winding up of the *firm* or proving the debt and claiming in the liquidation of the *firm*;
- (6) the subordinated debt must not become due and payable before its stated final maturity date except on an event of default complying with (4);
- (7) the agreement and the debt are governed by the law of England and

Wales, or of Scotland or of Northern Ireland;

- (8) to the fullest extent permitted under the rules of the relevant jurisdiction, creditors must waive their right to set off amounts they owe the *firm* against subordinated amounts owed to them by the *firm*;
- (9) the terms of the subordinated debt must be set out in a written agreement or instrument that contains terms that provide for the conditions set out in this *rule*; and
- (10) the debt must be unsecured and fully paid up.

4.4.8 R (1) This *rule* applies to a *firm* which:

- (a) carries on:
 - (i) *insurance mediation activity*; or
 - (ii) *mortgage mediation activity* (or both); and
- (b) in relation to those activities, holds *client money* or other *client assets*;

but is not carrying on *mortgage lending* or *mortgage administration*.

- (2) In calculating its capital resources, the *firm* must exclude any amount by which the aggregate amount of its subordinated loans and its redeemable preference *shares* exceeds the amount calculated as follows:

four times (a - b - c);		
where:		
a	=	items 1 to 5 in the Table of items which are eligible to contribute to a <i>firm's</i> capital resources (see <i>MIPRU</i> 4.4.2R)
b	=	the <i>firm's</i> redeemable preference <i>shares</i> ; and
c	=	the amount of its intangible assets (but not goodwill until 14 January 2008 - see transitional provision 1).

4.4.9 G If a *firm* wishes to see an example of a subordinated loan agreement which would meet the required conditions, it should refer to the FSA website.

5 Insurance undertakings and mortgage lenders using insurance or mortgage mediation services

5.1 Application and purpose

Application

5.1.1 R This chapter applies to a *firm* with a *Part IV permission* to carry on:

(1) *insurance business*; or

(2) *mortgage lending*;

(3) and which uses, or proposes to use, the services of another person consisting of:

(a) *insurance mediation*; or

(b) *insurance mediation activity*; or

(c) *mortgage mediation activity*.

Purpose

5.1.2 G The purpose of this chapter is to implement article 3.6 of the *Insurance Mediation Directive* in relation to *insurance undertakings*. The provisions of this chapter have been extended to *mortgage lenders* in relation to *insurance mediation activity*, and to *insurance undertakings* and *mortgage lenders* in relation to *mortgage mediation activity*, to ensure that *firms* using these services are treated in the same way and to ensure that *clients* have the same protection. To avoid the loss of protection where an intermediary itself uses the services of an *unauthorised person*, this chapter also ensures that each person in the chain of those providing services is authorised.

5.1.3 G This chapter supports the more general duties in *Principles 2* and *3*, and the relevant *rule* in the Senior Management Arrangements, Systems and Controls sourcebook (see *SYSC 3.1.1R*).

5.2 Use of intermediaries

5.2.1 R A *firm* must not use, or propose to use, the services of another person consisting of:

(1) *insurance mediation*; or

(2) *insurance mediation activity*; or

(3) *mortgage mediation activity*;

unless two conditions are satisfied.

[Note: Article 3(6) of the *IMD*]

- 5.2.2 R The first condition is that the person, in relation to the activity:
- (1) has *permission*; or
 - (2) is an *exempt person*; or
 - (3) is an *exempt professional firm*; or
 - (4) is registered in another *EEA State* for the purposes of the *IMD*; or
 - (5) in relation to *insurance mediation activity*, is not carrying this activity on in the *EEA*; or
 - (6) in relation to *mortgage mediation activity*, is not carrying this activity on in the *United Kingdom*.

[Note: Article 3(6) of the *IMD*]

- 5.2.3 E (1) A *firm* should:
- (a) before using the services of the intermediary, check:
 - (i) the *FSA Register*; or
 - (ii) in relation to *insurance mediation* carried on by an *EEA firm*, the register of its *Home State regulator*;for the status of the person; and
 - (b) use the services of that person only if the relevant register indicates that the person is registered for that purpose.
- (2) (a) Checking the *FSA Register* before using the services of the intermediary and using the services of that person only if the *FSA Register* indicates that the person is registered for that purpose may be relied on as tending to establish that:
- (i) the person, in relation to the activity, has *permission*; or
 - (ii) the person, in relation to *insurance mediation activity*, also is an *exempt person* or an *authorised professional firm*.
- (b) In relation to *insurance mediation* carried on by an *EEA firm*, checking the register of the *firm's Home State regulator* and using the services of the *EEA firm* only if the register indicates that the *firm* is registered for that purpose may be relied on as tending to establish that the *firm* is registered for

the purposes of the *IMD*.

- 5.2.4 R The second condition is that the *firm* takes all reasonable steps to ensure that the person that it uses in relation to the activity, is not, directly or indirectly, carrying out the activity as a consequence of the activities of another person which:
- (1) contravene section 19 of the *Act* (The general prohibition); or
 - (2) in the case of activities provided from an establishment in an *EEA State*, contravene the *IMD* registration requirements.
- [**Note:** Article 3(6) of the *IMD*]
- 5.2.5 R In order to comply with the second condition, a *firm* may rely on a confirmation provided by the other person in writing if:
- (1) the confirmation is provided by a person that satisfies the first condition;
 - (2) the *firm* checked that this is the case; and
 - (3) the *firm* is not aware that the confirmation is inaccurate and has no grounds for reasonably being aware that the confirmation is inaccurate.
- 5.2.6 G The *FSA Register* can be accessed through the *FSA* website under the link www.fsa.gov.uk/register.

Annex B

MIPRU Transitional Provisions

MIPRU TP Transitional Provisions

MIPRU TP 1.1 Transitional Provisions

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
1	<i>MIPRU</i> 4.4.4R and <i>MIPRU</i> 4.4.8R(3)	R	A <i>firm</i> is not required to include goodwill in its intangible assets until 14 January 2008.	From 31 October 2004 until 14 January 2008	31 October 2004
2	<i>MIPRU</i> 5.2.2R and <i>MIPRU</i> 5.2.4R	R	<i>MIPRU</i> 5.2.2R and <i>MIPRU</i> 5.2.4R have effect in respect of the use by a <i>firm</i> of the services of another <i>person</i> consisting of <i>insurance mediation</i> and provided from an establishment in an <i>EEA State</i> that has not implemented Article 3 (Registration) of the <i>IMD</i> , as if the condition in paragraph (4) of <i>MIPRU</i> 5.2.2R and the condition in paragraph (2) of <i>MIPRU</i> 5.2.4R were a condition that the <i>firm</i> has no reason to doubt the good repute, competence and financial standing of that <i>person</i> .	from 14 January 2005 until the implementation of Article 3 of the <i>IMD</i> by the relevant <i>EEA State</i>	14 January 2005

Annex C

Schedules to MIPRU

Insert, after MIPRU Chapter 5, the following schedules. In this annex, all text is new and is not underlined.

MIPRU

Schedule 1

Record keeping requirements

G

- 1.1 There are no record keeping requirements in *MIPRU*.

MIPRU
Schedule 2
Notification requirements

G

2.1 There are no notification requirements in *MIPRU*.

MIPRU
Schedule 3
Fees and other required payments

G

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

MIPRU
Schedule 4
Powers exercised

G

4.1

The following powers and related provisions in or under the <i>Act</i> have been exercised by the <i>FSA</i> to make the <i>rules</i> in <i>MIPRU</i> :	
(1)	Section 138 (General rule-making power);
(2)	Section 149 (Evidential provisions); and
(3)	Section 156 (General supplementary powers).

4.2

The following powers in the <i>Act</i> have been exercised by the <i>FSA</i> to give the <i>guidance</i> in <i>MIPRU</i> :	
(1)	Section 157(1) (Guidance).

MIPRU
Schedule 5
Rights of actions for damages

G

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

Table

Chapter/ Appendix	Section / Annex	Right of action under section 150		
		For private person	Removed	For other person
All <i>rules</i> in <i>MIPRU</i> with the status letter “E”		No	No	No
All other <i>rules</i> in <i>MIPRU</i>		No	Yes, <i>MIPRU</i> 1.2.1R	No

MIPRU
Schedule 6
Rules that can be waived

G

1. The *rules* in *MIPRU* may be waived by the *FSA* under section 148 of the *Act* (Modification or waiver of rules). However, if the *rules* incorporate requirements laid down in European directives, it will not be possible for the *FSA* to grant a *waiver* that would be incompatible with the *United Kingdom's* responsibilities under those directives. It therefore follows that if a *rule* in *MIPRU* contains provisions which derive partly from a directive, and partly not, the *FSA* will be able to consider a *waiver* of the latter requirements only, unless the directive provisions are optional rather than mandatory.

Annex D

Amendments to the Glossary of Definitions

Insert the following new definitions in the appropriate alphabetical position:

annual income

(in *MIPRU*)

the income referred to in *MIPRU* 4.3.

Annex E

General amendments to the Handbook consequential on the creation of *MIPRU*

References in the *Handbook* (other than those specifically mentioned in the CRD (Consequential Amendments) Instrument 2006) to provisions in column (1) of the tables 1 and 2 are replaced with references to the corresponding provisions in column (2) of those tables.

Table 1

Provision in PRU 9	Corresponding provision in MIPRU
9.1.1R	2.1.1R
9.1.2G	2.1.2G
9.1.3R	2.2.1R
9.1.4R	2.2.2R
9.1.5G	2.2.3G
9.1.6G	2.2.4G
9.1.7G	2.2.5G
9.1.8R	2.3.1R
9.1.9G	2.3.2G
9.1.10R	2.3.3R
9.1.11G	2.3.4G
9.1.12G	2.3.5G
9.2.1R	3.1.1R
9.2.2G	3.1.2G
9.2.3G	3.1.3G
9.2.4G	3.1.4G
9.2.5G	3.1.5G
9.2.6G	3.1.6G
9.2.7R	3.2.1R
9.2.8G	3.2.2G
9.2.9G	3.2.3G
9.2.10R	3.2.4R
9.2.11G	3.2.5G
9.2.12G	3.2.6G

9.2.13R	3.2.7R
9.2.14R	3.2.8R
9.2.15R	3.2.9R
9.2.16R	3.2.10R
9.2.17R	3.2.11R
9.2.18R	3.2.12R
9.2.19R	3.2.13R
9.2.20R	3.2.14R
9.2.23G	3.2.15G
9.3.1R	4.1.1R
9.3.2G	4.1.2G
9.3.3G	4.1.3G
9.3.4R	4.1.4R
9.3.5G	4.1.5G
9.3.6R	4.1.6R
9.3.7G	4.1.7G
9.3.8R	4.1.8R
9.3.9G	4.1.9G
9.3.10R	4.1.10R
9.3.11R	4.1.11R
9.3.12G	4.1.12G
9.3.13G	4.1.13G
9.3.14G	4.1.14G
9.3.15G	4.1.15G
9.3.16G	4.1.16G
9.3.17G	4.1.17G
9.3.18G	4.1.18G
9.3.19G	4.1.19G
9.3.20R	4.2.1R
9.3.21R	4.2.2R
9.3.22R	4.2.3R
9.3.23R	4.2.4R
9.3.24R	4.2.5R

9.3.25R	4.2.6R
9.3.26R	4.2.7R
9.3.27G	4.2.8G
9.3.28R	4.2.9R
9.3.29R	4.2.10R
9.3.30R	4.2.11R
9.3.31R	4.2.12R
9.3.32G	4.2.13G
9.3.33R	4.2.14R
9.3.34E	4.2.15E
9.3.35G	4.2.16G
9.3.36E	4.2.17E
9.3.37R	4.2.18R
9.3.38R	4.2.19R
9.3.39R	4.2.20R
9.3.40R	4.2.21R
9.3.41R	4.2.22R
9.3.42R	4.3.1R
9.3.43R	4.3.2R
9.3.44R	4.3.3R
9.3.45G	4.3.4G
9.3.46R	4.3.5R
9.3.47G	4.3.6G
9.3.48R	4.3.7R
9.3.49R	4.3.8R
9.3.50R	4.3.9R
9.3.51R	4.4.1R
9.3.52R	4.4.2R
9.3.52AG	4.4.3G
9.3.53R	4.4.4R
9.3.54R	4.4.5R
9.3.55G	4.4.6G
9.3.56R	4.4.7R

9.3.57R	4.4.8R
9.3.58G	4.4.9G
9.4.1R	5.1.1R
9.4.2G	5.1.2G
9.4.3G	5.1.3G
9.4.4R	5.2.1R
9.4.5R	5.2.2R
9.4.6E	5.2.3E
9.4.7R	5.2.4R
9.4.8R	5.2.5R
9.4.9G	5.2.6G

Table 2

Reference in PRU 9	Corresponding reference in MIPRU
<i>PRU 9</i>	<i>MIPRU</i>
<i>PRU 9.1</i>	<i>MIPRU 2</i>
<i>PRU 9.2</i>	<i>MIPRU 3</i>
<i>PRU 9.3</i>	<i>MIPRU 4</i>
<i>PRU 9.4</i>	<i>MIPRU 5</i>
<i>PRU 9.1</i> (Responsibility for insurance mediation activity)	<i>MIPRU 2</i> (Insurance mediation activity: responsibility, knowledge, ability and good repute)
<i>PRU 9.2</i> (Professional indemnity insurance requirements for insurance and mortgage mediation activities)	<i>MIPRU 3</i> (Professional indemnity insurance)
<i>PRU 9.3</i> (Capital resources for insurance and mortgage mediation activity and mortgage lending and administration)	<i>MIPRU 4</i> (Capital resources)
<i>PRU 9.4</i> (Insurance undertakings and mortgage lenders using insurance and mortgage mediation services)	<i>MIPRU 5</i> (Insurance undertakings and mortgage lenders using insurance and mortgage mediation services)

PRUDENTIAL SOURCEBOOK FOR UCITS FIRMS (AND CONSEQUENTIAL AMENDMENTS) INSTRUMENT 2006

Powers exercised

- A. The Financial Services Authority makes this instrument in the exercise of the following powers and related provisions:
- (1) the following sections of the Financial Services and Markets Act 2000 (“the Act”):
- (a) section 138 (General rule-making power);
 - (b) section 140 (Restrictions on managers of authorised unit trust schemes);
 - (c) section 156 (General supplementary powers);
 - (d) section 157(1) (Guidance);
 - (e) section 242 (Applications for authorisation of unit trust schemes);
 - (f) section 247 (Trust scheme rules);
 - (g) section 248 (Scheme particulars rules); and
- (2) regulations 6 and 12 of the Open-Ended Investment Company Regulations 2001 (SI 2001/1228).
- B. The rule-making powers and related provisions listed above are specified for the purpose of section 153(2) of the Act (Rule-making instruments).

Commencement

- C. This instrument comes into force on 1 January 2007.

Amendments to the Handbook

- D. The modules of the FSA's Handbook of rules and guidance listed in column (1) below are amended or made in accordance with the Annexes to this instrument listed in column (2).

(1)	(2)
Glossary of definitions is amended	Annex A
Prudential sourcebook for UCITS Firms (UPRU) is made	Annex B
Supervision manual (SUP) is amended	Annex C
Collective investment schemes sourcebook (CIS) is amended	Annex D

Citation

- E. This instrument may be cited as the Prudential sourcebook for UCITS Firms (and Consequential Amendments) Instrument 2006.
- F. Annex B to this instrument (including its schedules) may be cited as the Prudential sourcebook for UCITS Firms (or UPRU).

By order of the Board
25 October 2006

Annex A

Amendments to the Glossary of definitions

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

Amend the following definitions as shown:

...

annual accounts (in *UPRU*) accounts prepared to comply with the Companies Acts 1985 to 1989 and their equivalent in Northern Ireland, or other statutory obligations.

...

annual audited fixed expenditure (in *UPRU*) has the meaning given in *UPRU* 2.1.3R (Annual audited fixed expenditure).

...

annual financial return (in *UPRU*) means the return referred to in *SUP*.

...

client money (in *UPRU*) client money for the purposes of the *client money rules*.

...

client money rules (a) (in *CASS*, *UPRU* and *COB*) *CASS* 4.1 to *CASS* 4.3.

...

...

counterparty (in *UPRU*) any person with or for whom a firm carries on *designated investment business* or an *ancillary activity*.

...

financial resources (in *UPRU*) the financial resources calculated in accordance with *UPRU* 2.2.1R (Financial resources) that a *UCITS firm* needs to meet its *financial resources requirement*.

...

financial resources requirement (in *UPRU*) has the meaning given in *UPRU* 2.1.2R.

...

financial (in *UPRU*) means *annual financial return*, *quarterly financial return* or

return monthly financial return as the case may be.

...

funds under management (in UPRU)

(1) collective investment schemes other than OEICs managed by the firm including schemes where it has delegated the management function but excluding schemes that it is managing as delegate; and

(2) OEICs for which the firm is the designated management company.

...

initial capital (in UPRU) capital calculated in accordance with UPRU Table 2.2.1R (Method of calculation of financial resources) composed of the specified items set out in that Table.

...

monthly financial return (in UPRU) means the return referred to in SUP.

...

own funds (in UPRU) funds calculated in accordance with UPRU Table 2.2.1R (Method of calculation of financial resources) composed of the specified items set out in that Table.

...

participation (for the purposes of ELM, UPRU and PRU 8 (Group risk)):

...

...

permitted business (in UPRU) means permitted activity.

...

qualifying capital instrument (in UPRU) means that part of a firm's capital which is a security of indeterminate duration, or other instrument, that fulfils the following conditions:

(a) it may not be reimbursed on the bearer's initiative or without the prior agreement of FSA;

(b) the debt agreement must provide for the firm to have the option of deferring the payment of interest on the debt;

(c) the lender's claims on the firm must be wholly subordinated to those of

all non-subordinated creditors:

(d) the documents governing the issue of the securities must provide for debt and unpaid interest to be such as to absorb losses, whilst leaving the *firm* in a position to continue trading; and

(e) only fully paid-up amounts shall be taken into account.

...

qualifying
capital item

(in *UPRU*) means that part of a *firm*'s capital which has the following characteristics:

(a) it is freely available to the *firm* to cover normal banking or other risks where revenue or capital losses have not yet been identified;

(b) its existence is disclosed in internal accounting records; and

(c) its amount is determined by the management of the *firm* and verified by independent auditors, and is made known to, and is monitored by, *FSA*.

Note: verification by internal auditors will suffice until such time as EU provisions making external auditing mandatory have been implemented.

...

qualifying
subordinated
loan

(in *UPRU*) has the meaning given in *IPRU(INV)* 5.2.5(1) to (7) R (Qualifying subordinated loans).

...

qualifying
undertaking

(in *UPRU*) has the meaning given in *IPRU(INV)* 5.2.6(3) R (Qualifying undertakings).

...

quarterly
financial
return

(in *UPRU*) means the return referred to in *SUP*.

...

readily
realisable
investment

(except in *UPRU*)

(a) a ~~packaged product~~ *packaged product*;

...

(in *UPRU*) means a *unit* in a *regulated collective investment scheme*, a *life policy* or any *marketable investment* other than one which is traded on or under the rules of a *recognised or designated investment exchange* so irregularly or infrequently:

(a) that it cannot be certain that a price for that *investment* will be quoted at all times; or

(b) that it may be difficult to effect transactions at any price which may be quoted.

...

trading book (in *UPRU*) in relation to a *firm's* business or *exposures*, means:

(a) its proprietary positions in financial instruments:

(i) which are held for resale and/or are taken on by the *firm* with the intention of benefiting in the short term from actual and/or expected differences between their buying and selling prices or from other price or interest-rate variations;

(ii) arising from matched principal broking;

(iii) taken in order to hedge other elements of the trading book;

(b) *exposures* due to unsettled securities transactions, free deliveries, *OTC derivative* instruments, repurchase agreements and securities lending transactions based on securities included in (a)(i) to (iii) above, reverse repurchase agreements and securities borrowing transactions based on securities included in (a)(i) to (iii) above; and

(c) fees, commission, interest and dividends, and margin on exchange-traded derivatives which are directly related to the items included in (a) and (b) above.

...

transaction (in *ML* and *UPRU*) any transaction, including ...

...

UPRU the Prudential sourcebook for UCITS Firms.

...

Annex B

Prudential sourcebook for UCITS Firms (UPRU)

Transitional provision for UPRU

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
1.	This sourcebook	R	An <i>operator</i> of a <i>UCITS scheme</i> authorised on or before 12 February 2004 need not comply with the provisions in this sourcebook until 12 February 2007 provided it continues to comply instead with the provisions in <i>IPRU(INV) 5</i> and it continues to restrict its activities to those specified under <i>CIS 16.5.1R (1)</i> or <i>COLL 6.9.9R (1) to (3)</i> , as appropriate.	From 01/01/07 to 12/02/07	01/01/07

UCITS firms

1.1 Introduction

Application

1.1.1 R This sourcebook and any provisions of the Interim Prudential sourcebook for investment businesses incorporated into this sourcebook by reference, apply to every *UCITS firm*.

1.1.2 G *Firms* are reminded that a *UCITS management company* can be either:

(1) a *UCITS firm*; or

(2) a *UCITS investment firm*.

1.1.3 G This sourcebook only applies to *UCITS firms*. *UCITS investment firms* are *BIPRU limited licence firms* and the prudential requirements for those *firms* are set out in the Prudential sourcebook for banks, building societies and investment firms and the General prudential sourcebook. The difference between the two types of *UCITS management companies* is that a *UCITS investment firm* in addition to carrying on the activities permitted by Article 5.2 of the *UCITS Directive* (scheme management), may also carry on the activities permitted by Article 5.3 such as portfolio management.

1.2 Purpose

1.2.1 G (1) The purpose of this sourcebook is to amplify *Principle 4* (Financial prudence) which requires a *firm* to maintain adequate financial resources to meet its *designated investment business* commitments and to withstand the risks to which its business is subject. This assists in the achievement of the *regulatory objectives* of consumer protection and market confidence.

(2) This sourcebook also implements certain requirements of the *UCITS Directive* as amended by the amending Council Directive 2001/107/EC which among other matters imposes capital requirements on a *UCITS management company*.

2 Prudential requirements

2.1 Financial resources and financial resources requirements

Financial resources

2.1.1 R A *firm* must ensure that it has at all times *financial resources* which equal or exceed the applicable *financial resources requirement*.

Financial resources requirement

2.1.2 R The *financial resources requirement* for a *firm* is the higher of:

(1) subject to a maximum requirement of €10,000,000:

(a) *initial capital* requirement of €125,000; plus

(b) if the *funds under management* exceed €250,000,000, an additional amount of 0.02% of the excess; or

- (2) 13/52 of its annual audited fixed expenditure.

Annual audited fixed expenditure

- 2.1.3 R For the purposes of this sourcebook, a *firm's* annual audited fixed expenditure is:
- (1) the amount described as total expenditure in the most recent *annual financial return*, less the following items (if they are included within that expenditure):
 - (a) staff bonuses, except to the extent that they are guaranteed;
 - (b) *employees' and directors' shares* in profits, except to the extent that they are guaranteed;
 - (c) other appropriations of profits;
 - (d) shared *commission* and fees payable which are directly related to *commission* and fees receivable which are included within total revenue;
 - (e) interest charges in respect of borrowings made to finance the acquisition of the *firm's readily realisable investments*;
 - (f) interest paid to *customers* on *client money*;
 - (g) interest paid to *counterparties*;
 - (h) fees, brokerage and other charges paid to *clearing houses*, exchanges and *intermediate brokers* for the purposes of *executing*, registering or clearing transactions;
 - (i) foreign exchange losses;
 - (j) other variable expenditure; or
 - (2) where the previous accounting period does not include twelve months' trading, an amount calculated in accordance with (1) pro-rated to an equivalent annual amount; or
 - (3) where a *firm* has not prepared an *annual financial return* or *annual accounts* since the commencement of its *permitted business*, an amount based on forecast expenditure included in the budget for the first twelve months' trading, as submitted with its application for authorisation.

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

2.2 Method of calculation of financial resources

2.2.1 R

PART I		
A firm must calculate its financial resources as shown below, subject to the detailed requirements set out in Part II.		
Financial resources	Category	Part II
Para		
TIER 1		
(1) Paid-up share capital (excluding preference shares)	} A	2
(2) Share premium account		3
(3) Audited reserves		4
(4) Non-cumulative preference shares		
(5) <i>Eligible LLP members' capital</i>		
(6) Investments in own shares	} B	
(7) Intangible assets		5
(8) Material current year losses		6
(9) Material holdings in credit and financial institutions		7
Initial capital = (A-B) =	C	1(b)

TIER 2			1
(10) Revaluation reserves	}		
(11) Fixed term cumulative preference share capital			1(a)
(12) Long-term Qualifying Subordinated Loans			1(a); 8
(13) Other cumulative preference share capital and debt capital		D	
(14) Qualifying arrangements			9
Own funds = (C+D) =		E	
TIER 3			
(15) Illiquid assets		F	11
Financial resources = (E – F) =		G	

PART II

DETAILED REQUIREMENTS

1 Ratios

(Items 11 and 12)

- (a) the total of fixed term cumulative preference shares (item 11) and long-term *qualifying subordinated loans* (item 12) that may be included in Tier 2 capital is limited to 50 per cent of Tier 1 capital ;
- (b) Tier 1 capital must equal or exceed €125,000 at all times; and
- (c) Tier 2 capital must not exceed 100 per cent of Tier 1 capital.

2 Non corporate entities

- (a) In the case of partnerships or sole traders, the following terms should be substituted, as appropriate, for items 1 to 4 in Tier 1 capital:
 - (i) partners' capital accounts (excluding loan capital);
 - (ii) partners' current accounts (excluding unaudited profits and loan capital);
 - (iii) proprietor's account (or other term used to signify the sole trader's capital but excluding unaudited profits).
- (b) Loans other than *qualifying subordinated loans* shown within partners' or proprietors' accounts must be classified as Tier 2 capital under item 13.
- (c) For the calculation of *financial resources*, partners' current accounts figures are subject to the

following adjustments in respect of a *defined benefit occupational pension scheme*:

- (i) a *firm* must derecognise any *defined benefit asset*:
- (ii) a *firm* may substitute for *defined benefit liability* the *firm's deficit reduction amount*. The election must be applied consistently in respect of any one financial year.

Note

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

3 Audited Reserves

For the calculation of *financial resources*, the following adjustments apply to the audited reserves figure:

- (a) a *firm* must deduct any unrealised gains or, where applicable, add back in any unrealised losses on cash flow hedges of financial instruments measured at cost or amortised cost:
- (b) in respect of a *defined benefit occupational pension scheme*, a *firm* must derecognise any *defined benefit asset*;
- (c) a *firm* may substitute for a *defined benefit liability* the *firm's deficit reduction amount*. The election must be applied consistently in respect of any one financial year.

Note

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

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

Note

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

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

4 Eligible LLP members' capital (Item 5)

Members' capital of a *limited liability partnership* may only be included in Tier 1 of the calculation (see item 5) if the conditions in *IPRU(INV)* Annex A 2.2R (Specific conditions for eligibility) and *IPRU(INV)* Annex A 2.3R (General conditions for eligibility) are satisfied.

5 Intangible assets (Item 7)

Intangible assets comprise:

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

6 Material current year losses (Item 8)

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

7 Material holdings in credit and financial institutions (Item 9)

Material holdings comprise:

- (a) where the *firm* holds more than 10 per cent of the equity share capital of the institution, the value of that holding and the amount of any subordinated loans to the institution and the value of holdings in *qualifying capital items* or *qualifying capital instruments* issued by the institution;
- (b) in the case of holdings other than those mentioned in (a) above, the value of holdings of equity share capital in, and the amount of subordinated loans made to, such institutions and the value of holdings in *qualifying capital items* or *qualifying capital instruments* issued by such institutions to the extent that the total of such holdings and subordinated loans exceeds 10 per cent of the *firm's own funds* calculated before the deduction of item 9.

8 Long term qualifying subordinated loans (Item 12)

Loans having the characteristics prescribed by *IPRU(INV) 5.2.5(1) R* may be included in item 12, subject to the limits set out in paragraph (1) above.

9 Qualifying arrangements (Item 14)

A *firm* may only include a *qualifying undertaking* or other arrangement in item 14 if it is a *qualifying capital instrument* or a *qualifying capital item*.

10 Interim profits

Non-trading book interim profits may only be included in Tier 1 of the calculation if they have been independently verified by the *firm's* external auditors.

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

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

A *firm* wishing to include interim profits in Tier 1 capital in a *financial return* should submit to the *FSA* with the *financial return* a verification report signed by its auditor which states whether the interim results are fairly stated.

Profits on the sale of capital items or arising from other activities which are not directly related to the *designated investment business* of the *firm* may also be included within the calculation of *financial resources* if they can be separately verified by the *firm's* auditors. In such a case, such profits can form part of the *firm's* Tier 1 capital as audited profits.

11 Illiquid assets (Item 15)

Illiquid assets comprise:

- (a) tangible fixed assets;

Note

In respect of tangible fixed assets purchased under finance leases the amount to be deducted as an illiquid asset shall be limited to the excess of the asset over the amount of the related liability shown on the balance sheet.

- (b) holdings in, including subordinated loans to, *credit* or *financial institutions* which may be included in the *own funds* of such *institutions* unless they have been deducted under item 9;
- (c) any *investment* in undertakings other than *credit institutions* and other *financial institutions* where such *investments* are not readily realisable;
- (d) any deficiency in net assets of a *subsidiary*;
- (e) deposits not available for repayment within 90 days or less (except for payments in connection with margined futures or options contracts);

Note

Where cash is placed on deposit with a maturity of more than 90 days but is repayable on demand subject to the payment of a penalty, then this is not required to be deducted as an illiquid asset but a deduction is required for the amount of the penalty.

- (f) loans, other debtors and accruals not falling due to be repaid within 90 days or which are more than one month overdue by reference to the contractual payment date;
- (g) physical stocks ;
- (h) prepayments to the extent that the period of prepayment exceeds thirteen weeks ; and
- (i) if not otherwise covered, any holding in eligible capital instruments of an insurance undertaking, insurance holding company, or reinsurance undertaking that is a *subsidiary* or *participation*. Eligible capital instruments include ordinary share capital, cumulative preference shares, perpetual securities and long-term subordinated loans, that are eligible for insurance undertakings under *GENPRU 2* or, as the case may be, *INSPRU 7*.

2.3 Application of certain rules in the interim prudential sourcebook for investment businesses

2.3.1 R (1) The following *rules* in the Interim Prudential sourcebook for investment businesses apply to a *firm* in respect of *qualifying subordinated loans, qualifying undertakings* and records:

(a) *IPRU(INV)* 5.2.5(1), (2) and (4) to (7) R;

(b) *IPRU(INV)* 5.2.6(3) R; and

(c) *IPRU(INV)* 5.3.1(1) R and *IPRU(INV)* 5.3.1(4) to 5.3.1(6) R.

(2) References in those *rules* to:

(a) *IPRU(INV)* Table 5.2.2(1) R are to be construed as references to *UPRU* Table 2.2.1R;

(b) *IPRU(INV)* 5.2.3(1) R are to be construed as references to *UPRU* 2.1.1R;

(c) *IPRU(INV)* 5.3.1(3) R are to be construed as references to *UPRU* 2.4.2R; and

(d) *IPRU(INV)* 5.2.1(2) are to be construed as references to *UPRU* 2.1.1R.

2.4 Records

2.4.1 R A *firm* must ensure that proper accounting records are kept in English to show and explain the *firm's own account transactions*.

1 UPRU Schedule 1 – Record keeping requirements
G

UPRU Sch.1.1 Record keeping requirements

Handbook reference	Subject of record	Contents of record	When record must be made	Retention period
UPRU 2.4.1R	accounting records	proper accounting records to show and explain the <i>firm's own account transactions</i>	not specified	not specified

2 UPRU Schedule 2 – Notification requirements
G

UPRU Sch.2.1

There are no reporting requirements in this sourcebook.

3 UPRU Schedule 3 - Fees and other required payments
G

UPRU Sch. 3.1

There are no requirements for fees or other payments in this sourcebook.

4 UPRU Schedule 4 – Powers exercised
G

UPRU Sch.4.1

The following powers and related provision in or under <i>Act</i> have been exercised by the <i>FSA</i> to make the <i>rules</i> in this sourcebook:	
1.	section 138 (General rule-making power);
2.	section 140 (Restrictions on managers of authorised unit trust schemes);
3.	section 156 (General supplementary powers);
4.	section 242 (Applications for authorisation of unit trust schemes);
5.	section 247 (Trust scheme rules);
6.	section 248 (Scheme particulars rules); and
7.	regulation 6 and 12 of the Open-Ended Investment Company regulations 2001 (SI 2001/1228).
The following powers in the <i>Act</i> have been exercised by the <i>FSA</i> to give the guidance in this sourcebook:	
8.	section 157(1) (Guidance).

5 UPRU Schedule 5 – Rights of action for damages
G

UPRU Sch.5.1

The table below sets out the rules in this sourcebook contravention of which by an authorised person may be actionable under section 150 of the Act (Actions for damages) by a person who suffers loss as a result of the contravention.

1. If a Yes appears in the column headed For private person, the rule may be actionable by a private person under section 150 unless a Yes appears in the column headed Removed. A Yes in the column headed Removed indicates that the *FSA* has removed the right of action under section 150(2) of the Act. If so, a reference to the rule in which it is removed is also given.
2. In accordance with The Financial Services and Markets Act 2000 (Rights of Action) Regulations 2001 (SI 2001\2256), a private person is:
 - (1) any individual, except when acting in the course of carrying on a regulated activity; and
 - (2) any person who is not an individual, except when acting in the course of carrying on business of any kind; but does not include a government, a local authority or an international organisation.
3. The column headed "For other person?" indicates whether the rule is actionable by a person other than a private person, in accordance with those Regulations. If so, an indication of the type of person by whom the rule is actionable is given.

UPRU Sch.5.2

Actions for damages: the Prudential sourcebook for UCITS Firms

Chapter/ Appendix	Section/ Annex	Paragraph	Right of action under section 150			
			For private person	Removed	For other person?	
All rules in this sourcebook			No	No	No	

6 UPRU Schedule 6 – Rules that can be waived
G

UPRU Sch.6.1

1. The rules in this sourcebook can be *waived* by the *FSA* under section 148 or 250 of the *Act* (Modification or waiver of rules) or regulation 7 of the *OEIC Regulations* (Modification or waiver of FSA rules).
2. Although the *FSA* has the formal power of *waiver* under the *Act* in relation to these *rules*, much of this sourcebook implements the requirements of the *UCITS Directive* by ensuring that *UCITS firms* as *UCITS management companies* comply with such requirements. Accordingly, while formal power may exist to waive such *UCITS Directive* derived rules, the *FSA's* ability to do so is severely constrained.

Annex C

Amendments to the Supervision manual (SUP)

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

...

SUP 3.1.10G Other relevant sections of the Handbook (see SUP 3.1.9G)

	...	
	<i>Investment management firm, personal investment firm, securities and futures firm, UCITS management company</i>	<i>IPRU (INV)</i>
	<u>UCITS firm</u>	<u>(UPRU)</u>
	...	

...

SUP 3.9.5R Auditor's Report

...

(10) the *firm* not being a *corporate finance advisory firm* or ...

...

- (f) ~~a UCITS management company~~
~~IPRU (INV) 7.2.3R and IPRU (INV) 7.2.4~~
a UCITS firm (UPRU 2.1.2 and UPRU 2.1.3)

...

...

(13) the *firm* has kept proper accounting records in accordance with ...

...

- (e) ~~a UCITS management company~~
~~IPRU (INV) 7.4.1R~~
a UCITS firm (UPRU 2.3.1R (1)(c) and UPRU 2.4.2)

...

...

SUP 16.7.68R Financial reports from a UCITS management company (see SUP 16.7.67R)

Report	Frequency	Due Date
...		
...		
Note 3:	...	
	for its own internal use to ensure that it complies at all time with the <i>rules</i> in IPRU(INV) UPRU (for a	

	<i>UCITS firm</i>) or BIPRU (for a <i>UCITS investment firm</i>)
...	

...

SUP 16 Ann 16R: UCITS management companies reporting forms and requirements applying to their completion

...

Financial Resources Statement – UCITS Management Companies UAFS 3

Financial Resources

*Note: The references in brackets are to the items of capital ~~IPRU(INV) Table 7.3.1 Part 1~~
UPRU Table 2.2.1 Part 1*

...

Satisfaction of Financial Resource Tests – UCITS Management Companies UAFS 4

Financial Resources Requirements for all UCITS Management Companies

...

Test 2

Financial Resource Test

...

13/52 of annual audited fixed expenditure ~~IPRU(INV) Rule 7.2.2(2)~~ UPRU 2.1.2R (2) –form
 UAFS5

Surplus/Deficit of financial resources [54-57 or 58]

...

**Calculation of financial resources requirements for forthcoming year
– UCITS Management Companies**

UAFS 5

Annual Audited Fixed Expenditure

...

Annual Audited Fixed Expenditure
(pro-rated where relevant to annual amount) (~~IPRU(INV) 7.2.4(2)~~) (UPRU 2.1.3R (2))

...

**Financial Resources Statement – UCITS Management Companies
UQFS 3**

Financial Resources

*Note: The references in brackets are to the items of capita ~~IPRU(INV) Table 7.3.Part 11~~
(UPRU Table 2.2.1 Part 1)*

...

**Satisfaction of Financial Resource Tests – UCITS Management Companies
UQFS 4**

Financial Resources Requirements for all UCITS Management Companies

...

Test 2
Financial Resource Test

...

13/52 of annual audited fixed expenditure (~~IPRU(INV) Rule 7.2.2(2)~~) (UPRU 2.1.2R (2))
- form UAFS 5)

Surplus/Deficit of financial resources [54-57 or 58]

...

Annex D

Amendments to the Collective Investment Schemes sourcebook (CIS)

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

... CIS TP 1 Transitional Provisions

(1)	(2)	(3)	(4)	(5)	(6)
	Material to which the transitional provision applies		Transitional provision	Transitional provision: dates in force	Handbook provision: coming into force
...					
20	<i>CIS 16.5.1 R (4) to CIS 16.5.1 R (6)</i>	R	A <i>UCITS management company</i> may not carry on any of the activities specified in CIS 16.5.1 R (4) to CIS 16.5.1 R (6) unless it is a <i>UCITS investment firm</i> : (a) whose <i>permission</i> to carry on any such activity was given before 13 February 2004; or (b) which complies with Chapter 7 of IPRU(INV) <u>the relevant provisions of the Prudential sourcebook for banks, building societies and investment firms.</u>	From 13 February 2004 to 12 February 2007	13 February 2004
21	<i>CIS 16.5.1 R (4) to CIS 16.5.1 R (6)</i>	G	A <i>UK firm</i> will not be able to act as such and exercise an <i>EEA right</i> under the <i>UCITS Directive</i> unless it complies with Chapter 7 of IPRU(INV) <u>the Prudential sourcebook for UCITS Firms.</u>		
...					

MORTGAGES: CONDUCT OF BUSINESS SOURCEBOOK (HOME REVERSION AND HOME PURCHASE ACTIVITIES) INSTRUMENT 2006

Powers exercised

- A. The Financial Services Authority makes this instrument in the exercise of the powers and related provisions listed in Schedule 4 to the Mortgages: Conduct of Business sourcebook (Powers exercised) of the Handbook.
- B. The rule-making powers referred to above are specified for the purpose of section 153(2) (Rule-making instruments) of the Financial Services and Markets Act 2000.

Commencement

- C. Subject to The Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) (No.2) Order 2006 (SI No 2006/2383) being in force on 6 November 2006, this instrument comes into force on 6 April 2007.

Amendments to the Handbook

- D. The Mortgages: Conduct of Business sourcebook (MCOB) shall be cited as the Mortgages and Home Finance: Conduct of Business sourcebook (MCOB) and all references in the Handbook are changed accordingly.
- E. MCOB is amended in accordance with Annexes A and B to this instrument.

Citation

- F. This instrument may be cited as the Mortgages: Conduct of Business Sourcebook (Home Reversion and Home Purchase Activities) Instrument 2006.

By order of the Board
25 October 2006

Annex A

Amendments to the Mortgages and Home Finance: Conduct of Business sourcebook (MCOB)

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

Application and purpose

...

Purpose

1.1.2 G ... This chapter also provides *guidance* on the application of other parts of the ~~Handbook to a firm that carries on regulated mortgage activities.~~

1.2 General application: who? what?

1.2.1 R (1) ~~MCOB~~This sourcebook applies to every *firm* that:

- (a) carries on ~~regulated mortgage activities~~a home finance activity (subject to ~~MCOB 1.2.3R(1)~~the business loan application provisions); or
- (b) *communicates or approves a* ~~qualifying credit~~financial promotion of qualifying credit, of a home purchase plan or of a home reversion plan.

(2) ...

...

Firm types and the ~~regulated mortgage~~home finance activities

1.2.2 G (1) This sourcebook applies to activities carried out in respect of three types of product: regulated mortgage contracts (which includes lifetime mortgages), home purchase plans, and home reversion plans. Together, these products are referred to as home finance transactions.

(2) Lifetime mortgages and home reversion plans are together referred to as equity release transactions.

(3) The application of most of ~~MCOB~~this sourcebook is expressed by reference to four types of *firm*: ~~mortgage lenders, mortgage administrators, mortgage arrangers and mortgage advisers~~lenders/providers, administrators, arrangers, and advisers. Arrangers

and advisers are together referred to as intermediaries. ... *Guidance on these firm types, the regulated mortgage activities which they carry on, a description of what those activities cover and what is excluded is set out in MCOB 1 Annex 1. PERG 4 contains detailed guidance on these activities regulated mortgage activities and PERG 14 contains detailed guidance on home purchase activities and home reversion activities.*

...

1.2.4 G *MCOB 1 Annex 2 contains a table summarising the provisions of MCOB that apply to regulated mortgage contracts that are for a business purpose. ...*

...

Business loans: additional requirements if tailored route is used

1.2.7 R In relation to a *regulated mortgage contract* for a business purpose, if a *firm* has opted for the tailored route in *MCOB 1.2.3 R(2)*, it must adopt the following modifications to the provisions in *MCOB* the sourcebook:

- (1) (except in relation to sections 6 and 8 of any ~~initial disclosure document provided in accordance with MCOB 4.4.1 R(1)(c)(i)~~ *initial disclosure document* or sections 5 and 8 of any ~~initial disclosure document provided in accordance with MCOB 4.4.1 R(1)(c)(ii)~~ *combined initial disclosure document*) substitute an alternative description of the facility provided under the *regulated mortgage contract* for 'mortgage' where that term is used in any disclosure;

...

...

Home purchase plans

1.2.9A G For detail of the tailored provisions applying to *home purchase plans*, see the section on 'home purchase plans' set out in each relevant chapter.

Authorised professional firms

1.2.10 R *MCOB* does not apply to an *authorised professional firm* with respect to its *non-mainstream regulated activities* except for:

...

- (3) ~~MCOB 4.4 (Initial disclosure requirements)~~ initial disclosure requirements but only as regards providing the information contained in section 7 (What to do if you have a complaint) and section 8 (Are we covered by the Financial Services Compensation Scheme?) of ~~MCOB 4 Annex 1 or MCOB 4 Annex 2, and MCOB 8 Annex 1 or MCOB 8 Annex 2~~ an initial disclosure document or combined initial

disclosure document (see MCOB 4.4 and MCOB 4.10).

...

Pre-contractual arrangements by a ~~mortgage lender~~ home finance provider

1.2.12 R In *MCOB* the activities of a ~~mortgage lender~~ home finance provider which would be *arranging* but for article 28A of the *Regulated Activities Order* (Arranging contracts or plans to which the arranger is a party), are to be treated as *arranging* and therefore also as *regulated mortgage home finance activities*.

1.2.13 G The effect of article 28A of the *Regulated Activities Order* would normally mean that arrangements made by a party to a ~~regulated mortgage contract~~ home finance transaction would not fall within the ~~regulated mortgage home finance activity~~ of *arranging*. So in a direct sale, a ~~mortgage lender~~ home finance provider would not be carrying on the *regulated activity* of *arranging* but, where the transaction proceeds to completion, would instead be involved in ~~the regulated activity of~~ comprising entering into a regulated mortgage home finance transaction. However, the provisions in *MCOB* on arranging ~~regulated mortgage contracts~~ home finance transactions are applied to pre-contractual arrangements by a ~~mortgage lender~~ home finance provider.

~~Summary of the application of the chapters of MCOB~~ [deleted]

1.2.14 G ~~A table summarising the application of the various chapters of MCOB to firms that carry on regulated mortgage activities is set out in MCOB 1 Annex 3. For the detailed application of each chapter, see the application rule at the start of that chapter.~~ [deleted]

1.3 General application: where?

Location of the customer

1.3.1 R Except as set out in this section, *MCOB* applies if the *customer* of a *firm* carrying on ~~regulated mortgage~~ home finance activities is resident in:

- (1) the *United Kingdom*; or
- (2) another *EEA State*, but in this case only if the activity is carried on from an establishment maintained by the *firm* (or its *appointed representative*) in the *United Kingdom*;

at the time that the ~~regulated mortgage~~ home finance activity is carried on.

...

Distance contracts entered into from an establishment in another EEA State

- 1.3.4 R (1) The *rules* in (2) do not apply to a *firm* with respect to ~~an activity~~ regulated mortgage activity or a home purchase activity exclusively concerning a *distance contract* if the following conditions are satisfied:
- ...
- (2) The *rules* which do not apply are:
- (a) ~~MCOB 4.4 (Initial disclosure requirements)~~ initial disclosure requirements in MCOB 4.4 (in respect of regulated mortgage contracts) and MCOB 4.10 (in respect of home purchase plans);
- (b) *MCOB 4.5* (Additional disclosure for distance mortgage mediation contracts and distance home purchase mediation contracts with retail customers);
- (c) *MCOB 4.6* (Cancellation of distance mortgage mediation contracts and distance home purchase mediation contracts);
- ...
- (h) ~~MCOB 8.4 (Initial disclosure requirements: home reversion schemes)~~; ~~[deleted]~~
- ...
- (k) *MCOB 9.5* (Disclosure at offer stage for ~~lifetime mortgages~~ equity release transactions).

Distance contracts with retail customers

- 1.3.5 G Parts of *MCOB* relate to *distance contracts* (or *distance mortgage mediation contracts* and distance home purchase mediation contracts) with *retail customers*. ...

...

- 1.4 ~~Application of the Handbook in relation to mortgages~~ ~~[deleted]~~

- 1.4.1 G A table summarising the application of the *Handbook* to *firms* carrying on *regulated mortgage activities* is set out in *MCOB 1 Annex 4*. For the detailed application of each module, see the application provision at the start of the module, and each chapter or section. ~~[deleted]~~

...

- 1.6 Application to mortgages in relation to the Consumer Credit Act 1974

...

MCOB 1 Ann 1 to MCOB 1 Ann 4 is deleted in its entirety. The deleted text is not shown.

Annex 1 [deleted]

...

Annex 2 [deleted]

...

Annex 3 [deleted]

...

Annex 4 [deleted]

Conduct of business standards: general

2.1 Application

Who?

2.1.1 R This chapter applies to a *firm* in a category listed in column (1) of the table in *MCOB 2.1.2R* in accordance with column (2) of that table.

This table belongs to *MCOB 2.1.1R*

2.1.2 R	(1) Category of firm	(2) Applicable section
	<i>mortgage lender</i> <i>mortgage administrator</i> <i>mortgage adviser</i> <i>mortgage arranger</i>	whole chapter except <i>MCOB 2.2.6AR</i> , <i>MCOB 2.2.8AR</i> , <i>MCOB 2.2.8BG</i> , <i>MCOB 2.6A</i> and <i>MCOB 2.8.6G</i>
	<i>home purchase provider</i>	<i>MCOB 2.1</i> , <i>MCOB 2.2.1G</i> , <i>MCOB 2.2.6R</i> to <i>MCOB 2.2.9G</i> , <i>MCOB 2.5</i> , <i>MCOB 2.6</i> , <i>MCOB 2.6A.1R</i> to <i>MCOB 2.6A.4G</i> , <i>MCOB 2.6A.7G</i> to <i>MCOB 2.6A.10G</i> , <i>MCOB 2.7.4R</i> to <i>MCOB 2.7.6R</i> and <i>MCOB 2.8.6G</i>

<u>home purchase administrator</u>	As for a <u>home purchase provider</u> but <u>MCOB 2.6A1R to MCOB 2.6A.4G and MCOB 2.6A.7G</u> do not apply
<u>home purchase adviser</u> <u>home purchase arranger</u>	As for a <u>home purchase provider</u> but <u>MCOB 2.6A</u> does not apply
<u>reversion provider</u>	whole chapter except <u>MCOB 2.2.6AR, MCOB 2.2.8AR and MCOB 2.2.8BG, MCOB 2.6A.7G, MCOB 2.7.4R to MCOB 2.7.6R and MCOB 2.8.6G</u>
<u>reversion administrator</u> <u>reversion arranger</u>	As for a <u>reversion provider</u> but the relevant provisions of <u>MCOB 2.6A</u> apply only when <u>arranging for a home reversion plan to be entered into by a reversion occupier with, or administering a home reversion plan provided by, an unauthorised reversion provider.</u>
<u>reversion adviser</u>	As for a <u>reversion provider</u> but <u>MCOB 2.6A</u> does not apply
<u>a firm that communicates or approves a qualifying credit financial promotion of qualifying credit or of a home reversion plan</u>	<u>MCOB 2.5, MCOB 2.6, MCOB 2.7</u> (except, when the <u>financial promotion</u> relates to a <u>home reversion plan, MCOB 2.7.4R to MCOB 2.7.6R</u>) and <u>MCOB 2.8</u> (except <u>MCOB 2.8.6G</u>)
<u>a firm that communicates or approves a financial promotion of a home purchase plan</u>	<u>MCOB 2.2.6R to MCOB 2.2.9G, MCOB 2.5, MCOB 2.6, MCOB 2.7 and MCOB 2.8.6G</u>

What?

2.1.3 R This chapter applies in relation to:

(1) regulated mortgage home finance activities;

- (2) those activities in *MCOB 12* and *MCOB 13* that are carried on after a regulated mortgage contract or home purchase plan has come to an end following the sale of a *repossessed* property, and those activities in *MCOB 12* that are carried on after a home reversion plan has ended for any reason; and
- (3) the *communication* or *approval* of a ~~qualifying credit~~financial promotion of qualifying credit, of a *home purchase plan* or of a home reversion plan.

2.2 Communications

...

General

2.2.2 G In many circumstances there will be two or more *customers* under any ~~regulated mortgage contract~~home finance transaction, or two or more prospective *customers* looking to enter into the same ~~regulated mortgage contract~~home finance transaction. In such circumstances, ...

Prescribed terms for regulated mortgage contracts and home reversion plans

2.2.3 R In any communication to a *customer*, a *firm* must:

- (1) describe any *early repayment charge* as an 'early repayment charge' ~~and not use any other expression to describe such charges~~;
- (2) describe any *higher lending charge* as a 'higher lending charge' ~~and not use any other expression to describe such charges~~; and
- (3) describe any ~~regulated lifetime mortgage contract~~ as a 'lifetime mortgage' ~~and not use any other expression to describe such a mortgage~~; ~~and~~;

(4) describe any home reversion plan as a 'home reversion plan';

and not use any other expression to describe them.

...

Related investment advice

2.2.5 G *Firms* are reminded that they should follow the relevant *rules* in *COB 5* and *COB 6* relating to advice and disclosure on *investments* if they are *advising* the *customer* on an *investment* such as an annuity ~~linked to a regulated lifetime mortgage contract~~associated with an equity release transaction or an *ISA* used as a *repayment vehicle*.

Clear, fair and not misleading communications and financial promotions

- 2.2.6 R (1) When a *firm* communicates information to a *customer*, it must take reasonable steps to communicate in a way that is clear, fair and not misleading.
- (2) ~~Paragraph (1) does not apply to a *firm* when it communicates a *qualifying credit promotion* in circumstances in which *MCOB 3* (Financial promotion) applies to the *firm*. [deleted]~~
- 2.2.6A R A *firm* which approves a financial promotion of a home purchase plan must take reasonable steps to ensure that the financial promotion is clear, fair and not misleading.
- 2.2.7 G When considering how to comply with the requirements of *MCOB 2.2.6R* ~~these rules~~ on clear, fair and not misleading communications and *financial promotions*, a *firm* should have regard to the *customer's* knowledge of the ~~regulated mortgage contract~~ home finance transaction to which the information relates.
- 2.2.8 G ~~*MCOB 2.2.6R*~~ The rule on clear, fair and not misleading communications covers all communications with *customers*, for example any oral or written statements, telephone calls and any correspondence which is not a ~~*qualifying credit*~~ financial promotion to which *MCOB 3* (Financial promotion) applies. In respect of ~~*qualifying credit*~~ financial promotions of qualifying credit or of home reversion plans, *firms* should note the separate requirements of *MCOB 3*.
- 2.2.8A R If a *firm* uses a figure equivalent to an *APR* in a communication of a financial promotion of a home purchase plan, when calculating that figure it must use an approach equivalent to the *APR rules*.
- 2.2.8B G The following guidance may be relevant to a *firm* that communicates or approves a financial promotion of a home purchase plan:
- (1) guidance on what 'communicate', 'approve' and 'financial promotion' mean, and on the media of communication to which financial promotion rules apply (see *MCOB 3.2.1G* and *MCOB 3.2.2G*);
 - (2) guidance on other Handbook provisions relevant to financial promotions (see *MCOB 3.2.8G* to *MCOB 3.2.9G*);
 - (3) guidance on other regulations and guidelines relevant to financial promotions (see *MCOB 3.5.3G*);
 - (4) guidance on referring to the *FSA* (see *MCOB 3.6.2G(3)*);
 - (5) guidance on the clear, fair and not misleading standard (see *MCOB*

3.6.5G, MCOB 3.6.10G and MCOB 3.6.14G); and

- (6) guidance on the use of the Internet for *communicating financial promotions* (see MCOB 3.12 and PERG 8.22).

Note: A comparative *financial promotion* will need to comply with regulation 4A of the Control of Misleading Advertisements Regulations 1988.

...

2.3 Inducements: regulated mortgage contracts and home reversion plans

Purpose

- 2.3.1 G ~~*Principles 1 and 6* require a *firm* to conduct its business with integrity, to pay due regard to the interests of its *customers* and to treat them fairly. The purpose of MCOB 2.3 is to ensure, in accordance with *Principles 1, 6 and 8*, that a *firm* does not conduct business under arrangements that might give rise to a conflict with its duty to *customers* or to unfair treatment of them.~~

Prohibition of inducements

- 2.3.2 R A *firm* must take reasonable steps to ensure that it, and any *person* acting on its behalf, does not:

- (1) offer, give, solicit or accept an inducement; or
(2) direct or refer any actual or potential business in relation to a *regulated mortgage contract* or *home reversion plan* to another *person* on its own initiative or on the instructions of an *associate*;

if it is likely to conflict to a material extent with any duty that the *firm* owes to its *customers* in connection with such a *regulated mortgage contract* or *home finance transaction* or any duty which such a recipient *firm* owes to its *customers* in connection with such a *regulated mortgage contract* or *home finance transaction*.

...

- 2.3.5 G MCOB 2.3.2R does not prevent a *firm*:

- (1) assisting a ~~*mortgage*~~ *home finance intermediary* so that the quality of the ~~*mortgage*~~ *home finance intermediary's* service to *customers* is enhanced; or

...

- 2.3.6 R (1) A *firm* must not operate a system of giving or offering inducements to a *mortgage intermediary*, *reversion intermediary* or any other

third party whereby the value of the inducement increases if the ~~mortgage intermediary~~intermediary or third party, such as a packager, exceeds a target set for the amount of business referred (for example, a volume override).

(2)

Quantification of inducements

- 2.3.7 R (1) A mortgage lender or reversion provider must quantify, in cash terms, any material inducement it offers to a mortgage intermediary, reversion intermediary or a third party.
- (2) In quantifying the value of the material inducement, the firm must include any subsequent payments (such as a trail fee) made where the customer continues with the same regulated mortgage contract home finance transaction.
- 2.3.8 G (1) Quantification of any material inducement offered by the mortgage lender or reversion provider supports the disclosure requirements elsewhere in MCOB. Further guidance on the disclosure of any inducement in cash terms is provided in MCOB 5.6.118G for regulated mortgage contracts other than lifetime mortgages, MCOB 9.4.124G for lifetime mortgages and MCOB 9.4.173G for home reversion plans.
- (2) A payment made to a third party unconnected with the mortgage home finance intermediary, where that payment only reflects the cost of outsourcing work relating to the processing of mortgage applications, would not be considered an inducement for these purposes in the context of MCOB 2.3.7R.

2.4 High pressure sales: regulated mortgage contracts and home reversion plans

Purpose

- 2.4.1 G The purpose of ~~MCOB 2.4~~this section is to remind firms of the relevance of the high level standards in PRIN, especially with regard to the use of sales methods that may lead a customer to feel pressurised to enter into, or vary, a regulated mortgage contract or home reversion plan.

Fair treatment

- 2.4.2 G ... a firm should avoid selling practices that commit customers (or lead customers to believe that they are committed) to any regulated mortgage contract or home reversion plan before they have been able to consider the illustration and offer document. ...

Information

- 2.4.3 G ... a firm should avoid giving any customer a false impression about the

availability of a *regulated mortgage contract* or *home reversion plan*, such as ...

2.5 Reliance on others

Purpose

2.5.1 G ... MCOB 2.5 indicates the extent to which *firms* that carry on ~~*regulated mortgage contract*~~ *home finance* activities and that *communicate* or *approve* a ~~*qualifying credit*~~ *financial* promotion can meet this requirement by relying on others.

...

After MCOB 2.6 insert the following new section. The inserted text is not underlined.

2.6A Protecting customers' interests: home purchase plans and home reversion plans

Protecting customers' interests: home purchase plans and home reversion plans

2.6A.1 R A *firm* must ensure that the interests of its *customer* under a *home purchase plan* or *home reversion plan* are protected to a reasonable standard.

2.6A.2 G Circumstances that a *firm* should consider include how the *customer* will be protected in the event of:

- (1) the *failure* of a *reversion provider* or *home purchase provider*;
- (2) the transfer of a *reversion provider's* or *home purchase provider's* interest (or the interest the provider would have had, had it not nominated a third party to hold it) in the property to a third party;
- (3) other dealings by a *reversion provider* or *home purchase provider* (or its nominee) with a third party; and
- (4) a *reversion provider's* or *home purchase provider's* (or its nominee's) failure to perform obligations owed to third parties, or imposed by statute.

2.6A.3 G The steps that a *firm* might take in order to protect its *customer's* interests will depend on a number of factors, including the nature and structure of the *home purchase plan* or *home reversion plan* and the jurisdiction in which the property is situated. If it is not possible to achieve reasonable protection (for example, due to impediments under a particular legal system) then a *firm* should not enter into, arrange or administer the plan.

2.6A.4 G (1) In the *FSA's* view, a *customer's* interests will include:

- (a) protection of the *customer's* rights under the plan, in

particular the right to occupy the property throughout its term;

- (b) protection of any interest (legal or beneficial) that the *customer* retains, acquires or is intended to acquire in the property, including the expectation that such interests will be unencumbered by third party interests; and
- (c) that, where a *customer* pays sums under a *home purchase plan* towards the purchase price of the property, those sums will be applied towards the purchase price. Or, in circumstances where that is not practicable (for example, on *repossession*), that an appropriate amount will be returned to the *customer*.

(2) The protections that a *firm* should consider include:

- (a) the extent to which different forms of tenure protect the tenant's right to occupy the property and afford protection against removal. In particular, granting the *customer* a licence to occupy the property is unlikely to provide an adequate level of security;
- (b) (except in Scotland) the need for any agreement under which a *customer* has a right to acquire an interest in the property to be specifically enforceable;
- (c) the extent to which appropriate registrations, restrictions, notices or other entries should be made in the relevant land register;
- (d) the timing of entries in the relevant land register and who should be responsible for making them; and
- (e) the *customer's* need for a full and clear understanding of all the steps that the *firm* expects him or his advisers to take to protect his interests both at the time the plan is entered into, and throughout its duration.

Protecting customers' interests: additional material for home reversion plans

2.6A.5 R Unless it is satisfied on reasonable grounds based on the *customer's* knowledge, expertise and experience that it is unnecessary, a *firm* must obtain from its *customer's* legal adviser, before its *customer* enters into a *home reversion plan*, confirmation that:

- (1) he has been instructed to ensure that the *customer's* legal rights under the plan are protected to a reasonable standard; and
- (2) he has explained to the *customer* those aspects of the *customer's* legal rights and obligations under the *home reversion plan* that he needs to understand.

- 2.6A.6 G *Firms* remain responsible for ensuring that their *customers'* interests are protected to a reasonable standard.

Protecting customers' interests: additional material for home purchase plans

- 2.6A.7 G A *home purchase provider* should consider obtaining confirmation from the *customer's* legal adviser that he has carried out, or will carry out, the steps that the *firm* expects the *customer* or his legal advisers to take to protect his interests at the time the plan is taken out.

Treating customers fairly: home purchase plans and home reversion plans

- 2.6A.8 R A *firm* must pay due regard to the interests of its *customer* and treat him fairly when drafting, amending the terms of, or imposing obligations or exercising rights or discretions under, a *home purchase plan* or *home reversion plan*.

- 2.6A.9 G A *firm* is unlikely, for example, to be treating its *customer* fairly in relation to termination of a *home purchase plan* or *home reversion plan* if:

- (1) the grounds on which it may terminate all or part of a plan are unduly wide, or on which a *customer* may terminate are unduly narrow; or
- (2) the *customer* is not given appropriate notice of termination.

- 2.6A.10 G A *firm* is also unlikely to be treating its *customer* fairly if, upon termination of an agreement under a *home purchase plan* or *home reversion plan*, the *customer* does not receive (net of any reasonable sums payable by the *customer*):

- (1) in the case of a *home reversion plan* where the *customer* retains a beneficial interest in the property, the value of that beneficial interest; or
- (2) in the case of a *home purchase plan*, the value of purchase payments made.

Note: The terms of a *home purchase plan* or *home reversion plan* should take into account relevant legal obligations such as those under the *Unfair Terms Regulations* and, where applicable, the Housing Act 1988 (or, in Scotland, the Housing (Scotland) Act 1988). A *firm* may find material on the FSA website concerning the FSA's consumer protection powers useful. The Office of Fair Trading has also published guidance on the impact of the *Unfair Terms Regulations* on tenancy agreements.

Treating customers fairly: home reversion plans

- 2.6A.11 G A *firm* is unlikely, for example, to be treating a *reversion occupier* fairly if:

- (1) the *reversion occupier* is obliged to maintain the property to a standard which exceeds the standard that the property is in when the

home reversion plan commences;

- (2) the *reversion occupier* is not entitled to, or is not given, reasonable notice of an inspection, or the inspection is conducted in a way that is biased against him;
- (3) unreasonable restrictions are imposed on who may occupy the property, taking into account the potential needs of the *reversion occupier* throughout the duration of the *home reversion plan*;
- (4) unreasonable restrictions are imposed on the uses to which the property may be put;
- (5) the *reversion occupier* is unreasonably treated as having abandoned the property. For example, it is likely to be unreasonable to treat a property as abandoned based only on a period of non-occupation;
- (6) where the *reversion occupier* has a reasonable expectation that the *home reversion plan* can be transferred to another property, agreement to such a transfer is, or can be, refused unreasonably.

Independent valuation: home reversion plans

- 2.6A.12 R A *firm* must ensure that any valuation is carried out by a competent valuer who is independent of the *reversion provider*.
- 2.6A.13 E
- (1) A valuer may be considered competent if he is a suitably qualified member of a professional body.
 - (2) A valuer may be considered independent if:
 - (a) the *customer* can choose the valuer subject to the *firm* objecting on reasonable grounds and to the valuer being competent;
 - (b) he owes a duty of care to the *customer* in valuing the property; and
 - (c) the *customer* has an appropriate remedy against him under a complaints procedure which allows the complaint to be referred to an independent person whose decision is binding on the valuer.
 - (3) Compliance with (1) and (2) may be relied on as tending to establish compliance with *MCOB 2.6A.12R*.
- 2.6A.14 G Members of the Royal Institution of Chartered Surveyors, for example, are required to operate a complaints procedure that allows the complaint to be referred to an independent person whose decision binds the valuer and which, in the *FSA's* view, provides a *customer* with an appropriate remedy.

Obtaining best price: partial home reversion plans

- 2.6A.15 R A *firm* must take reasonable steps to ensure that, when a *home reversion plan* ends and the *customer* retains a beneficial interest in the property:
- (1) the property is sold within a reasonable period of time; and
 - (2) the best price that might reasonably be obtained is paid.
- 2.6A.16 G It is recognised that a balance has to be struck between the need to sell the property as soon as possible, and other factors, such as market conditions, which may prompt the delay of the sale. Legitimate reasons for deferring action might include the expiry of a period when a grant is repayable on re-sale, or the discovery of a title defect that needs to be remedied if the optimal selling price is to be achieved.
- Arranging or administering for unauthorised providers: home reversion plans
- 2.6A.17 R For the purpose of this section (except this *rule*), a *reversion arranger* or *reversion administrator's customer*:
- (1) includes a *reversion occupier* or potential *reversion occupier* who enters, or proposes to enter, into a *home reversion plan* with an *unauthorised reversion provider* who is the *firm's customer*; and
 - (2) excludes an *unauthorised reversion provider*.
- 2.6A.18 G A *person* may enter into a *home reversion plan* as provider without being regulated by the *FSA* (or an *exempt person*) if the *person* does not do so by way of business (see *PERG* 14.5). If a *firm* arranges for such a *person* to enter into a *home reversion plan* as provider, the *firm* will be responsible for ensuring that the *reversion occupier's* interests are protected to a reasonable standard, even if the *reversion arranger* is not acting for the *reversion occupier*. A *reversion administrator* is under the same obligation in relation to a *reversion occupier* under a *home reversion plan* which it *administers* on behalf of an *unauthorised reversion provider*.

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

2.7 Application to electronic media and distance communications

...

- 2.7.2 G For any electronic communication with a *customer* in relation to a ~~*regulated mortgage contract*~~ *home finance transaction*, a *firm* should:

...

...

General provisions related to distance contracts

- 2.7.4 R During the course of a *distance contract* with a *retail customer*, the making or performance of which constitutes or is part of a *regulated mortgage contract* or *home purchase plan*:
- (1) the *firm* must, at the *retail customer's* request, provide a paper copy of the contractual terms and conditions of the *regulated mortgage contract*, *home purchase plan* or ~~of the~~ services being provided by the *firm*; and
 - (2) the *firm* must comply with the *customer's* request to change the *means of distance communication* used, unless this is incompatible with the *regulated mortgage contract*, *home purchase plan* or service being provided by the *firm*.

...

Unsolicited services

- 2.7.6 R (1) ...
- (2) Paragraph (1) applies in relation to ~~advising on, arranging or entering into a regulated mortgage contract~~ *mortgage mediation activities, entering into a regulated mortgage contract, home purchase mediation activities or entering into a home purchase plan* under an organised distance sales or service-provision scheme ...

...

2.8 Record keeping

...

Home purchase plans

- 2.8.6 G This sourcebook does not specify detailed record keeping requirements for a firm that carries on a home purchase activity or that communicates or approves a financial promotion of a home purchase plan (but note the high-level record-keeping provisions in the Senior Management Arrangements, Systems and Controls sourcebook).

Financial promotion of qualifying credit and of home reversion plans

3.1 Application: who?

- 3.1.1 R This chapter applies to every *firm* which *communicates* or *approves* a ~~qualifying credit~~ *financial promotion of qualifying credit* or of a *home*

reversion plan.

3.1.2 G This chapter applies generally to *firms* in relation to all ~~*qualifying credit financial promotions of qualifying credit*~~ or of a *home reversion plan*. This wide application is however cut back by *MCOB 3.2* (Application: what?) and *MCOB 3.3* (Application: where?) which limit the application of this chapter for:

- (1) ~~*qualifying credit financial promotions*~~ which would fall within the scope of the exemptions in the *Financial Promotion Order* or the additional exemptions set out in *MCOB 3.2.5R* (Applications: what? Exemptions); and
- (2) ~~*qualifying credit financial promotions*~~ to persons outside the *United Kingdom*.

...

3.1.6 R This chapter does not apply to a *firm* in relation to the *communication* or *approval* of a *financial promotion of a home reversion plan to an unauthorised reversion provider* that is not a ~~*qualifying credit promotion*~~ (but see ~~*COB 3*~~ (*Financial promotion*)).

3.1.7 G A ~~*communication*~~ may contain both a *financial promotion* and a *qualifying credit promotion* and *home reversion plans*, for example a building society leaflet which describes the range of mortgage, and savings and insurance products it provides. In such cases, both ~~*MCOB 3*~~ and ~~*COB 3*~~ the *financial promotion rules* in this and other sourcebooks will each apply as be relevant.

...

Nationals of other EEA States

3.1.11 G A national of an *EEA State* (other than the *United Kingdom*) wishing to take advantage of the exemption in article 36 of the *Financial Promotion Order* in respect of a ~~*qualifying credit financial promotion of qualifying credit*~~ or of a *home reversion plan* should act in conformity with the *rules* in this chapter.

...

3.2 Application: what?

Application for a financial promotion of qualifying credit

3.2.-3 R This chapter applies to the *communication* or *approval* of a *financial promotion of qualifying credit* as follows:

<u>Application, purpose and general</u>	<u>MCOB 3.1 to MCOB 3.5</u>
<u>Form and content of non-real time qualifying credit promotions</u>	<u>MCOB 3.6</u>
<u>Unsolicited real time promotions of qualifying credit or home reversion plans</u>	<u>MCOB 3.7</u>
<u>Form and content of real time qualifying credit promotions</u>	<u>MCOB 3.8</u>
<u>Confirmation of compliance: financial promotions of qualifying credit or home reversion plans</u>	<u>MCOB 3.9</u>
<u>Records: non-real time financial promotions of qualifying credit or home reversion plans</u>	<u>MCOB 3.10</u>
<u>Communication and approval of qualifying credit promotions for an overseas person or an unauthorised person</u>	<u>MCOB 3.11</u>
<u>The Internet and other electronic media</u>	<u>MCOB 3.12</u>

Application for a financial promotion of a home reversion plan

3.2.-2 R This chapter applies to the communication or approval of a financial promotion of a home reversion plan as follows:

<u>Application, purpose and general</u>	<u>MCOB 3.1 to MCOB 3.5</u>
<u>Form and content of non-real time qualifying credit promotions</u>	<u>MCOB 3.6 in accordance with MCOB 3.8A</u>
<u>Unsolicited real time financial promotions of qualifying credit or home reversion plans</u>	<u>MCOB 3.7</u>
<u>Form and content of financial promotions of home reversion plans</u>	<u>MCOB 3.8A</u>
<u>Confirmation of compliance: financial promotions of qualifying credit or home reversion plans</u>	<u>MCOB 3.9</u>
<u>Records: non-real time financial promotions of qualifying credit or home reversion plans</u>	<u>MCOB 3.10</u>
<u>The Internet and other electronic media</u>	<u>MCOB 3.12</u>

Application for a financial promotion of a home purchase plan

3.2.-1 G The rules in this chapter do not apply to the communication or approval of a financial promotion of a home purchase plan. However, the clear, fair and not misleading standard still applies as does certain relevant guidance from this chapter (see MCOB 2.2).

...

Media of communication

3.2.2 G ...

(2) ~~Qualifying credit~~Financial promotions may be communicated for example, by means of:

...

(h) other publications, which may contain non-personal recommendations as to obtaining qualifying credit or entering into a home reversion plan.

3.2.3 G Guidance on the use of the Internet for ~~communicating qualifying credit~~financial promotions is in MCOB 3.12 (The Internet and other electronic media) and PERG 8.22 (The Internet).

Exemptions

3.2.4 R This chapter does not apply to a firm in relation to a ~~qualifying credit~~financial promotion of qualifying credit of a kind listed in MCOB 3.2.5R, except that if the firm approves the ~~qualifying credit~~financial promotion, the following apply:

(1) ...

(2) ~~MCOB 3.6.3R (Non-real time qualifying credit promotions: e~~Clear, fair and not misleading);

...

(4) if the firm approves a ~~non-real time qualifying credit~~financial promotion of qualifying credit by an overseas person MCOB 3.11.5R (Non-real time qualifying credit promotions for overseas persons) applies.

3.2.4A R This chapter does not apply to a firm in relation to a financial promotion of a home reversion plan of a kind listed in MCOB 3.2.5R, unless the firm approves the financial promotion.

3.2.5 R This table belongs to MCOB 3.2.4R and MCOB 3.2.4AR.

...

- 3.2.6 G *MCOB 3.2.5R(2) exempts a ~~qualifying credit~~financial promotion made by a firm or an appointed representative which refers to its activities only in general terms in image or brand advertising. The items identified in MCOB 3.2.5R(2) do not enable detailed information to be given about the ~~qualifying credit or home reversion plan~~ available from the firm. Thus firms should avoid the use of names, logos or addresses, for example, which attempt to convey additional ~~mortgage~~product or cost-related information.*

...

Other relevant handbook rules ~~relevant to qualifying credit promotions~~

...

- 3.2.9 G *Firms are reminded that if in the course of making a ~~qualifying credit~~financial promotion of any kind an adviser gives specific advice on ~~regulated mortgage contracts~~a home finance transaction to a customer about the suitability of a product for that individual, the adviser in giving the advice is subject to the rules, as appropriate, on advising and selling in MCOB 4 (Advising and selling standards) and MCOB 8 (~~Lifetime mortgages~~Equity release: advising and selling standards).*

3.3 Application: where?

Territorial Scope

- 3.3.1 R This chapter applies to a firm only in relation to:
- (1) the communication of a ~~qualifying credit~~financial promotion to a person inside the United Kingdom;
 - (2) the communication of an unsolicited real time ~~qualifying credit~~financial promotion of qualifying credit or of a home reversion plan, unless:

...
 - (3) the approval of a non-real time ~~qualifying credit~~financial promotion of qualifying credit or a home reversion plan for communication to a person inside the United Kingdom;
-
- 3.3.2 G (1) The application under MCOB 3.3.1R is relevant both when a firm communicates a ~~qualifying credit~~financial promotion itself and when a firm approves a non-real time ~~qualifying credit~~financial

promotion for communication by others. But see also *MCOB 3.3.3R* (Exceptions to territorial scope: rules without territorial limitation for approval of financial promotions) ~~regarding approvals.~~

...

Exceptions to territorial scope: rules without territorial limitation for approval of financial promotions

- 3.3.3 R Subject to *MCOB 3.3.5R* the following parts of this chapter apply without any territorial limitation if a *firm approves a qualifying credit/financial promotion of qualifying credit* or of a *home reversion plan*:

...

- (2) rules requiring a financial promotion to be clear, fair and not misleading (see *MCOB 3.6.3R(1)* (Non-real time qualifying credit promotions: clear, fair and not misleading) in relation to qualifying credit and *MCOB 3.8A.1R* in relation to a home reversion plan); and
- (3) the provisions regarding approval of financial promotions (except those relating to approval of financial promotions of qualifying credit provided by an overseas person) (see *MCOB 3.11.1G* to *MCOB 3.11.4G* (Approval of qualifying credit promotions; No approval of real time qualifying credit promotions; Approval of real time qualifying credit promotions when not all the rules apply) and *MCOB 3.8A.6R*).

- 3.3.4 G There is no need for a *qualifying credit/financial promotion* which is indicated in *MCOB 3.3.1R* to be outside the territorial scope of the application of *MCOB 3* to be approved ... If a *firm* nevertheless approves such a *qualifying credit/financial promotion*, it must comply with the *rules* indicated in ~~*MCOB 3.3.3R*~~. However, a *firm* must not approve a *real time qualifying credit/financial promotion* (see *MCOB 3.11.2R* (No approval of real time qualifying credit promotions) or *MCOB 3.8A.6R* (No approval of real time financial promotions of a home reversion plan)).

Exceptions to territorial scope: financial promotions of qualifying credit relating to distance contracts

- 3.3.5 R ...

- (3) The *rules* which do not apply are:
- (a) *MCOB 3.6.1R* (Non-real time qualifying credit promotions: Name and contact point);

...

- (f) *MCOB 3.8.2R(3) and (4) (Form and content of real time qualifying credit promotions).*

... Meaning of 'directed only at persons outside the United Kingdom'

3.3.7 R ...

- (4) The conditions are that:

...

- (d) there are in place proper systems and procedures to prevent recipients in the *United Kingdom* (other than those to whom the ~~*qualifying credit financial promotion*~~ might otherwise lawfully have been made) obtaining the ~~*qualifying credit product*~~ to which the ~~*qualifying credit financial promotion*~~ relates, from the *person* directing the ~~*qualifying credit financial promotion*~~, a *close relative* of his or a member of the same *group*;

...

3.4 Purpose

3.4.1 G (1) Section 21(1) of the *Act* (Restriction on financial promotion) imposes a restriction on the *communication of financial promotions* (~~*qualifying credit promotions in MCOB*~~) by *unauthorised persons*. A *person* must not, in the course of business, *communicate a qualifying credit financial promotion* unless:

- (a) he is an *authorised person*; or
- (b) the content of the ~~*qualifying credit financial promotion*~~ is *approved by an authorised person*.

(2) However, the *Financial Promotion Order* exempts from the restriction created by section 21(1) of the *Act* certain types of *financial promotions* (~~*qualifying credit promotions in MCOB*~~).

3.4.2 G (1) The purpose of this chapter is to provide *rules and guidance* for a *firm* which wishes to *communicate or approve a qualifying credit financial promotion of qualifying credit or of a home reversion plan*. ~~*MCOB 3.5.2G (Application: what? Exemptions) provides a guide to the topics covered in this chapter.*~~

(2) This chapter amplifies, for activities within its scope:

- (a) *Principle 6* (Customers' interests) ~~which requires a *firm* to pay due regard to the interests of its *customers* and treat them fairly;~~ and

- (b) *Principle 7* (Communications with clients) ~~which requires a~~

firm to pay due regard to the information needs of its clients, and communicate information to them in a way which is clear, fair and not misleading.

3.5 General

~~Topics covered in this chapter~~

3.5.1 G ~~[deleted – see application tables in MCOB 3.2]MCOB 3 includes some provisions which are applicable to all types of *qualifying credit promotion* and others which apply only to specific types. MCOB 3.5.2G has been provided to help locate the areas of particular relevance to types of *qualifying credit promotion*.~~

3.5.2 G ~~[deleted]This table belongs to MCOB 3.5.1G~~

Areas of particular relevance to types of qualifying credit promotion			
(1)	Provisions applying to all <i>qualifying credit promotions</i>	Application – who?	<i>MCOB 3.1</i>
		Application – what?	<i>MCOB 3.2</i>
		Application – where?	<i>MCOB 3.3</i>
		Purpose	<i>MCOB 3.4</i>
		General	<i>MCOB 3.5</i>
(2)	Provisions applying only to <i>non-real time qualifying credit promotions</i>	Form and content of non-real time qualifying credit promotions	<i>MCOB 3.6</i>
		Confirmation of compliance	<i>MCOB 3.9</i>
		Records	<i>MCOB 3.10</i>
(3)	Provisions applying only to <i>real time qualifying credit promotions</i>	Unsolicited real time qualifying credit promotions	<i>MCOB 3.7</i>
		Form and content of real time qualifying credit promotions	<i>MCOB 3.8</i>
(4)	Provisions applying only to certain types of <i>qualifying credit promotions</i>	Communication and approval of qualifying credit promotions for an overseas or unauthorised person	<i>MCOB 3.11</i>
		The Internet and other electronic media	<i>MCOB 3.12</i>

...

~~Non-real time qualifying credit promotions:~~ nName and contact point

3.6.1 R ...

3.6.2 G ...

(3) A *firm* is not required in a ~~qualifying credit~~financial promotion which it *communicates* or *approves* to name the *FSA* as its regulator. However, to ~~comply with MCOB 3.6.3R (Non-real time qualifying credit promotions:~~ ensure the financial promotion is clear, fair and not misleading), if the *firm* chooses to name the *FSA* as its regulator and the ~~qualifying credit~~financial promotion refers to matters not regulated by the *FSA*, it should also make clear that those matters are not regulated by the *FSA*. This might arise, for example, where the communication included both a ~~qualifying credit~~financial promotion of qualifying credit and a promotion for *unsecured lending*...

~~Non-real time qualifying credit promotions:~~ eClear, fair and not misleading

...

3.6.8 R In ~~complying with its obligations under MCOB 3.6.3R (Non-real time qualifying credit promotions:~~ ensuring a financial promotion is clear, fair and not misleading), a *firm* must...

...

Required risk statements

3.6.13 R A *non-real time* ~~qualifying credit~~financial promotion must, unless ~~MCOB 3.6.15R (the t~~Transient advertising)rule applies, prominently contain one or more of the following statements in the circumstances described:

(1) where ~~the qualifying credit promotion~~it relates to a *regulated lifetime mortgage contract*: 'This is a lifetime mortgage. To understand the features and risks, ask for a personalised illustration.'. If the promotion also relates to a home reversion plan the statement may be adapted to the extent necessary to comply with the equivalent requirement for a home reversion plan (see MCOB 3.8A.3R(2)(a));

(2) where ~~the qualifying credit promotion~~it refers to paying off unsecured debts...

...

(5) where more than one of the statements in (1) to (4) applies, each relevant statement should be included ~~in the qualifying credit promotion~~....

...

...

3.7 Unsolicited real time ~~qualifying credit~~ financial promotions of qualifying credit or a home reversion plan

Meaning of 'solicited' and 'unsolicited' real time ~~qualifying credit~~ financial promotion

3.7.1 R ...

(4) If a ~~qualifying credit~~ financial promotion is solicited by a person ('R') it is treated as also having been solicited by any other person to whom it is made at the same time as R if that other person is a close relative of R or is expected to enter into a home reversion plan or any contract for *qualifying credit* jointly with R.

...

Prohibition on unsolicited real time ~~qualifying credit~~ financial promotions to customers

3.7.3 R A firm must not make an *unsolicited real time ~~qualifying credit~~ financial promotion of qualifying credit or of a home reversion plan unless ... the customer envisages receiving such ~~unsolicited real time qualifying credit~~ financial promotions.*

...

3.8 Form and content of real time qualifying credit promotions

...

3.8.6 G Firms should note the additional disclosure requirements in ... *MCOB 4.5 (Additional disclosure for distance mortgage mediation contracts and distance home purchase mediation contracts with retail customers) ...*

After MCOB 3.8 insert the following new section. Inserted text is not underlined.

3.8A Form and content of financial promotions of home reversion plans

Clear, fair and not misleading

3.8A.1 R A firm which *communicates* or *approves* a financial promotion of a home reversion plan must take reasonable steps to ensure that the financial

promotion is clear, fair and not misleading.

- 3.8A.2 G The guidance on the clear, fair and not misleading standard at *MCOB* 3.6.5G, *MCOB* 3.6.10G and *MCOB* 3.6.14G may be relevant.

Note: A comparative *financial promotion* will need to comply with regulation 4A of the Control of Misleading Advertisements Regulations 1988.

Non-real time financial promotions to customers

- 3.8A.3 R A *non-real time financial promotion* of a *home reversion plan* must:

- (1) describe any *home reversion plan* as a 'home reversion plan' and not use any other expression to describe it; and
- (2) unless it is *communicated* by way of sound broadcasting or television where the primary purpose of the programming in which the promotion is contained is not to promote home finance or by an exhibition of pictures or photographic or cinematographic films:
 - (a) (if made to or directed at a *customer* other than an *unauthorised reversion provider*) prominently state that it relates to a *home reversion plan* and that the *customer* should ask for a personalised illustration to understand its features and risks; or
 - (b) (if made to or directed at an *unauthorised reversion provider*) prominently state that a *home reversion plan* is a long-term investment and a complex legal arrangement, and that expert independent legal advice should always be obtained before entering into any agreement.

- 3.8A.4 E (1) A *firm* should take reasonable steps to ensure that, for a *non-real time financial promotion*:
- (a) it includes any matters the omission of which causes the *financial promotion* not to be clear, fair and not misleading;
 - (b) if it describes a feature of any *home reversion plan*, it gives no less prominence to the possible disadvantages than to the benefits associated with that feature;
 - (c) it uses plain and intelligible language, and is easily legible (or, in the case of oral promotions, clearly audible);
 - (d) the accuracy of all statements of fact in it can be substantiated;
 - (e) its promotional purpose is not in any way disguised or misrepresented;

- (f) any statement of fact, promise or prediction is clear, fair and not misleading and any relevant assumptions are clearly and prominently disclosed;
 - (g) any statement of opinion is honestly held and, unless consent is impracticable, given with the written consent of the *person* concerned;
 - (h) the facts on which any comparison or contrast is made are verified, or, alternatively, that relevant assumptions are prominently disclosed and that the comparison or contrast is presented in a fair and balanced way, which is not misleading and includes all factors which are relevant to the comparison or contrast;
 - (i) it does not contain any false indications, in particular as to:
 - (i) the *firm's* independence; or
 - (ii) the *firm's* resources and scale of activities;
 - (j) the design, content or format does not in any way disguise, obscure or diminish the significance of any statement, warning or other matter which the *home reversion plan* is required by this chapter to contain;
 - (k) it does not include any reference to approval by the *FSA* or any government body, unless such approval has been obtained in writing from the *FSA* or that body (see also *GEN* 1.2 (Referring to approval by the *FSA*));
- (2)
- (a) Contravention of (1) may be relied on as tending to show contravention of *MCOB* 3.8A.1R.
 - (b) Compliance with (1) may be relied on as tending to show compliance with *MCOB* 3.8A.1R.

3.8A.5 G The effect of giving no less prominence to the possible disadvantages than to the benefits associated with a feature will depend upon the content of the promotion. The following non-exhaustive examples would satisfy the requirement:

- (1) a promotion which, when describing any possible monetary saving, also clearly states how this could be achieved; and
- (2) a promotion which, when including references to non-standard services or facilities, also clearly states that an additional fee may be payable for these.

No approval of real time financial promotions of a home reversion plan

3.8A.6 R A *firm* must not approve a real time financial promotion of a home

reversion plan.

Referring to the FSA

- 3.8A.7 G The guidance on referring to the *FSA* in a *financial promotion* may be relevant (see *MCOB 3.6.2G(3)*).

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

3.9 Confirmation of compliance: financial promotions of qualifying credit or home reversion plans

...

- 3.9.2 G (1) ~~In *MCOB 3.9.1R(2)*'a'~~ Appropriate expertise' will vary depending on the complexity of the ~~*qualifying credit financial promotion*~~ and the *qualifying credit or home reversion plan* to which it relates. The individuals engaged by a *firm* to confirm the compliance of its ~~*qualifying credit financial promotions*~~ with this chapter may themselves have different levels of expertise and therefore a different level of authority for confirmation depending on the type of promotion and the *qualifying credit or home reversion plan* involved.
- (2) A *firm* may arrange for a third party with appropriate expertise to carry out the confirmation exercise on the *firm's* behalf, but the responsibility for the ~~*qualifying credit financial promotion*~~ remains with the *firm*.

...

Communicating a ~~*qualifying credit financial promotion*~~ where another firm has confirmed compliance

- 3.9.5 R ...

...

3.10 Records: non-real time financial promotions of qualifying credit or of a home reversion plan

...

Content of records

- 3.10.2 G In deciding what is an adequate record ~~under *MCOB 3.10.1R*~~, a *firm* should consider including, or providing reference to, where appropriate,

such matters as:

...

- (4) the evidence supporting any material factual statement about *qualifying credit* or a *home reversion plan* in the ~~*qualifying credit/financial*~~ promotion. ...

...

...

Approval of qualifying credit promotions

- 3.11.1 G (1) Section 21(1) of the *Act* (Restrictions on financial promotion) prohibits an *unauthorised person* from *communicating a financial promotion* (~~*qualifying credit promotion*~~ in the case of *MCOB*), in the course of business, unless an exemption applies or the ~~*qualifying credit/financial*~~ promotion is approved by a firm.
- (2) Most of the *rules* in this chapter apply when a firm approves a ~~*qualifying credit/financial*~~ promotion of *qualifying credit* in the same way as when a firm communicates a ~~*qualifying credit/financial*~~ promotion of *qualifying credit* itself. A firm therefore has a similar responsibility for a ~~*qualifying credit/financial*~~ promotion of *qualifying credit* that it approves as for one that it communicates. For example, a firm which approves a non-real time ~~*qualifying credit/financial*~~ promotion must:
- (a) ~~if *MCOB 3.9.1R* applies,~~ confirm that the ~~*qualifying credit/financial*~~ promotion complies with the *rules* in this chapter; and
- (b) ~~if *MCOB 3.6.3R(1)* applies,~~ be able to show that it has taken reasonable steps to ensure that the ~~*qualifying credit/financial*~~ promotion is clear, fair and not misleading.
- (3) A firm may also wish to approve a ~~*qualifying credit/financial*~~ promotion of *qualifying credit* that it communicates itself. This would ensure that an *unauthorised person* who then also communicates ~~the *qualifying credit promotion*~~ it to another person will not contravene the restriction in section 21(1) of the *Act* (Restrictions on financial promotion).

...

...

3.12 The Internet and other electronic media

...

- 3.12.2 G Any material, which meets the definition of a ~~qualifying credit~~financial promotion of qualifying credit or of a home reversion plan, including any video or moving image material incorporated in any website containing such a ~~qualifying credit~~ financial promotion, should comply with the rules in this chapter. ...
- 3.12.3 G ...
- (2) ... a description of the qualifying credit or home reversion plan ...
- 3.12.4 G (1) ...
- (2) In relation to ~~qualifying credit~~financial promotions communicated by way of television...
- (3) ... Any ~~qualifying credit~~financial promotion of qualifying credit or of a home reversion plan communicated by the Internet, digital or other forms of interactive television is subject to the requirements in ~~MCOB 3.6 (Form and content of non-real time qualifying credit promotions)~~ and ~~MCOB 3.8 (Form and content of real time qualifying credit promotions)~~ as applicable on form and content in this chapter.

...

Advising and selling standards

4.1 Application

Who?

- 4.1.1 R This chapter applies to a *firm* in a category listed in column (1) of the table in *MCOB 4.1.2R* in accordance with column (2) of that table.
- 4.1.2 R This table belongs to *MCOB 4.1.1R*

(1) Category of firm	(2) Applicable section
<i>mortgage lender</i>	whole chapter except MCOB 4.5—MCOB 4.7 <u>MCOB 4.1 to MCOB 4.4, and MCOB 4.8 to MCOB 4.9</u>
<i>mortgage adviser</i>	whole chapter <u>except MCOB 4.10</u>
<i>mortgage arranger</i>	whole chapter except MCOB 4.7 <u>and MCOB 4.10</u>

<u>home purchase provider</u>	<u>MCOB 4.1, MCOB 4.2 and MCOB 4.10 (except MCOB 4.10.5G to MCOB 4.10.7G).</u> <u>MCOB 4.3, MCOB 4.4 and MCOB 4.8 in accordance with MCOB 4.10</u>
<u>home purchase adviser</u>	<u>MCOB 4.1, MCOB 4.2, MCOB 4.5, MCOB 4.6 and MCOB 4.10.</u> <u>MCOB 4.3, MCOB 4.4, MCOB 4.7 and MCOB 4.8 in accordance with MCOB 4.10</u>
<u>home purchase arranger</u>	<u>As for a home purchase adviser except MCOB 4.10.5G to MCOB 4.10.7G and MCOB 4.7 do not apply</u>
<u>reversion provider</u> <u>reversion adviser</u> <u>reversion arranger</u>	<u>see MCOB 8 for the application of this chapter</u>

What?

- 4.1.3 R This chapter applies if a *firm* in the course of carrying on a *regulated mortgage home finance activity*:
- (1) makes, or anticipates making, a *personal recommendation* about; or
 - (2) gives, or anticipates giving, personalised information relating to; the *customer*:
 - (3) entering into a *regulated mortgage contract home finance transaction*; or
 - (4) varying the terms of a *regulated mortgage contract home finance transaction* entered into by the *customer*.
- ...
- 4.1.5 R In relation to an *regulated lifetime mortgage contract* or a *home reversion scheme equity release transaction*, this chapter ~~MCOB 4~~ is modified by *MCOB 8 (Lifetime mortgages Equity release: advising and selling standards)*.
- 4.1.6 G *MCOB 4.1.5R* means that this chapter, *MCOB 4*, deals with standard *regulated mortgage contracts* and *home purchase plans* only and therefore *firms* should note that the scope of service rules in ~~MCOB 4.3.1R~~ this chapter do not apply in respect of ~~standard regulated mortgage contracts only~~ *equity*

release transactions.

- 4.1.7 G If a firm is an *authorised professional firm*, ~~MCOB 1.2.10R(3) has the effect that when the firm conducts non-mainstream regulated activities with a customer, the only initial disclosure requirements that apply are those relating to the *Financial Ombudsman Service* and the *FSCS* (see *MCOB 1.2.10R(3)*). *MCOB 4.4* (Initial disclosure requirements) applies. The firm is only required to provide the initial disclosure information in *MCOB 4 Annex 1* or *MCOB 4 Annex 2* section 7 (What to do if you have a complaint) and section 8 (Are we covered by the Financial Services Compensation Scheme (FSCS)?).~~

...

4.2 Purpose

- 4.2.1 G (1) This chapter amplifies *Principle 6* (Customers' interests), *Principle 7* (Communications with clients) and *Principle 9* (Customers: relationships of trust). ~~*Principle 6* requires a firm to pay due regard to the interests of its customers and treat them fairly. *Principle 7* requires a firm to pay due regard to the information needs of its clients and communicate information to them in a way which is clear, fair and not misleading. *Principle 9* requires a firm to take reasonable care to ensure the suitability of its advice.~~

(2) The purpose of this chapter is to ensure that:

- (a) *customers* are adequately informed about the nature of the service which they may receive from a *firm* in relation to ~~*regulated mortgage contracts*~~ *home finance transactions*. In particular *firms* need to make clear to *customers* the scope of ~~*regulated mortgage contracts*~~ *home finance transactions* available from them; and
- (b) ... will vary depending on the demands and needs of the *customer* and the type of ~~*regulated mortgage contract*~~ *home finance transaction*.

...

- (3) This chapter also implements certain requirements of the *Distance Marketing Directive* in relation to *distance mortgage mediation contracts* (see ~~*MCOB 4.5* (Additional disclosure for distance mortgage mediation contracts with retail customers) and *MCOB 4.6* (Cancellation of distance mortgage mediation contracts)~~) and *distance home purchase mediation contracts*.

4.3 Scope of service provided

Providing services within and beyond scope

- 4.3.1 R (1) Subject to (2), a *firm* must take reasonable steps to ensure that the scope of the service given to a *customer*, and the ~~regulated mortgage contracts~~home finance transactions offered, is based on a selection from one of the following:
- (a) the whole market; or
 - (b) a limited number of ~~mortgage lenders~~home finance providers; or
 - (c) a single ~~mortgage lender~~home finance provider.
- (2) ...

...

- 4.3.4A R In applying this chapter, there is:
- (1) one market for regulated mortgage contracts that are not lifetime mortgages; and
 - (2) another market for home purchase plans.

...

Independence

- 4.3.7 R (1) When providing information or giving advice to a *customer* on ~~regulated mortgage contracts~~home finance transactions, a *firm* must not hold itself out as acting independently unless it intends to:
- (a) provide that service wholly or predominantly based on the whole market in the relevant type of home finance transaction; and
 - (b) ...
- (2) A *firm* which in accordance with (1) holds itself out as independent must ensure that the information or advice subsequently given to the *customer* concerned is information or advice on ~~regulated mortgage contracts~~home finance transactions from the whole market in the relevant type of home finance transaction.
- 4.3.8 G (1) ... A *firm* which wishes to hold itself out generally as acting independently should ensure that doing so (for example through a trading name or advertising) is consistent with the kind of service which *customers* receive in relation to ~~regulated mortgage contracts~~the relevant home finance transactions.

- (2) A *firm* that sells both *investments* and ~~*regulated mortgage contracts*~~ home finance products can offer from the whole market (or the whole market for a type of home finance transaction) and therefore be 'independent' for one but offer only a limited range for the other. ...

...

Appointed representatives

- 4.3.10 R A *firm* may restrict the ~~*regulated mortgage contracts*~~ home finance transactions it authorises a particular *appointed representative* to sell. If it does so, the *appointed representative* must reflect this restricted scope in ~~the initial disclosure document~~ any initial disclosure document or combined initial disclosure document provided to the *customer* ~~in accordance with MCOB 4.4.1R(1)(e)~~.

4.4 Initial disclosure requirements

Disclosure where initial contact is not made by telephone

- 4.4.1 R (1) A *firm* must ensure that, on first making contact with a *customer* when it anticipates giving personalised information or advice on a *regulated mortgage contract*, it:
- ...
- (c) ~~(unless (2) applies)~~ provides the *customer* with either:
- (i) ~~the initial disclosure document in MCOB 4 Annex 1~~ initial disclosure document; or
 - (ii) if the *firm* has reasonable grounds to be satisfied that the services which it is likely to provide to the *customer* will, ~~in addition to relating to regulated mortgage contracts or regulated lifetime mortgage contracts~~ relate to a combination of different types of home finance transaction, or will relate to home finance transactions and one or more of non-investment insurance contracts or packaged products, ~~the combined initial disclosure document in MCOB 4 Annex 2~~ a combined initial disclosure document;
- subject to (3) and in a *durable medium*.

...

- (3) A *firm* may choose not to include the initial disclosure information required by sections 6, 7 and 8 of ~~MCOB 4 Annex 1~~ the initial disclosure document, and sections 5, 7 and 8 of ~~MCOB 4 Annex 2~~ the

combined initial disclosure document, if ...

(4) A firm must not use a combined initial disclosure document in relation to a combination of:

(a) regulated mortgage contracts or home purchase plans; and

(b) equity release transactions.

...

4.4.7 R ...

(2) ... the firm must send the customer a copy of ~~the initial disclosure document required by MCOB 4.4.1R in the form set out in MCOB 4 Annex 1 or MCOB 4 Annex 2~~ an initial disclosure document or combined initial disclosure document...

...

...

4.5 Additional disclosure for distance mortgage mediation contracts and distance home purchase mediation contracts with retail customers

4.5.1 G (1) There are certain additional disclosure requirements laid down by the *Distance Marketing Directive* that will have to be provided by a mortgage intermediary and a home purchase intermediary to a retail customer prior to the conclusion of a distance mortgage mediation contract or a distance home purchase mediation contract. The purpose of this section, MCOB 4.5, is to set out those additional requirements. MCOB 4.6 sets out the cancellation rights that apply in relation to ~~a distance mortgage mediation contracts~~ such contracts.

(2) The FSA expects the requirements in MCOB 4.5 and MCOB 4.6 to be relevant only in a small minority of cases. Mediation at a distance (see MCOB 1.3.5G and MCOB 1.3.6G) is unlikely in the ~~mortgage home finance~~ market. MCOB 4.5 and MCOB 4.6 will only be relevant if a mortgage intermediary or a home purchase intermediary enters into a distance contract in respect of its mortgage mediation activities or home purchase mediation activities quite independent of any contractual arrangement with a retail customer relating to a particular regulated mortgage contract or home purchase plan. ...

4.5.2 R If the initial contact of a kind in MCOB 4.4.1R(1) is with a retail customer with a view to concluding a distance mortgage mediation contract or a distance home purchase mediation contract-, a firm must:

(1) in addition to ~~the~~ initial disclosure information ~~required by MCOB~~

4.4.1R(1)(e) and any other required information, provide the *retail customer* with the information in MCOB 4 Annex 3 in a *durable medium* in good time before the conclusion of the *distance mortgage mediation contract* or *distance home purchase mediation contract* with that *customer* unless an exemption in (2), (3), (4) or (5) applies.

...

(3) Exemption: certain other means of distance communication. ... In that case, the *firm* must provide the *retail customer* with the information in a *durable medium* immediately after its conclusion of the *distance mortgage mediation contract*.

...

4.5.3 G (1) ...

(2) ... However, if a service of a different nature is proposed, the *firm* is expected to provide a fresh initial disclosure document and, in respect of *distance mortgage mediation contracts* and *distance home purchase mediation contracts* with *retail customers*, this will need to be accompanied by the information in MCOB 4 Annex 3.

...

4.6 Cancellation of distance mortgage mediation contracts and distance home purchase mediation contracts

4.6.1 G A *retail customer* has no right to cancel a ~~*regulated mortgage contract*~~ *home finance transaction* concluded with a *firm* but may have a right to cancel a *distance contract* concluded with a *mortgage intermediary* or a *home purchase intermediary* for the provision of his services. Whether a *mortgage intermediary* or a *home purchase intermediary* concludes a *distance mortgage mediation contract* or a *distance home purchase mediation contract* with a *retail customer* will depend on the circumstances. For example, an intermediary may not, in *advising on* or *arranging a regulated mortgage contract* or *home purchase plan*, act contractually on behalf of, or for, the *customer*. In such circumstances, no *distance mediation contract* will arise for the *firm's* services, and therefore no right to cancel. If there is a contract between the *customer* and the ~~*mortgage intermediary*~~ *firm*, however, and therefore there is a right to cancel, the *firm* is required by MCOB 4.5.2R(1) to provide the information in MCOB 4 Annex 3(5).

...

Cancellation period

4.6.4 R (1) A *retail customer* has a right to cancel a *distance mortgage mediation contract* or a *distance home purchase mediation contract* in accordance with this section.

...

Exercising the right to cancel

4.6.5 R A *retail customer* who has a right to cancel a *distance mortgage mediation contract* or a *distance home purchase mediation contract* may, without giving any reason, cancel the contract by ...

...

4.7.12 G ...

(2) Where the scope of the *advice* provided is ~~restricted (within the meaning of MCOB 4.3.1R(1)(b) or (c)), MCOB 4.7.4R(2) means that~~ based on a selection of *regulated mortgage contracts* from a single or limited number of lenders, the assessment of suitability should not be limited to the types of *regulated mortgage contracts* which the *firm* offers. ~~MCOB 4.7.4R(2) prevents a firm recommending~~ A *firm* cannot recommend the 'least worst' *regulated mortgage contract* where the *firm* does not have access to products appropriate to the *customer's* needs and circumstances. ~~¶~~ This means, for example, that a *firm* dealing solely in the sub-prime market should not recommend one of these *regulated mortgage contracts* if approached for advice by a *customer* with an unblemished credit record.

...

4.7.14 G ...

(2) ... the *customer's* wish for a *regulated mortgage contract* that is compliant with ~~Sharia~~ Islamic law. ...

...

...

4.9.4 G (1) *Firms* are reminded that MCOB 1.2.7R enables them to substitute an alternative for 'mortgage' in the initial disclosure document (except in relation to sections 6 and 8 of any ~~initial disclosure document provided in accordance with MCOB 4.4.1R(1)(e)(i)~~ initial disclosure document or sections 5 and 8 of any ~~initial disclosure document provided in accordance with MCOB 4.4.1 R(1)(e)(ii)~~ combined initial disclosure document).

(2) MCOB 1.2.7R also means that a *firm* must amend ~~the initial disclosure document in MCOB 4 Annex 1~~ any initial disclosure document so that the final sentence of prescribed text in section 4 states: 'You will receive an illustration which will tell you about any fees relating to a particular [term used by the firm to describe the

borrowing, for example "mortgage"]].

...

After MCOB 4.9 insert the following new section. The inserted text is not underlined.

4.10 Home purchase plans

Scope of service provided

- 4.10.1 R A *firm* must comply with the scope of service requirements at *MCOB* 4.3.1R and *MCOB* 4.3.2R (Providing services within and beyond scope), *MCOB* 4.3.4AR (Whole of market) and *MCOB* 4.3.10R (Appointed representatives).

Initial disclosure requirements

- 4.10.2 R (1) A *firm* must, on first making contact with a *customer* when it anticipates giving personalised information or *advice* on *entering into a new home purchase plan*, ensure that the *customer* is, or has been, provided with an appropriate *initial disclosure document* or *combined initial disclosure document* in a *durable medium*.
- (2) If the initial contact in (1) is by telephone, a *firm* must:
- (a) (if the call is with a view to concluding a *distance home purchase mediation contract*) give the following information before proceeding further:
- (i) the name of the *firm* and (if initiated by the *firm*) the commercial purpose of the call;
- (ii) the scope of the service provided by the *firm*; and
- (iii) whether or not the *firm* will provide the *customer* with *advice* on those *home purchase plans* within its scope; and
- (b) ensure that the *customer* is, or has been, provided with such a document in a *durable medium* as soon as is practicable.
- 4.10.3 G In accordance with *Principle 7*, where a *firm* is likely to provide services in relation to both *regulated mortgage contracts* and *home purchase plans*, it should provide a *combined initial disclosure document* rather than two separate *initial disclosure documents*.

- 4.10.4 G The guidance on initial disclosure requirements at *MCOB 4.4.2G* to *MCOB 4.4.4G* may be relevant.

Additional requirements for distance home purchase mediation contracts with retail customers

Note: The rules regarding additional disclosure requirements for, and cancellation of, *distance home purchase mediation contracts* are set out in *MCOB 4.5* and *MCOB 4.6* respectively.

Advised sales: suitability

- 4.10.5 G In accordance with *Principle 9*, a *firm* should take reasonable steps to obtain from a *customer* all information likely to be relevant to ensuring the suitability of its advice.
- 4.10.6 R A *firm*, before making a *personal recommendation* on a *home purchase plan*, must take reasonable steps to ensure that it is:
- (1) affordable;
 - (2) appropriate to the *customer's* needs and circumstances; and
 - (3) the most suitable of those *home purchase plans* that the *firm* has available to it within the scope of the service provided to the *customer*.
- 4.10.7 G The guidance on suitability at *MCOB 4.7.8G* to *MCOB 4.7.10G* and *MCOB 4.7.16G* may be relevant.

Non-advised sales

- 4.10.8 R If a *firm* arranges a *home purchase plan* or a variation to an existing *home purchase plan* without giving a *personal recommendation*, it must ensure that the questions it asks about the *customer's* needs and circumstances are scripted in advance.
- 4.10.9 G The guidance on non-advised sales at *MCOB 4.8.2G* and on scripted questions at *MCOB 4.8.5G* and *MCOB 4.8.6G* may be relevant.

Risks and features statement and tariff of charges

- 4.10.10 R A *firm* must, before making a *personal recommendation* to a *customer* of, or when a *customer* requests or selects, a *home purchase plan*, ensure that the *customer* is, or has been, provided with an appropriate risks and features statement about that plan.

- 4.10.11 R A risks and features statement need not be personalised to the *customer's* circumstances but must:
- (1) include the keyfacts logo in a prominent position at the top of the statement;
 - (2) state that the *FSA* requires a *firm* to provide the statement;
 - (3) state that mortgages are available and that the *customer* should think carefully about the product appropriate to his needs;
 - (4) describe the significant features of the plan, including:
 - (a) how the *home purchase plan* works;
 - (b) the nature of the *customer's* commitment;
 - (c) when and how a *customer's* commitment is reviewed;
 - (d) any significant restrictions of the plan; and
 - (e) the charges that a *customer* may incur under the plan, including the reason for, and amount of, each charge, when they are payable, whether they will be reimbursed and, if so, when;
 - (5) describe the risks associated with the plan, including:
 - (a) the risks to the *customer* if he fails to keep up repayments and the circumstances in which this might occur; and
 - (b) risks to the *customer* of the *home purchase provider failing* or disposing of any of its obligations or rights (including its interest in the property) to a third party (taking into account steps that will be taken by the *home purchase provider* to mitigate such risks); and
 - (6) state the importance of obtaining independent legal advice.
- 4.10.12 R A *firm* may omit details of the charges that a *customer* may incur under a *home purchase plan* from the risks and features statement if they are included in a separate *tariff of charges* provided to the *customer* at the same time.

...

Amendments to MCOB 4 Annex 1R, MCOB 4 Annex 2R and MCOB 4 Annex 3R.
Underlining indicates new text and striking through indicates deleted text.


Annex 1R: Initial disclosure document ("IDD")

Table 1R

This Annex belongs to *MCOB 4.4.1R(1)* and *MCOB 4.10.2R*

Firms must omit the notes and square brackets that appear in the following IDD. The IDD must contain the keyfacts logo, headings and text in the order shown and in accordance with the Notes.

[Note 1]

 **about our [mortgage/Islamic home purchase plan] services [Note 1A][Note 2]**

...

[1A.] Compliance with Islamic law [Note 5A]

Our services are regularly checked by [name(s) of scholar(s)] to ensure compliance with Islamic law. Ask us if you want further information about the role of our scholar(s).]

2. Whose [mortgages/Islamic home purchase plans] do we offer? [Note 6][Note 7]

We offer [mortgages/Islamic home purchase plans] from the whole market.

We [can] **[Note 8]** only offer [mortgages/Islamic home purchase plans] from a limited number of [lenders/providers].

Ask us for a list of the [lenders/providers] we offer [mortgages/Islamic home purchase plans] from. **[Note 9]**

We [can] **[Note 8]** only offer [a limited range of the] [a] [mortgage[s] / Islamic home purchase plan[s]] from [a single lender/provider] [name of single lender/provider]. **[Note 10]**

[or]

We only offer our own [mortgages/Islamic home purchase plans]. **[Note 11]**

....

4. What will you have to pay us for this service? [Note 6]

No fee [we will be paid by commission from the lender/provider]. **[Note 12]**

A fee [of £ [] payable at the outset and £ [] payable when you apply for a mortgage/Islamic home purchase plan]. [We will also be paid commission from the lender/provider.] **[Note 12] [Note 13]**

You will receive a key facts illustration when considering a particular mortgage which will tell you about any fees relating to it. **[Note 13A]**

5. Refund of fees **[Note 14] [Note 15]**

If we charge you a fee, and your [mortgage/Islamic home purchase plan] does not go ahead, you will receive:

A full refund [if the lender/provider rejects your application]. **[Note 16]**

A refund of £ [] [if the purchase falls through]. **[Note 16] [Note 17]**

No refund [if you decide not to take out a [mortgage/Islamic home purchase plan]. **[Note 16]**

6. Who regulates us? **[Note 18]**

[XYZ Financial Services][123 Any Street, Some Town ST21 7QB] **[Note 19] [Note 19A]** is authorised **[Note 20]** and regulated by the Financial Services Authority. Our FSA Register number is [].

Our permitted business is []. **[Note 21]**

[or] [Note 19B]

[Name of *appointed representative*] **[Notes 3 and 4]** is an appointed representative of [name of *firm*] [address of *firm*] **[Note 19] [Note 19A]** which is authorised and regulated by the Financial Services Authority. [Name of *firm*]'s FSA Register number is [].

[Name of *firm*]'s permitted business is []. **[Note 21]**

You can check this on the FSA's Register by visiting the FSA's website www.fsa.gov.uk/register/ or by contacting the FSA on 0845 606 1234.

7. What to do if you have a complaint **[Note 18]**

If you wish to register a complaint, please contact us:

... in writing Write to [XYZ Financial Services], [Complaints Department, 123 Any Street,

Some Town, ST21 7QB] [Note 22]

... by phone Telephone [0121 100 1234] [Note 22]

If you cannot settle your complaint with us, you may be entitled to refer it to the Financial Ombudsman Service. [Note 22A]

8. Are we covered by the Financial Services Compensation Scheme (FSCS)?
[Note 18] [Note 23] [Note 24]

We are covered by the FSCS. You may be entitled to compensation from the scheme if we cannot meet our obligations. This depends on the type of business and the circumstances of the claim.

[Mortgage/Home purchase plan] advising and arranging is covered for 100% of the first £30,000 and 90% of the next £20,000 so the maximum compensation is £48,000.

Further information about the compensation scheme arrangements is available from the FSCS.

<p><u>Think carefully about the product and services you need. [We can only offer services in relation to Islamic home purchase plans and cannot provide advice on standard mortgages.] [If you want [information] [or] [advice] on standard mortgages, please ask.]</u> [Note 25]</p>

...

Note 1 - ...

Note 1A – insert the appropriate description using the words in square brackets based on the *firm's* scope of service. A firm's scope of service cannot combine regulated mortgage activities and home purchase activities in the same IDD. A firm that carries on home purchase activities may omit the word "Islamic" from "Islamic home purchase plan(s)" provided that it does so consistently throughout the document. However, a firm may omit the word "Islamic" in sections 6 and 8 without having to omit it throughout the document. A firm that wishes to hold itself, its products or services out as compliant with religious or philosophical beliefs other than Islamic law in the IDD may make appropriate amendments to references to 'Islamic' and 'Islamic law'.

Note 2 - ... The keyfacts logo and the text "about our [mortgage/Islamic home purchase plan] services" must be used ...

...

Section 1A: Compliance with Islamic law

Note 5A – Section 1A is optional unless the *firm* holds itself, its products or services out as compliant with Islamic law in the IDD. If a *firm* includes Section 1A then it must describe the

section on the IDD as section 2 and renumber subsequent sections accordingly.

A firm that wishes to hold itself, its products or services out as compliant with religious or philosophical beliefs other than Islamic law in the IDD may also use Section 1A in accordance with this note and modify the wording in the section to the extent appropriate.

...

Section 2: Whose [mortgages/Islamic home purchase plans] do we offer?

...

Note 8 – insert "can" if the *firm's* range of *regulated mortgage contracts* or home purchase plans is determined by any contractual obligation.

Note 9 – this sentence is required only where a firm selects this service option. It may also be omitted if a *firm* chooses to list all of the lenders or providers it offers *home finance transactions*~~mortgages~~ from instead of the text "a limited number of [lenders/providers]", in the previous line, so long as the *firm* offers all of the mortgages or home purchase plans generally available from each lender or provider.

Note 10 – if the *firm* selects this box, it must insert the name of the lender or provider. If the *firm* does not select this box, it must insert the words "a single lender/provider" instead. If the *firm* does not offer all of the mortgages or home purchase plans generally available from that lender or provider, it must insert the words "a limited range of", as shown. If the lender or provider only has one ~~mortgage~~ relevant product, the *firm* should amend the text to "We can only offer a [mortgage/home purchase plan] from [name of single lender/provider]."

Note 11 – if the *firm* is a provider or lender~~mortgage lender~~ offering only its own *home finance transactions*~~mortgages~~, or is part of a provider or lender~~mortgage lender~~ offering only the *home finance transactions*~~mortgages~~ sold under that part's trading name, it may use this alternative text.

...

Note 13 – insert a plain language description of when any fees are payable. ...

Note 13A – A firm must not include this paragraph if the services to which the IDD relates are home purchase activities.

...

Note 14 – if, in section 4, it has been indicated that there will be 'No fee' or that any *fee* will be payable only if the ~~mortgage~~ transaction completes...

...

Note 18 – ~~these sections may be omitted in accordance with MCOB 4.4.1R(3).~~ A firm may choose not to include these sections if it provides the customer with the information required by them in some other durable medium before the customer makes an application for a home finance transaction. ...

...

Note 21 – insert a plain language description of the business for which the firm has permission in relation to either regulated mortgage contracts or home purchase plans, as relevant to the scope of service described.

...

Note 25 – a firm must only include this paragraph if the services to which the IDD relates are home purchase activities. If the firm does not carry on regulated mortgage activities, it must include the second sentence and delete the third. If the firm carries on regulated mortgage activities as well as home purchase activities it must omit the second sentence and include the third.

Delete MCOB 4 Annex 2R in its entirety. The deleted text is not shown

MCOB 4 Annex 2R: Combined initial disclosure document (“CIDD”)
[deleted – see COB 4 Annex 5R]

Annex 3R Additional information requirements in respect of distance mortgage mediation contracts and distance home purchase mediation contracts with retail customers

This table belongs to MCOB 4.5.2R

Additional information for distance contracts with retail customers	
All the contractual terms and conditions on which the service will be provided including, in particular, the following information:	
...	...
(6)	details of:

	<p>(a) the <i>EEA State</i> or States whose laws are taken by the <i>firm</i> as a basis for the establishment of relations with the <i>customer</i> prior to the conclusion of the <i>regulated mortgage contract</i> <u>or home purchase plan</u>;</p> <p>(b) any contractual clause on law applicable to the <i>regulated mortgage contract</i> <u>or home purchase plan</u>, or on competent court, or both; and</p> <p>(c) the language in which the contract is supplied and in which the <i>firm</i> will communicate during the course of the <i>regulated mortgage contract</i> <u>or home purchase plan</u>.</p>
--	----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------

Pre-application disclosure

5.1 Application

Who?

5.1.1 R This chapter applies to a *firm* in a category listed in column (1) of the table in *MCOB 5.1.2R* in accordance with column (2) of that table.

5.1.2 R This table belongs to *MCOB 5.1.1R*

(1) Category of firm	(2) Applicable section
<i>mortgage lender</i> <i>mortgage adviser</i> <i>mortgage arranger</i>	whole chapter <u>except MCOB 5.8</u>
<i>home purchase provider</i> <i>home purchase adviser</i> <i>home purchase arranger</i>	<i>MCOB 5.1.1R</i> to <i>MCOB 5.1.3R</i> , <i>MCOB 5.1.6R</i> to <i>MCOB 5.1.8G</i> , <i>MCOB 5.2</i> , <i>MCOB 5.3</i> and <i>MCOB 5.8</i> . <i>MCOB 5.5</i> and <i>MCOB 5.6</i> in accordance with <i>MCOB 5.8</i>
<i>reversion provider</i> <i>reversion adviser</i> <i>reversion arranger</i>	see <i>MCOB 9.3</i> for the application of <u>this chapter</u>

What?

5.1.3 R (1) This chapter applies if a *firm*:

- (a) makes a *personal recommendation* to a *customer* to enter into a ~~*regulated mortgage contract*~~ *home finance transaction*; or
- (b) provides information to a *customer* that is specific to the amount ~~that the *customer* wants to borrow~~ to be provided on

a particular ~~regulated mortgage contract~~ home finance transaction, including information provided in response to a request from a customer; or

- (c) provides the means for a customer to make an application to it;

in connection with entering into, or agreeing to enter into, a ~~regulated mortgage contract~~ home finance transaction provided by a mortgage lender home finance provider, other than an ~~regulated lifetime mortgage contract~~ equity release transaction or a variation to an existing ~~regulated mortgage contract~~ home finance transaction.

- (2) In relation to further advances and other variations, MCOB 5 is modified by MCOB 7 (Disclosure at start of contract and after sale), regardless of whether they are variations to an existing ~~regulated mortgage contract~~ home finance transaction, or are such that they involve the customer entering into a new ~~regulated mortgage contract~~ home finance transaction.
- (3) In relation to an ~~regulated lifetime mortgage contract~~ equity release transaction, MCOB 5 is modified by MCOB 9 (~~Lifetime mortgages~~ Equity release: product disclosure).

...

5.1.6 R In this chapter, references to a ~~regulated mortgage contract~~ home finance transaction include, where the context requires, references to arrangements which are capable of becoming a ~~regulated mortgage contract~~ home finance transaction.

5.1.7 G (1) MCOB 5.1.3R means that this chapter applies where the customer can apply to enter into a ~~regulated mortgage contract~~ home finance transaction. This includes circumstances where, for example, the means to apply is provided in person, by telephone, through a website or through an application pack sent through the post.

(2) The effect of this chapter is to require a customer to be provided with an illustration key information about a home finance transaction before he submits an application to a mortgage lender home finance provider.

5.1.8 G Although an illustration is a financial promotion in respect of the ~~controlled activity of providing qualifying credit~~, the effect of MCOB 3.2.5R(1), section 145(3) of the Act (Financial promotion rules) and article 28 of the Financial Promotion Order (One-off non-real time communications and solicited real time communications) is that an illustration is exempt from the provisions of MCOB 3 (Financial promotion). However, the general requirement to communicate information in a way which is clear, fair and

not misleading applies to both an illustration and (in relation to a home purchase plan) a financial information statement (see MCOB 5.8.1R).

- 5.1.9 G In relation to a regulated mortgage contract, ~~W~~where part of the loan is not a regulated mortgage contract, for example it is a linked unsecured loan, the details of this loan can be shown in Section 12 of the illustration as an additional feature. It should not be added to the regulated mortgage contract loan amount in MCOB 5.6.6R(2).

...

5.2 Purpose

- 5.2.1 G (1) MCOB 5 amplifies Principle 6 and Principle 7, ~~which require a firm to pay due regard to the information needs of its customers and to treat them fairly.~~
- (2) The purpose of MCOB 5 is to ensure that, before a customer submits an application for a particular ~~regulated mortgage contract~~home finance transaction, he is supplied with information that makes clear:
- (a) (in relation to a regulated mortgage contract) its ~~the~~ features, any linked deposits, any linked borrowing and any tied products of that regulated mortgage contract, and
- (b) the price that the customer will be required to pay under that ~~regulated mortgage contract~~home finance transaction, to enable the customer to assess whether it is affordable to him;
and
- (c) any linked deposits, and linked borrowing and any tied products. ~~[deleted]~~
- (3) MCOB 5 requires information to be disclosed in a consistent way to facilitate comparison between regulated mortgage contracts provided by different mortgage lenders products of different providers.

5.3 Applying for a ~~regulated mortgage contract~~home finance transaction

- 5.3.1 R A mortgage lender~~home finance provider~~ must not enter into a regulated mortgage contract~~home finance transaction~~, or agree to do so, with a customer unless the customer has submitted an application for that particular regulated mortgage contract~~home finance transaction~~.

- 5.3.2 G (1) The purpose of MCOB 5.3.1R, taken in conjunction with other rules in this chapter, is to ensure that the customer has received details of the particular ~~regulated mortgage contract~~home finance transaction for which he has applied, ~~in the form of an illustration~~, and has had

the opportunity to satisfy himself that it is appropriate for him.

- (2) In relation to a regulated mortgage contract, ~~The~~ application should
...

...

5.4 Mortgage illustrations: general

...

MCOB 5 Annex 1

The mortgage illustration: table of contents, prescribed text and prescribed section headings and subheadings.

...

After MCOB 5.7 insert the following new section. The inserted text is not underlined.

5.8 Home purchase plans

Applying for a home purchase plan

Note: The rules regarding applying for a *home purchase plan* are set out in *MCOB 5.3*.

Financial information statement: timing

- 5.8.1 R A *firm* dealing directly with a *customer* must ensure that the *customer* is, or has been, provided with an appropriate financial information statement for a *home purchase plan* in a *durable medium*:
- (1) before the *customer* submits an application for that particular plan to a *home purchase provider*; and
 - (2) without undue delay when any of the following occurs:
 - (a) the *firm* makes a *personal recommendation* to the *customer* to enter into a *home purchase plan* (unless the *personal recommendation* is made by telephone, in which case a *firm* must ensure the financial statement is or has been provided as soon as practicable after the telephone call);
 - (b) the *firm* provides written information that is specific to the amount of finance to be provided on a particular plan; or
 - (c) the *customer* requests written information from the *firm* that is specific to the amount of finance to be provided on a particular plan, unless the *firm* does not wish to do business with the *customer*.

(3) A *firm* may comply with (1) and (2) by providing an *offer document* if this can be done as quickly as providing a financial information statement.

5.8.2 G In ensuring that the *customer* is provided with an appropriate financial information statement, a *firm* need not provide another when one that remains appropriate has already been provided for that particular *home purchase plan*. If a financial information statement ceases to be appropriate, for example because the terms of the proposed plan are subsequently materially altered, a new appropriate statement must be provided.

5.8.3 G The guidance on the timing of mortgage *illustrations* may be relevant (see *MCOB 5.5*).

Financial information statement: format

5.8.4 R A financial information statement must:

- (1) be personalised to reflect the *customer's* requirements;
- (2) contain only the material prescribed or permitted in this section;
- (3) contain that material in the order set out in this section; and
- (4) present the material concisely, clearly and consistently.

5.8.5 R A financial information statement, if not set out in a separate document, must be:

- (1) in a prominent place within the other document and clearly identifiable as key information that the *customer* should read; and
- (2) separate from the other content of the document in which it is included.

5.8.6 G The guidance on the content, order and format of *illustrations* may be relevant (see *MCOB 5.6.4G*).

Financial information statement: content

5.8.7 R A financial information statement must contain:

- (1) a prominent keyfacts logo at the top of the statement;
- (2) the term of the *home purchase plan*;
- (3) the overall cost of the plan, comprising:
 - (a) the purchase price of the property;
 - (b) the deposit payable;

- (c) the amount of the plan required;
 - (d) the amount of any *fees* added to the plan;
 - (e) the total amount payable; and
 - (f) the amount the *customer* must pay per £1 provided under the plan;
- (4) details of the payments the *customer* must make, including:
- (a) the assumed start date;
 - (b) all rental rates that will apply;
 - (c) when the rental rates will apply and for how long;
 - (d) for each rental rate, the number, frequency and amount of the periodic payments that will apply;
 - (e) in relation to the first periodic payment, the amount of the purchase payment and of the rental payment;
 - (f) the amount of any insurance rent payments;
 - (g) a summary total; and
 - (h) details of when the summary total will change.

5.8.8 R A financial information statement may contain a figure equivalent to an *APR* after the amount the *customer* must pay per £1 provided under the *home purchase plan*. A *firm* must use an approach equivalent to the *APR rules* when calculating an *APR* equivalent.

5.8.9 G See the *keyfacts logo provisions* for further requirements regarding the use of the *keyfacts logo* and the location of specimens.

5.8.10 G The details of the rental rate charged should be based on information available to a *firm* at the time of producing the financial information statement. For example, if a rental rate cannot be ascertained at that time because it is based on a fluctuating rate of interest, a *firm* should base the information on the current fluctuating rate.

Opportunity to consider pre-application disclosure

5.8.11 R A *firm* must ensure that the *customer* has had a reasonable opportunity to consider the financial information statement and risks and features statement before committing the *customer* to an application.

Disclosure at the offer stage

6.1 Application

Who?

6.1.1 R This chapter applies to a *firm* in a category listed in column (1) of the table in *MCOB* 6.1.2R in accordance with column (2) of that table.

6.1.2 R This table belongs to *MCOB* 6.1.1R

(1) Category of firm	(2) Applicable section
<i>mortgage lender</i>	whole chapter <u>except</u> <i>MCOB</i> 6.8
<i>home purchase provider</i>	<i>MCOB</i> 6.1 (except <i>MCOB</i> 6.1.6G), <i>MCOB</i> 6.2 and <i>MCOB</i> 6.8
<i>reversion provider</i>	see <i>MCOB</i> 9.5 for the application of <u>this chapter</u>

What?

6.1.3 R This chapter applies with respect to an offer made by a *firm* to a *customer* with a view to the *firm*:

- (1) *entering into a ~~regulated mortgage contract~~ home finance transaction; or*
- (2) *varying the terms of a ~~regulated mortgage contract~~ home finance transaction entered into by the *customer* in any of the following ways:*

...

(whether or not the *customer* agrees to enter into the ~~regulated mortgage contract~~ home finance transaction or variation).

6.1.4 R In relation to a ~~regulated lifetime mortgage contract~~, this chapter, *MCOB* 6, is modified by *MCOB* 9 (~~Lifetime mortgages~~ Equity release: product disclosure).

6.1.5 R In *MCOB* 6, a reference to an offer to enter into a ~~regulated mortgage contract~~ home finance transaction is to be read as including a reference to an offer to vary an existing ~~regulated mortgage contract~~ home finance transaction in a manner specified in ~~*MCOB* 6.1.3R~~ this section if the context so requires.

...

6.2 Purpose

- 6.2.1 G (1) ~~MCOB 6 amplifies Principle 6 and Principle 7, which require a firm to pay due regard to the information needs of its clients, and communicate information to them in a way which is clear, fair and not misleading.~~ The purpose of MCOB 6 is to ensure that a *customer* receives a clear *offer document* to enable him to check the features and price of the ~~regulated mortgage contract~~home finance transaction before he enters into it. The *offer document* should include an updated and suitably adapted *illustration* (for a regulated mortgage contract) or financial information statement (for a home purchase plan) so that the *customer* can compare it with the illustration he received before he applied for the ~~regulated mortgage contract~~home finance transaction.
- (2) ~~To ensure that the customer has a record of the information required by MCOB 6, MCOB 6.3.2R requires the information to be provided to the customer in a durable medium.~~[deleted]

...

6.4 €Mortgages: content of the offer document

...

6.5 £Mortgages: information to be provided in the offer document or separately

...

6.6 ⊖Mortgages: offer documents in place of illustrations

...

After MCOB 6.7 insert the following new section. The inserted text is not underlined.

6.8 Home purchase plans

Offer document

- 6.8.1 R (1) If a *firm* offers to *enter into a home purchase plan* with a *customer*, it must ensure that the *customer* is, or has been provided with an appropriate *offer document* in a *durable medium* which includes:
- (a) the period for which the offer is valid;
 - (b) an explanation of the consequences that might arise from the *customer* not entering into the *home purchase plan* including details of any *fees* that the *customer* has paid which will not be refunded;
 - (c) an explanation of when the *customer* will become bound by

the offer and the implications of this;

- (d) the charges that a *customer* may incur under the plan, including the reason for, and amount of, each charge, when they are payable, whether they will be refunded and, if so, when;
- (e) a financial information statement;
- (f) the *firm's* contact details, including its name and address; and
- (g) how to complain to the *firm* and whether or not complaints may subsequently be referred to the *Financial Ombudsman Service*.

- (2) A *firm* may omit details of the charges that a customer may incur under a *home purchase plan* from the risks and features statement if they are included in a separate *tariff of charges* provided to the customer at the same time.

6.8.2 G Although an *offer document* may not match information given in a financial information statement before an offer is made, an *offer document* should be an accurate reflection of the actual costs of the *home purchase plan*.

6.8.3 G A *firm* should bear in mind its obligations under *Principle 6*. For example, if a *firm* knows that its interest in a *home purchase plan* will be assigned and the *firm* will no longer be responsible for setting rental payments and charges, the *offer document* should state this fact and who will become responsible after the assignment (if this is not known at the offer stage the *customer* should be notified as soon as it becomes known).

6.8.4 R A *firm* must ensure that the financial information statement forms the main, and an integral, part of the *offer document*.

Distance contracts with retail customers

6.8.5 R (1) A *firm* must communicate to a *retail customer* the *distance marketing information* in a *durable medium* available and accessible to the *retail customer* in good time before the *retail customer* is bound by any *distance contract* or offer to *enter into a home purchase plan*.

- (2) If the *distance contract* or offer has been concluded at the *retail customer's* request using a *means of distance communication* which does not enable providing the information in accordance with (1) then it must be communicated no later than immediately after the conclusion of the *home purchase plan*.

[**Note:** article 5 *DMD*]

6.8.6 G *Distance contract* information may be included in an *offer document* provided that it does not significantly increase its length.

After MCOB 6.8 insert the following new annex. The inserted text is not underlined.

MCOB 6 Annex 1

Distance home purchase plans: information to be provided to retail customers.

1R This table belongs to *MCOB 6.8.5R*.

Distance home purchase plans: information to be provided to retail customers	
(1)	the identity and the main business of the <i>home purchase provider</i> , the geographical address at which the <i>home purchase provider</i> is established and any other geographical address relevant for the <i>retail customer's</i> relations with the <i>home purchase provider</i> ;
(2)	the identity of the representative of the <i>home purchase provider</i> established in the <i>retail customer's</i> Member State of residence and the geographical address relevant for the customer's relations with the representative, if such a representative exists;
(3)	when the <i>retail customer's</i> dealings are with any professional other than the <i>home purchase provider</i> , the identity of this professional, the capacity in which he is acting vis-à-vis the <i>retail customer</i> , and the geographical address relevant for the <i>customer's</i> relations with this professional;
(4)	Details of the <i>FSA Register</i> and any other trade register in which the <i>home purchase provider</i> is entered and his registration number or an equivalent means of identification in that register;
(5)	confirmation that the <i>home purchase provider</i> is authorised and regulated by the <i>FSA</i> ;
(6)	the total price to be paid by the <i>retail customer</i> to the <i>home purchase provider</i> for the financial service, including all related fees, charges and expenses, and all taxes paid via the <i>home purchase provider</i> or, when an exact price cannot be indicated, the basis for the calculation of the price enabling the <i>retail customer</i> to verify it;
(7)	notice of the possibility that other taxes and/or costs may exist that are not paid via the <i>home purchase provider</i> or imposed by him;
(8)	any specific additional cost for the <i>retail customer</i> of using the <i>means of distance communication</i> , if such additional cost is charged;
(9)	the absence of a right of withdrawal;
(10)	information on any rights the parties may have to terminate the contract early or unilaterally by virtue of the terms of the <i>distance contract</i> , including any penalties imposed by the contract in such cases;

(11)	the <i>EEA State</i> or <i>States</i> whose laws are taken by the <i>home purchase provider</i> as a basis for the establishment of relations with the <i>retail customer</i> prior to the conclusion of the <i>distance contract</i> ;
(12)	any contractual clause on law applicable to the <i>distance contract</i> and/or on competent court;
(13)	in which language, or languages, the contractual terms and conditions, and the prior information referred to in this table are supplied, and furthermore in which language, or languages, the <i>home purchase provider</i> , with the agreement of the <i>retail customer</i> , undertakes to communicate during the duration of this <i>distance contract</i> ; and
(14)	whether or not there is an out-of-court complaint and redress mechanism for the <i>retail customer</i> that is party to the <i>distance contract</i> and, if so, the methods for having access to it;
(15)	whether or not compensation may be available from the <i>compensation scheme</i> should the <i>firm</i> be unable to meet its liabilities, and information about any other applicable named compensation scheme; and, for each applicable scheme, the extent and level of cover and how further information can be obtained; and
(16)	all the contractual terms and conditions of the <i>home purchase plan</i> to which the <i>offer document</i> relates.

[**Note:** articles 3 and 5 *DMD*]

2G A *firm* is not required to provide this information if it has already done so, for example in an initial disclosure document, and that information remains accurate.

Disclosure at start of contract and after sale

7.1 Application

Who?

7.1.1 R This chapter applies to a *firm* in a category listed in column (1) of the table in *MCOB 7.1.2R* in accordance with column (2) of that table.

7.1.2 R This table belongs to *MCOB 7.1.1R*

(1) Category of firm	(2) Applicable section
<i>mortgage lender</i>	whole chapter <u>except</u> <i>MCOB 7.8</i>
<i>mortgage administrator</i>	<i>MCOB 7.1 - MCOB 7.3-3R</i> and <i>MCOB 7.5 - MCOB 7.7</i>

<i>mortgage adviser and mortgage arranger</i>	<i>MCOB 7.1 - MCOB 7.3-3R and MCOB 7.6.7R - MCOB 7.7</i>
<i>home purchase provider</i>	<i>MCOB 7.1.1R to MCOB 7.1.4R, MCOB 7.2, MCOB 7.3 and MCOB 7.8</i>
<i>home purchase administrator</i>	<i>As for a home purchase provider except MCOB 7.8.1R and MCOB 7.8.2G do not apply</i>
<i>home purchase adviser and home purchase arranger</i>	<i>MCOB 7.1.1R to MCOB 7.1.4R, MCOB 7.2 and MCOB 7.8.7G</i>
<i>reversion provider</i> <i>reversion administrator</i> <i>reversion adviser</i> <i>reversion arranger</i>	<i>see MCOB 9.6 for the application of this chapter</i>

What?

- 7.1.3 R This chapter applies if a *firm*:
- (1) enters into a ~~regulated mortgage contract~~ home finance transaction with a *customer*; or
 - (2) ~~administers a regulated mortgage contract~~ administers a home finance transaction which was entered into with a *customer*; or
 - (3) *arranges or advises on* or makes a further advance or other variation to the terms of a ~~regulated mortgage contract~~ home finance transaction entered into with a *customer*.
- 7.1.4 R This chapter applies in relation to further advances and other variations (as specified in ~~MCOB 7.6.7R - MCOB 7.7.4R~~ in relation to a regulated mortgage contract) regardless of whether they are variations to an existing ~~regulated mortgage contract~~ home finance transaction or are such that they involve the customer entering into a new ~~regulated mortgage contract~~ home finance transaction.
- ...
- 7.1.7 G ~~Firms are reminded that in MCOB, references to "arranging" include the activities of a mortgage lender which would be arranging but for article 28A of the Regulated Activities Order (Arranging contracts to which the arranger is a party). [deleted]~~
- 7.1.8 R In relation to a ~~regulated lifetime mortgage contract~~, this chapter ~~MCOB 7~~ is modified by ~~MCOB 9 (Lifetime mortgages)~~ Equity release: product disclosure.

7.2 Purpose

- 7.2.1 G (1) This chapter amplifies *Principle 6* and *Principle 7*, ~~which require a firm to pay due regard to the information needs of its customers and to treat them fairly.~~
- (1A) This chapter requires information to be supplied to *customers* at the start of ~~the~~ *a regulated mortgage contract* to enable them to check that the *regulated mortgage contract* has been set up in accordance with their requirements and to notify them of the first and subsequent payments.
- (2) ...
- (3) This chapter also ensures that *customers* are supplied with information which enables them to check the payments and charges on a ~~regulated mortgage contract~~ *home finance transaction*, to keep track of the transactions on, and the features of, a ~~regulated mortgage contract~~ *home finance transaction* and to be kept informed of material changes.
- (4) ...

...

7.4 ~~D~~Mortgages: disclosure at the start of the contract

...

7.5 ~~S~~Mortgages: statements

...

7.6 ~~E~~Mortgages: event-driven information

...

After MCOB 7.7 insert the following new section. The inserted text is not underlined.

7.8 Home purchase plans

General

Note: The rules in this chapter regarding how a *firm* must provide information required by this section apply (see *MCOB 7.3*).

Post-sale disclosure

- 7.8.1 R A *firm* that enters into a home purchase plan with a *customer* must ensure that before making the first payment the *customer* is provided with a prominent reminder that the *customer* should check that his right to occupy the property has been properly safeguarded.

- 7.8.2 G A *firm* is reminded of its obligation to ensure that its *customer's* interests are protected to a reasonable standard (see *MCOB 2.6A*).

Annual statement

- 7.8.3 R A *firm* must provide the *customer* with a statement at least once a year (or, in relation to the first statement, within the first 13 months of the plan term) covering the *home purchase plan* and including information about:

- (1) payments due and made during the period since the last statement (or, where the statement is the first statement, since the *customer* entered into the *home purchase plan*), including:
 - (a) whether the payment is a rental payment or a purchase payment;
 - (b) the applicable rental rate(s);
 - (c) where relevant, the *customer's* beneficial interest in the property;
- (2) the remaining acquisition amount;
- (3) the actual remaining term;
- (4) the ability of the *customer* to terminate it early and sell the property, together with any charges that would apply.

Annual statement - additional content for customers in arrears

- 7.8.4 G If a *firm* uses the annual statement to provide a *customer* with a written statement relating to *arrears*, it will need to include the actual payment shortfall in the annual statement (see *MCOB 13.5.2G(4)*).

- 7.8.5 G In some circumstances, a *firm* may agree a temporary payment plan with a *customer* that does not involve the *customer* paying the full amount he owes in each payment period. Where an account in *arrears* is subject to such a payment plan, and the amount that falls due each payment period is greater than the agreed payment, the *firm* will still need to show the payments that were due during the period since the last statement. However, in these circumstances, the *firm* may wish to add information to acknowledge that a temporary payment plan is in place.

Tariff of charges

- 7.8.6 R A *firm* must include a *tariff of charges* with the annual statement if it has changed since the previous version provided.

Event-driven information

- 7.8.7 G When a post-sale variation of the *home purchase plan* is proposed or takes place, a *firm* should have regard to the *Principles* (in particular, *Principles 6* and *7*) in determining the action it should take and what information to

provide to the *customer*.

~~Lifetime mortgages~~ Equity release: advising and selling standards

...

8.1.2 R This table belongs to *MCOB 8.1.1R*

(1) Category of firm	(2) Applicable section
mortgage lender <u>equity release provider</u>	whole chapter except <i>MCOB 8.5</i> and <i>MCOB 8.7</i>
mortgage adviser <u>equity release adviser</u>	whole chapter <u>except <i>MCOB 8.6</i>. <i>MCOB 8.7</i> does not apply in relation to a <i>lifetime mortgage</i></u>
mortgage arranger <u>equity release arranger</u>	whole chapter except <i>MCOB 8.5</i> . <i>MCOB 8.7</i> does not apply in relation to a <i>lifetime mortgage</i>

8.1.3 R What?

(1) This chapter applies if a *firm*:

(1) in the course of carrying on a ~~regulated mortgage activity~~ an equity release activity:

- (a) makes, or anticipates making, a *personal recommendation* about; or
- (b) gives, or anticipates giving, personalised information relating to;

the *customer*:

(c) entering into a ~~regulated lifetime mortgage contract~~ an equity release transaction; or

(d) varying the terms of a ~~regulated lifetime mortgage contract~~ an equity release transaction entered into by the *customer*; ~~or~~

(2) ~~in addition to (1), gives advice or personalised information to the customer on home reversion schemes.~~

(2) In respect of arranging or advising on a home reversion plan for a customer who is acting in his capacity as an unauthorised reversion provider, only *MCOB 8.1*, *MCOB 8.2* and *MCOB 8.7* apply.

- 8.1.4 R (1) ~~MCOB 4.4 (Initial disclosure requirements) (as modified by MCOB 8)~~ applies Initial disclosure requirements apply only in relation to varying the terms of an *regulated lifetime mortgage contract equity release transaction* entered into by the customer in any of the following ways:
- (a) ...
- (2) Otherwise, this chapter, ~~MCOB 8~~, applies in relation to any form of variation of an *regulated lifetime mortgage contract equity release transaction*.
- 8.1.5 G ... The *firm* is only required to provide the initial disclosure information in ~~MCOB 8 Annex 1R or MCOB 4 Annex 2R~~ section 7 (What to do if you have a complaint) and section 8 (Are we covered by the Financial Services Compensation Scheme (FSCS)?) of the *initial disclosure document* or *combined initial disclosure document*.
- 8.2 Purpose
- 8.2.1 G The purpose of this chapter for ~~*regulated lifetime mortgage contracts equity release transactions*~~ is the same as that for *regulated mortgage contracts and home purchase plans* in MCOB 4.
- 8.3 Application of rules in MCOB 4
- 8.3.1 R (1) (a) MCOB 4.1 to MCOB 4.6 and MCOB 4.8 (with the modifications stated in MCOB 8.3.3R and MCOB 8.3.4R) apply to a *firm* where the *regulated mortgage contract home finance transaction* is a *regulated lifetime mortgage contract*.
- (b) MCOB 4.1 to MCOB 4.4 and MCOB 4.8 (with the modifications stated in MCOB 8.3.3R and MCOB 8.3.4R) apply to a *firm* where the *home finance transaction* is a *home reversion plan*, except for those provisions that by their nature are only relevant to *regulated mortgage contracts*.
- (2) ...
- (4) The terms that by their nature are relevant only to *regulated mortgage contracts* must be replaced with the appropriate equivalent terms and expressions for *home reversion plans*.
- 8.3.1A G The *rules and guidance* that are not relevant to *home reversion plans* are those related, for example, to interest rates, *APR*, *higher lending charge*, *mortgage credit cards*, multi-part mortgages and foreign currency mortgages.
- 8.3.1B G *Firms* should substitute equivalent home reversion terminology for *lifetime mortgage* terminology, where appropriate. Examples of terms and expressions that should be replaced in relation to *home reversion plans* are 'loan' or 'amount borrowed', which should be replaced with 'amount released'

or 'amount to be released', as appropriate, and '*mortgage lender*' and '*mortgage intermediary*' which should be replaced with '*reversion provider*' and '*reversion intermediary*'.

...

8.3.2 R In applying ~~MCOB 4.3~~ initial disclosure requirements to ~~regulated lifetime mortgage contracts~~ equity release transactions, the market for equity release transactions should be treated as one single market with two separate sectors. ~~References to the 'whole market' must be read as references to the whole market for regulated lifetime mortgage contracts equity release transactions.~~ This is unless the *firm* only gives personalised information or *advice to customers* on products in one market sector, in which case references to the 'whole market' must be read as references to the whole market for *lifetime mortgages* or *home reversion plans* as the case may be.

8.3.2A G The effect of the *rules* on independence is that a *firm* that sells *lifetime mortgages* and *home reversion plans* from the whole market and enables the *customer* to pay a fee for the provision of the service, can hold itself out as being 'independent' for the equity release market (see *MCOB 4.3.7R*). If the *firm* offers a service on this basis for only one of these market sectors, then it can only describe itself as 'independent' for that sector.

8.3.3 R Table of modified cross-references to other *rules*: This table belongs to *MCOB 8.3.1R*.

Subject	Rule or guidance	Reference in rule or guidance	To be read as a reference to:
...			
Initial disclosure requirement (for regulated lifetime mortgage contracts <u>equity release transactions</u> only)	<i>MCOB 4.4.1R(1)(c)</i> and (3)	<i>MCOB 4 Ann 1R</i>	<i>MCOB 8 Ann 1R</i>
...			
Initial disclosure requirements where initial contact is by telephone (for regulated lifetime mortgage contracts <u>equity release transactions</u> only)	<i>MCOB 4.4.7R(2)</i>	<i>MCOB 4 Ann 1R</i>	<i>MCOB 8 Ann 1R</i>
...			

...

8.4 Initial disclosure requirements: Home reversion schemes ~~[deleted]~~

8.4.1 R ~~If a firm gives, or anticipates giving, advice or personalised information on home reversion schemes in addition to *regulated lifetime mortgage contracts*, the initial disclosure information in *MCOB 4.4.1R* and *MCOB 4.4.7R* must be provided in respect of the home reversion schemes, as well as the *regulated lifetime mortgage contracts*, using the text set out in *MCOB 8 Annex 1R* and *MCOB 4 Annex 2R*. [deleted]~~

8.5 Advised sales

Suitability: general

8.5.1 G ...

8.5.2 R A firm must take reasonable steps to ensure that it does not make a *personal recommendation* to a customer to enter into an *regulated lifetime mortgage contract equity release transaction*, or to vary an existing *regulated lifetime mortgage contract equity release transaction*, unless ~~the *regulated lifetime mortgage contract* it is, or after the variation will be,~~ suitable for that customer (see *MCOB 4.3.4R(2)*, *MCOB 4.3.5G* and *MCOB 4.3.6G*).

8.5.3 R In ~~*MCOB 8.5*~~ this section, a reference to a recommendation to enter into an *regulated lifetime mortgage contract equity release transaction* is to be read as including a reference to a recommendation to vary an existing *regulated lifetime mortgage contract equity release transaction* if the context so requires.

8.5.4 R ~~For the purposes of *MCOB 8.5.2R*:~~

(1) ~~a *regulated lifetime mortgage contract*~~ An equity release transaction will be suitable if, having regard to the facts disclosed by the customer and other relevant facts about the customer of which the firm is or should reasonably be aware, the firm has reasonable grounds to conclude that:

(a) ...

(b) alternative methods of raising the required funds such as, in particular:

(i) an equity release transaction from the other market sector ~~a home reversion scheme~~; or

(ii) (where relevant) a local authority (or other) grant;

are less suitable;

(c) where the ~~*regulated lifetime mortgage contract equity release transaction*~~ requires that payments are made to the ~~*mortgage lender equity release provider*~~ (for example an *interest-only mortgage*), the customer can afford to enter into the *regulated lifetime mortgage contract transaction*;

- (d) the ~~regulated lifetime mortgage contract equity release transaction~~ is appropriate to the needs, objectives and circumstances of the *customer*; and
 - (e) the ~~regulated lifetime mortgage contract equity release transaction~~ is the most suitable of those that the *firm* has available to it within the scope of the service provided to the *customer*;
- (2) ~~no~~ No recommendation must be made if there is no ~~regulated lifetime mortgage contract equity release transaction~~ from within the scope of the service provided to the *customer* which is appropriate to his needs and circumstances; and
- (3) ~~if~~ If a *firm*...

...

Suitability: means-tested benefits, customer's tax position and alternative methods of finance

8.5.5 R ...

...

8.5.7 R If for any reason a *customer*:

- (1) declines to seek further information ~~in accordance with MCOB 8.5.5R or MCOB 8.5.6E(1)~~ on means-tested benefits, tax allowances or the scope for local authority (or other) grants; or
- (2) rejects the conclusion of a *firm* ~~under MCOB 8.5.4R(1)(b)~~ that alternative methods of raising the required funds are more suitable;

a *firm* can make a *personal recommendation* (in accordance with the remaining requirements of ~~MCOB 8.5~~ this chapter) where there is a ~~regulated lifetime mortgage contract an equity release transaction~~ (or more than one ~~regulated lifetime mortgage contract equity release transaction~~) that is appropriate to the needs and circumstances of the *customer*, but must confirm to the *customer*, in a *durable medium*, the basis on which the *personal recommendation* has been made.

8.5.8 R In determining whether ~~MCOB 8.5.4R(1)(b)(i)~~ applies an equity release transaction from the other market sector is less suitable, and in relation to MCOB 8.5.4R(1)(d) the appropriateness of the transaction to the customer's needs, objectives and circumstances, a *firm* must consider:

- (1) whether the *customer's* requirements meet the eligibility criteria for the ~~regulated lifetime mortgage contract equity release transaction~~ (for example, the amount that the *customer* wishes to borrow or to release, ~~or~~ the loan-to-value ratio, the age of the customer, the value of the property, as appropriate) ~~or a home reversion scheme~~;

(2) ...

...

(6) whether the *customer* has a preference or need for any other features of a ~~regulated lifetime mortgage contract~~ an equity release transaction or a ~~home reversion scheme~~.

8.5.9 G Where a *firm* sells only ~~regulated lifetime mortgages contracts~~, ~~MCOB 8.5.8R~~ does not require the *firm* it is not required to assess the suitability of individual ~~home reversion scheme~~ home reversion plans, and vice-versa. However, where a *firm* sells products from both market sectors, it should assess the suitability of all equity release transactions within its range.

Suitability: affordability

8.5.10 R ...

8.5.11 R In relation to ~~MCOB 8.5.4R(1)(e) and (d)~~ whether the equity release transaction is affordable and appropriate to the *customer's* needs, objectives and circumstances, where a *firm* makes a *personal recommendation* to a *customer* to enter into an ~~regulated lifetime mortgage contract~~ equity release transaction where a main purpose is to consolidate existing debts, it must also take account of the following, where relevant, in assessing whether the ~~regulated lifetime mortgage contract~~ equity release transaction is suitable for the *customer*:

(1) ...

...

(3) where the *customer* is known to have payment difficulties, whether it would be more appropriate for the *customer* to negotiate an arrangement with his creditors than to ~~take out a regulated lifetime mortgage contract~~ enter into an equity release transaction.

8.5.12 E (1) In assessing whether a *customer* can afford to enter into a particular ~~regulated lifetime mortgage contract~~ equity release transaction, a *firm* should give due regard to the following:

...

...

8.5.14 G ~~MCOB 8.5.4R(3) explains that d~~ Different considerations apply when making a *personal recommendation* to a *customer* in arrears. For example, the circumstances of the *customer* may mean that, viewed as a new transaction, a *customer* could not be recommended to enter into an ~~regulated lifetime mortgage contract~~ equity release transaction. In such cases, a *firm* will still be able to make a *personal recommendation* to that *customer* where this recommendation is, in the circumstances, a more suitable one than the *customer's* existing ~~regulated lifetime mortgage contract~~ equity release

transaction.

- 8.5.15 G In complying with *MCOB 8.5.4R* a *firm* is not required to consider whether it would be preferable for the *customer* to:
- (1) trade down (that is release funds by selling his existing property and purchasing a less expensive property) rather than enter into an ~~regulated lifetime mortgage contract~~ equity release transaction;
 - (2) rent a property, rather than purchase one or enter into an ~~regulated lifetime mortgage contract~~ equity release transaction on his existing property; or
 - (3) delay entering into an ~~regulated lifetime mortgage contract~~ equity release transaction until a later date on the grounds that property prices would have changed in the intervening period, or that the interest rate in relation to a ~~the regulated lifetime mortgage contract~~ would be lower, or both.

Suitability: appropriate to the customer's needs, objectives and circumstances

- 8.5.16 G (1) ...
- (2) Where the scope of the *advice* provided is ~~restricted (within the meaning of *MCOB 4.3.1R(1)(b)* or (c)), *MCOB 8.5.4R(2)* means that~~ based on a selection of equity release transactions from a single or limited number of providers, the assessment of suitability should not be limited to the ~~types of *regulated lifetime mortgage contract* equity release transactions~~ which the *firm* offers. ~~*MCOB 8.5.4R(2)* prevents a *firm* recommending~~ A *firm* cannot recommend the 'least worst' ~~regulated lifetime mortgage contract~~ equity release transaction where the *firm* does not have access to products appropriate to the *customer's* needs and circumstances. ~~¶~~ This means, for example, that a *firm* dealing solely in the sub-prime market should not recommend one of these ~~regulated lifetime mortgage contracts~~ equity release transactions if approached for advice by a *customer* with an unblemished credit record.

8.5.16A G In assessing whether a *home reversion plan* is appropriate to the needs, objectives and circumstances of its *customer*, matters that a *firm* should take into account include:

- (1) the duration of the right to occupy the property; and
- (2) where an *unauthorised reversion provider* will provide the plan, the loss of those protections of the *regulatory system* that apply when a *customer* enters into a *home reversion plan* with an authorised *reversion provider*.

Suitability: most suitable

- 8.5.17 E (1) A *firm* should, out of all the ~~*regulated lifetime mortgage contracts*~~

equity release transactions identified as being appropriate for that *customer*, recommend the one that is the least expensive for that *customer* taking into account those pricing elements identified by the *customer* as being most important to him.

(2) ...

8.5.18 G (1) ...

(2) ~~MCOB 8.5.17E(1) does not prevent a firm~~ A firm is not prevented from making a recommendation on grounds other than price. For example, it would be open to a firm to have regard to the speed or quality of service of different ~~mortgage lenders~~ equity release providers, the policies of ~~mortgage lenders~~ equity release providers on further lending or capital repayments, the underwriting stance of ~~mortgage lenders~~ equity release providers or the *customer's* wish for an regulated lifetime mortgage contract equity release transaction that is compliant with Sharia Islamic law. The obligation to satisfy ~~MCOB 8.5.4R(1)(e)~~ have reasonable grounds to conclude that the transaction is the most suitable remains the same in such cases.

8.5.19 G (1) If circumstances arise in which a firm has reasonable grounds to conclude that there are several ~~regulated lifetime mortgage contracts~~ equity release transactions that would satisfy the suitability requirement in ~~MCOB 8.5.4R~~ be suitable, the firm will act in conformity with that rule if it may recommend only one of those ~~regulated lifetime mortgage contracts~~ equity release transactions.

(2) If for any reason a *customer* rejects a recommendation made by a firm (for example, on the grounds that the ~~mortgage lender~~ equity release provider selected is unknown to him), the firm can make a further suitable recommendation (in accordance with the requirements of ~~MCOB 8.5~~) where there remains an regulated lifetime mortgage contract equity release transaction that is appropriate to the needs and circumstances of the *customer*.

Rejected recommendations

8.5.20 R (1) If a *customer* has:

(a) rejected all of the *personal recommendations* made by a firm and requested information instead on an regulated lifetime mortgage contract equity release transaction that the firm does not consider suitable (and therefore could not recommend to the *customer* in accordance with ~~MCOB 8.5.2R~~); and

(b) been issued with a new ~~initial disclosure document~~ in accordance with ~~MCOB 4.4.1R~~ or ~~MCOB 4.4.7R~~ (as modified by ~~MCOB 8~~) initial disclosure document or combined initial disclosure document;

the firm may be able to provide information on that regulated lifetime mortgage contract equity release transaction in the light of the

information on which the *personal recommendations* in (1) were made.

- (2) If the *firm* needs to ask further questions regarding the needs and circumstances of the *customer* to be able to provide information on that ~~regulated lifetime mortgage contract~~ equity release transaction, the *firm* must obtain that information by asking scripted questions (in accordance with ~~MCOB 4.8.1R~~ and ~~MCOB 8.6~~ the rules on non-advised sales).

8.5.21 G A *firm* may consider it prudent to record any cases where, after all *personal recommendations* it has made to a *customer* have been rejected, it changes the nature of the service it provides (as in ~~MCOB 8.5.20R~~) and provides the *customer* with information about an ~~regulated lifetime mortgage contract~~ equity release transaction.

...

8.6 Non-advised sales

8.6.1 R ~~In relation to MCOB 4.8.1R~~ The questions used to help a *customer* select a ~~regulated lifetime mortgage contract~~ an equity release transaction must cover the following:

- (1) the matters regarding eligibility criteria, customer's preferences for his estate, customer's health and life expectancy, customer's future plans and needs, customer's preference or need for stability in the amount of payments, and whether the customer has a preference or need for any other features, set out in MCOB 8.5.8R;
- (2) whether the *customer* has considered alternative methods of raising the required funds, and in particular:
 - (a) an equity release transaction from the other market sector home reversion scheme; and
 - (b) ...

...

8.6.2 G ~~In complying with MCOB 8.6.1R(2) and (3)~~ a *firm* should encourage a *customer* to seek advice on an ~~regulated lifetime mortgage contract~~ equity release transaction if the *customer* is unsure about making their own choice. ~~In the case of MCOB 8.6.1R(2)(b) and (3)~~ In relation to grant assistance, means-tested benefits and the customer's tax position, a *firm* should, where relevant, encourage the *customer* to seek further information from an appropriate source such as their local authority or Citizens Advice Bureau (or other similar agency).

8.6.3 G Firms are reminded that ~~FC 2~~ the Training and Competence sourcebook sets out requirements for:

- (1) *employees* designing scripted questions for use in sales to *customers* of ~~regulated lifetime mortgage contracts~~ equity release transactions

which do not involve *personal recommendations*; and

- (2) *employees* overseeing on a day-to-day basis the sales to *customers* of ~~*regulated lifetime mortgage contracts*~~ *equity release transactions* which do not involve *personal recommendations*.

8.7 Initial disclosure information: unauthorised reversion provider

8.7.1 R A firm must ensure that, on first making contact with a customer who is an individual and an unauthorised reversion provider, when it anticipates giving personalised information or advice on a home reversion plan, it must provide the customer with the following warnings in a durable medium:

- (1) that a home reversion plan is a long-term investment; and
- (2) that a home reversion plan is a complex legal arrangement, and that expert independent legal advice should be obtained before entering into any agreement.

8 Annex 1 Initial disclosure document ("IDD")

R This annex belongs to *MCOB 4.4.1R* (as modified by *MCOB 8*) ~~and~~
MCOB 8.4.1R.

Firms must omit the notes and square brackets that appear in the following IDD. The IDD must contain the key facts logo, headings and text in the order shown and in accordance with the Notes [**Note 1**].



About our ~~lifetime mortgage [and home reversion scheme]~~ equity release services [Note 2**] [~~Note 3~~]**



[**Note 4**] [**Note 5**]

[**Note 6**]
123 Any Street
Some Town
ST21 7QR

1. The Financial Services Authority (FSA)

The FSA is the independent watchdog that regulates financial services. It requires us to give you this document. Use this information to decide if our services are right for you.

2. Whose products do we offer? [Note 3**] [**Note 7**] [**Note 8**]**

- We offer [lifetime mortgages] [home reversion plans] [equity release products] from the whole market.
- We [can] [**Note 9**] only offer [lifetime mortgages] [home reversion plans] [equity release products] from a limited number of companies.

Ask us for a list of the companies we offer products from. [**Note 10**]

- We [can] **[Note 9]** only offer [a limited range of ~~the~~] [lifetime mortgages] [home reversion plans] [equity release products] [~~a~~] product[s] from [a single company] [name of single company]. **[Note 11]** **[Note 11A]**

[or]

We only offer our own [lifetime mortgages] [home reversion plans] [equity release products]. **[Note 12]**

- We do not offer [lifetime mortgages] [home reversion plans]. **[Note 8A]**
-

3. Which service will we provide you with? **[Note 3] **[Note 7]****

- We will advise and make a recommendation on [lifetime mortgages] [home reversions] [equity release products] for you after we have assessed your needs.
- You will not receive advice or a recommendation from us. We may ask some questions to narrow down the selection of ~~products~~ [lifetime mortgages] [home reversions] [equity release products] on which we will provide details. You will then need to make your own choice about how to proceed.
-

4. What will you have to pay us for this service? **[Note 3] **[Note 7]****

- No fee [we will be paid by commission from the company that [lends you money] [buys your home]]. **[Note 13]**
- A fee [of £ [] payable at the outset and £[] payable when you apply for [a lifetime mortgage] [a home reversion plan scheme] [an equity release product]]. [We will also be paid commission from the company that [lends you money] [buys your home].] **[Note 13]** **[Note 14]**

You will receive a key facts illustration when considering a particular ~~lifetime mortgage~~ [equity release product] ~~for further information about a particular home reversion scheme~~, which will tell you about any fees relating to it. **[Note 3]**

5. Refund of fees **[Note 15] **[Note 16]****

If we charge you a fee, and your ~~lifetime mortgage~~ [equity release sale] ~~[home reversion scheme]~~ does not go ahead, you will receive: **[Note 3]**

- A full refund [if the company rejects your application]. **[Note 17]**
- A refund of £ [] [if the application falls through]. **[Note 17]** **[Note 18]**
- No refund [if you decide not to proceed]. **[Note 17]**
-

6. Who regulates us? **[Note 19]**

[XYZ Financial Services][123 Any Street, Some Town, ST21 7QB] [Note 20] [Note 20A] is authorised [Note 21] and regulated by the Financial Services Authority. Our FSA Register number is [].

Our permitted business is []. [Note 22]

[or] [Note 20B]

[Name of *appointed representative*] [Notes 4 and 5] is an appointed representative of [name of *firm*] [address of *firm*] [Note 20] [Note 20A] which is authorised and regulated by the Financial Services Authority. [Name of *firm*]'s FSA Register number is [].

[Name of *firm*]'s permitted business is []. [Note 22]

You can check this on the FSA's Register by visiting the FSA's website www.fsa.gov.uk/register/ or by contacting the FSA on 0845 606 1234.

~~[Home reversion schemes are not regulated by the FSA.] [Note 3]~~

7. What to do if you have a complaint

If you wish to register a complaint, please contact us:

...in writing Write to [XYZ Financial Services], [Complaints Department, 123 Any Street, Some Town, ST21 7QB] [Note 23]

...by phone Telephone [0121 100 1234] [Note 23]

If you cannot settle your complaint with us, you may be entitled to refer it to the Financial Ombudsman Service. ~~[The Financial Ombudsman Service does not consider complaints about home reversion schemes.] [Note 3] [Note 23A]~~

8. Are we covered by the Financial Services Compensation Scheme (FSCS)? [Note 19] [Note 24] [Note 25]

We are covered by the FSCS. You may be entitled to compensation from the scheme if we cannot meet our obligations. This depends on the type of business and the circumstances of the claim.

~~Mortgage~~Equity release advising and arranging is covered for 100% of the first £30,000 and 90% of the next £20,000 so the maximum compensation is £48,000. ~~[Home reversion schemes are not covered by the FSCS.] [Note 3]~~

Further information about the compensation scheme arrangements is available from the FSCS.

Message from the Financial Services Authority
Think carefully about this information before deciding whether you want to go ahead.
If you are at all unsure about which ~~lifetime mortgage home reversion scheme~~ equity release transaction is right for you, you should ask your adviser to make a recommendation.
Please remember that home reversion schemes are not regulated by the FSA.

The following notes do not form part of the IDD.

...

Note 2 – the *Financial Services Authority* has developed a common ‘key facts’ logo to be used on significant pieces of information directed to *customers*. The ‘key facts’ logo and the text “about our ~~lifetime mortgage~~ equity release services” must be used and positioned as shown on the IDD. The logo may be re-sized, but it must be reasonably prominent and its proportions must not be distorted. When reproducing the logo, *firms* may use colour providing this does not diminish the prominence of the logo.

Note 3 – *firms* must insert the text in square brackets relating to lifetime mortgages home reversion schemes if they advise or give personalised information on their scope of service includes lifetime mortgages; the text in square brackets relating to home reversion plans schemes if their scope of service includes home reversion plans; and the text in square brackets relating to equity release products if their scope of service includes products from both market sectors. The texts in square brackets are mutually exclusive. This means that *firms* should use only one of the square bracketed texts and must omit those not used. ~~in addition to advising or giving personalised information on regulated lifetime mortgage contracts.~~

...

Note 7 - *firms* must describe their scope of service by selecting and by ticking, for example, one the box or boxes that describe the products and services that the firm which is (are) appropriate for the service that they expects to provide to the customer. This means a *firm* will select either one or both boxes within this section. *Firms* must not delete the boxes not selected (but see Note 8A). In the text associated with boxes that are not ticked, a *firm* must delete references to ‘home reversions’ and ‘lifetime mortgages’ but leave references to ‘equity release products’, omitting the square brackets. This is so that a *customer* can see other possible options, even if not available from the *firm* issuing the IDD.

...

Note 8A – if the *firm's* scope of service does not include both types of equity release transactions, it must use this box to indicate to the *customer* the sector that it does not cover.

Note 9 - insert "can" if the *firm's* range of equity release transactions ~~regulated lifetime mortgage contracts~~ is determined by any contractual obligation.

...

Note 11A - If the *firm* offers home reversion plans from only one *reversion provider*, and lifetime mortgages from only one *lender*, which is different from the *reversion provider*, then the *firm* should identify the *lender* and the *reversion provider* and specify the equity release transaction to which they relate. For example, "We can only offer lifetime mortgages from ABC Mortgages Ltd and home reversion plans from XYZ Reversions Ltd."

...

Note 14 – insert a plain language description of when any *fees* are payable. This description could include, for example, a cash amount, a percentage of the loan or reversion amount or the amount per hour, as appropriate. However, where a cash amount is not disclosed, one or more examples of the cash amount must be included. If the *firm* offers more than one pricing option, ~~it may illustrate each with a separate box.~~ it should specify the pricing policy for each product. For example, "A fee of £100 payable at the outset and £120 when you apply for a lifetime mortgage and £80 when you apply for a home reversion plan". If a *firm* does not charge a *fee*, the text for the second box should be abbreviated to 'A fee'.

...

Note 17 – insert a plain language description of the circumstances in which the *fee* is refundable or not refundable as described. If the refund policy is different depending on the equity release transaction in question, the firm should specify the refund policy for each of them. For example, "A refund of £100 if your lifetime mortgage application falls through and a refund of £120 if your home reversion plan application falls through."

...

Note 20B – where the information is provided by an *appointed representative*, the *appointed representative* must use this text instead. The *appointed representative* must give details of the *authorised firm(s)* that is its *principal(s)* for each type of service that it is providing to a particular *customer*.

...

Note 22 - insert a short, plain language description of the business for which the *firm* has *permission* in relation to ~~regulated lifetime mortgage contracts~~ equity release transactions.

...

~~Lifetime mortgages~~ Equity release: product disclosure

9.1 Application

9.1.1 R Who?

This chapter applies to a *firm* in a category listed in column (1) of the table in *MCOB 9.1.2R* in accordance with column (2) of that table, except that those provisions that by their nature are only relevant to *regulated mortgage contracts* do not apply to *home reversion plans*.

9.1.2 R This table belongs to *MCOB 9.1.1R*

(1) Category of firm	(2) Applicable section
<i>mortgage lender</i>	whole chapter <u><i>MCOB 9.1 - 9.4.132R, MCOB 9.5 - 9.8</i></u>
<i>mortgage administrator</i>	<u><i>MCOB 9.1—9.4, MCOB 9.2, MCOB 9.6 and MCOB 9.8</i></u>
<i>mortgage adviser; mortgage arranger</i>	<u><i>MCOB 9.1 - 9.4.132R and MCOB 9.8.5R-MCOB 9.8.10R</i></u>
<i>mortgage arranger</i>	<i>MCOB 9.1—9.4 and MCOB 9.8.5R—MCOB 9.8.10R</i>
<u><i>reversion provider</i></u>	<u><i>MCOB 9.1 – 9.4.17AR, MCOB 9.4.133R -9.6; MCOB 9.9</i></u>

<u>reversion administrator</u>	<u>MCOB 9.1, MCOB 9.6 and MCOB 9.9</u>
<u>reversion adviser; reversion arranger</u>	<u>MCOB 9.1 - 9.4.17AR, MCOB 9.4.133R - 9.4.176G; MCOB 9.9.8R</u>

9.1.2A G The rules and guidance that are not relevant to home reversion plans are those related, for example, to interest rates, APR, higher lending charge, mortgage credit cards, multi-part mortgages and foreign currency mortgages.

9.1.3 R What?

This chapter applies in the circumstances set out in other ~~rules~~ in MCOB this sourcebook, but in relation to a ~~regulated lifetime mortgage contract~~ an equity release transaction, in accordance with the table in MCOB 9.1.4R.

9.1.4 R This table belongs to MCOB 9.1.3R

Section of MCOB 9	Applies in relation to a regulated lifetime mortgage contract <u>an equity release transaction</u> as set out in the following MCOB rules:
<u>MCOB 9.1, MCOB 9.2</u>	all of the <i>rules</i> listed below <u>in this column</u>
<u>MCOB 9.3, MCOB 9.4</u>	<u>MCOB 5.1.3R</u>
<u>MCOB 9.5</u>	<u>MCOB 6.1.3R</u>
<u>MCOB 9.5 6</u>	<u>MCOB 7.1.3R</u>

9.1.5 R In this chapter, references to a ~~regulated lifetime mortgage contract~~ an equity release transaction include, where the context requires, references to arrangements which are capable of becoming a ~~regulated lifetime mortgage contract~~ an equity release transaction.

9.1.6 R This chapter does not apply in relation to arranging, advising on or administering a home reversion plan for a customer acting in his capacity as an unauthorised reversion provider.

9.2 Purpose

9.2.1 G The purpose of the requirements in this chapter is the same as that in MCOB 5.2, MCOB 6.2 and MCOB 7.2 in respect of ~~regulated lifetime mortgage contracts~~ equity release transactions.

9.3 Pre-application disclosure

9.3.1 R (1) MCOB 5.1 to MCOB 5.5 (with the modifications stated in MCOB 9.3.2R to MCOB 9.3.12R) apply to a firm where the ~~regulated mortgage contract~~ home finance transaction is an ~~regulated lifetime mortgage contract~~ equity release transaction, except that those

provisions that by their nature are only relevant to regulated mortgage contracts do not apply to home reversion plans (see MCOB 9.1.2AG).

(2) ...

...

(5) The terms that by their nature are relevant only to regulated mortgage contracts must be replaced with the appropriate equivalent terms and expressions for home reversion plans.

9.3.1A G The provisions in this sourcebook that apply to home reversion plans should be read in a purposive way. This means that firms should substitute equivalent home reversion terminology for lifetime mortgage terminology, where appropriate. Examples of terms and expressions that must be replaced are 'loan' or 'amount borrowed', which should be replaced with 'amount released' or 'amount to be released', as appropriate, and 'mortgage lender' and 'mortgage intermediary' which should be replaced with 'reversion provider' and 'reversion intermediary'.

Table of modified cross-references to other rules

9.3.2 R This table belongs to MCOB 9.3.1R.

Subject	Rule or guidance	Reference in rule or guidance	To be read as a reference to:
...			
Part of loan not a regulated lifetime mortgage contract <u>an equity release transaction</u>	MCOB 5.1.9G	MCOB 5.6.6R(2)	MCOB 9.4.6R(2)
...			
Tied products	MCOB 5.4.24G	MCOB 5.6.74R	MCOB 9.4.73R or MCOB 9.4.160R
...			

...

9.3.5 R An illustration on a particular ~~regulated lifetime mortgage contract~~ equity release transaction issued by, or on behalf of an ~~mortgage lender~~ equity release provider, must be an accurate reflection of the costs of the ~~regulated lifetime mortgage contract~~ equity release transaction.

9.3.6A R A reversion intermediary must take reasonable steps to ensure that an

illustration which it issues, or which is issued on its behalf, other than that provided by an *reversion provider*, is accurate, except in the case of conveyancing fees and insurance premiums (where estimates may be used).

...

- 9.3.8 G There are no restrictions on figures which are quoted as higher than those actually charged by the ~~*mortgage lender*~~ *equity release provider* although this should not be purposely done in order to make one ~~*regulated lifetime mortgage contract*~~ *equity release transaction* look more expensive than another.
- 9.3.9 G It is the responsibility of a ~~*mortgage*~~ *an equity release intermediary* to ensure ~~compliance with *MCOB 9.3.6R*~~ *an illustration is accurate*. However, where a *firm* can show that it was reasonable for it to rely on information provided to it by another *person*, other than the ~~*mortgage lender*~~ *equity release provider*, ~~that an *illustration* was within the tolerances described in *MCOB 9.3.6R*~~, he may be able to rely on that *person* (see *MCOB 2.5.2R*), if ~~this turns out not to be the case~~.
- 9.3.10 G An *offer document* may not always exactly match the *illustration* provided before application even when the ~~loan~~ *equity release* requirements have not changed. For example, where a fixed rate has a defined end date, the *total amount payable* may be different because the number of payments at the fixed rate has reduced, or the estimated amount of interest to be charged has changed, assuming a later date at which the ~~*regulated lifetime mortgage contract*~~ will start.
- 9.3.11 R Where ~~*MCOB 5.4.13R(2)*~~ applies a *firm* provides a *customer* with information specific to an *equity release transaction* on a screen:
- (1) if the *customer* initiates the accessing of quotation information on screen (for example, by using the internet or interactive television), the following warning must be displayed equally prominently on each page on screen: This information does not contain all of the details you need to choose a ~~lifetime mortgage~~ *an equity release product*. Make sure that you read the separate key facts illustration before you make a decision;
 - (2) ...
- 9.3.12 R In meeting a request ~~under *MCOB 5.5.1R(2)(e)*~~ for written information specific to the *customer's* requirements on a particular *equity release transaction* (see *MCOB 5.5.1R(2)(c)*), the *firm* must not delay the provision of the *illustration* by requesting information other than:
- (1) the information necessary to personalise the *illustration* ~~in accordance with *MCOB 9.4.6R*~~, if the *firm* does not already know it;

(2) where the *firm* acts in accordance with ~~MCOB 5.5.11R(2)~~ is uncertain whether the transaction will be an equity release transaction, such information as is necessary to ascertain ~~this whether or not the contract will be a regulated lifetime mortgage contract~~;

(3) ...

...

9.4 Content of illustrations

Purpose

9.4.1 G ~~MCOB 9.4~~ This section sets out the required content of an *illustration* for a ~~regulated lifetime mortgage contract~~ an equity release transaction provided to a *customer* by a *firm*. The template of an illustration for a lifetime mortgage is set out in MCOB 9 Annex 1 and for a home reversion plan, in MCOB 9 Annex 2.

Content, order, format etc

9.4.2 R An *illustration* provided to a *customer* must:

(1) contain the material set out in ~~MCOB 9 Annex 1~~ the relevant annex to this chapter in the order and using the numbered section headings, sub-headings and ~~prescribed text prescribed in MCOB 9 Annex 1~~, except where ~~provided for in MCOB 9.4~~ this section provides otherwise;

(2) follow the format of the template in ~~MCOB 9 Annex 1~~ the relevant annex to this chapter, with:

(a) prominent use of the keyfacts logo followed by the text 'about this lifetime mortgage' or 'about this home reversion plan';

...

...

(6) replace "[name of mortgage lender]" or "[name of reversion provider]" with the name of the ~~mortgage lender~~ equity release provider providing the ~~regulated lifetime mortgage contract~~; a trading name used by the ~~mortgage lender~~ equity release provider may be stated, as long as the name of the ~~mortgage lender~~ is also disclosed in Section 5 of the *illustration* in accordance with ~~MCOB 9.4.24R(1)~~;

(7) ...

...

- (9) describe any ~~regulated lifetime mortgage contract~~ as a "lifetime mortgage" and any home reversion plan as a "home reversion plan" and not use any other expression to describe such a mortgage or plan or omit that description from the name given to any product that meets the definition.

9.4.3 G (1) ...

...

- (3) The *illustration* can contain the ~~mortgage lender's equity release provider's~~ or ~~mortgage equity release intermediary's~~ logo and other "brand" information, ~~so long as the requirements of MCOB 9.4 are satisfied.~~

(4) ...

...

9.4.4 R A *firm* must include in the *illustration* all prescribed section headings ~~in MCOB 9 Annex 1~~, except that:

- (1) in Section 8 of the lifetime mortgage illustration (What you owe and when):

...

- (2) Section 16 of the lifetime mortgage illustration (Using a mortgage intermediary) or section 12 of the home reversion plan illustration (Using a home reversion intermediary) is required only where the *illustration* is provided to the *customer* by, or on behalf of, an mortgage equity release intermediary; and

- (3) where the *illustration* is issued in connection with a further advance ~~in accordance with MCOB 9.8.5R~~, an additional section "Total borrowing" must be inserted after Section 8 of a lifetime mortgage illustration, and must be numbered "9", with all subsequent sections renumbered accordingly.

...

9.4.6 R As a minimum the *illustration* must be personalised to reflect the following:

- (1) the specific ~~regulated lifetime mortgage contract~~ equity release transaction in which the *customer* is interested;
- (2) the amount of the loan or equity required by the *customer*, or for drawdown mortgages and instalment reversion plans, the amount the *customer* wishes to draw down or to receive on a monthly (or such frequency that amounts are available) basis. Where the amount the *customer* can draw down is variable, the *firm* must agree with the *customer* an expected amount to be drawn down per year (see MCOB 9.4.13R);

- (3) the price or value of the property on which the equity release amount is based~~regulated lifetime mortgage contract~~ would be secured (estimated where necessary);
- (4) such information relating to the *customer*, or the property, or both as is necessary to determine that the *customer* would qualify for the ~~regulated lifetime mortgage contract~~ equity release transaction in question; and
- (5) the term of the instalment reversion plan or, in the case of a lifetime mortgage and an open-ended instalment reversion plan, the estimated term of the ~~regulated lifetime mortgage contract~~, calculated in accordance with ~~MCOB 9.4.10R~~.

- 9.4.7 G A *firm* should not illustrate more than one ~~regulated lifetime mortgage contract~~ equity release transaction in the same *illustration*, for example by using one *illustration* to compare alternative products.
- 9.4.8 G ~~MCOB 9.4.6R sets out~~These are minimum requirements. The *illustration* may be personalised to a greater degree if the ~~mortgage lender~~ equity release provider or ~~mortgage~~ equity release intermediary wishes, subject to the restrictions on the information that can be obtained from the *customer* ~~in MCOB 9.3.12R~~ when the *illustration* is provided in accordance with ~~MCOB 5.5.1R(2)(e)~~when he requests written information on a particular transaction (see ~~MCOB 5.5.1R(2)(c)~~).
- 9.4.9 G In relation to ~~MCOB 9.4.6R(3)~~the price or value of the property, in order for the *firm* to comply with the principle of "that an illustration should be clear, fair and not misleading" in ~~MCOB 2.2.6R~~, an estimated valuation, where the estimated valuation is not that provided by the *customer*, must be a reasonable assessment based on all the facts available at the time. For example, an overstated valuation could enable a more attractive ~~regulated lifetime mortgage contract~~ to be illustrated on the basis of a lower ratio of the loan amount to the property value - for example, one with a lower rate of interest.
- 9.4.10 R (1) In estimating ~~at~~ the term ~~under MCOB 9.4.6R(5)~~of a lifetime mortgage or an open-ended instalment reversion plan, a *firm* must:
- ...
- ...
- 9.4.11 R Where the *illustration* is issued to two or more *customers* who intend to borrow jointly, or who own the property jointly, the term estimated ~~in accordance with MCOB 9.4.10R~~ should be based on the longest life expectancy.
- 9.4.12 R If the *customer* requests an *illustration* showing a term of the *customer's* choice, that *illustration* must be issued in addition to the *illustration* showing the term calculated in accordance with ~~MCOB 9.4.10R~~these rules. The term chosen should be stated in Section 4 of the *illustration* "What you

have told us" ~~(see MCOB 9.4.21R(2)).~~

- 9.4.13 R The amount to be specified in the illustration and referred to in MCOB 9.4.6R(2) is:
- (1) the amount that the *customer* has asked to borrow, release or draw down; or
 - (2) ...
 - (3) in cases where, on the basis of the information obtained from the *customer* before providing the *illustration*, it is clear that the *customer* would not be eligible to borrow, release or draw down the amount he requested, an estimate of the amount that the *customer* could borrow, release or draw down, based on the information obtained from the *customer*.

- 9.4.14 G *MCOB 9.4.13R(3)* does not require information to be obtained from the *customer* before providing an *illustration* in order to ascertain the amount the *customer* is eligible to borrow or to release from the property. ...

...

Information to be included at the head of the illustration

- 9.4.17 R The following information must be included at the head of the *illustration*:
- (1) the *customer's* name;
 - (2) the date of issue of the *illustration*;
 - (3) details of how long the *illustration* is valid for, and whether there is any date by which the ~~regulated lifetime mortgage contract~~ equity release transaction covered by the *illustration* needs to commence (for example, where a fixed interest rate is only available if the ~~regulated lifetime mortgage contract~~ commences before a certain date); and
 - (4) the prescribed text at the head of the *illustration* ~~in MCOB 9 Annex 1.~~

- 9.4.17A R (1) The requirements for a lifetime mortgage illustration are set out in MCOB 9.4.18R to MCOB 9.4.132R.
- (2) The requirements for a home reversion plan illustration are set out in MCOB 9.4.133R to MCOB 9.4.176G.

Section 1 of a lifetime mortgage illustration: “About this information”

...

Section 2 of a lifetime mortgage illustration: “Which service are we providing you with?”

...

Section 3 of a lifetime mortgage illustration: “What is a lifetime mortgage?”

...

Section 4 of a lifetime mortgage illustration: “What you have told us”

...

Section 5 of a lifetime mortgage illustration: “Description of this mortgage”

...

Section 6 of a lifetime mortgage illustration: “Benefits”

...

Section 7 of a lifetime mortgage illustration: “Risks - important things you must consider”

...

Section 8 of a lifetime mortgage illustration: “What you will owe and when”
(A) “Details of mortgage payments”

...

Section 8 of a lifetime mortgage illustration: “What you will owe and when”
(B) “Projection of roll-up of interest”

...

Section 9 of a lifetime mortgage illustration: “Will the interest rate change?”

...

Section 10 of a lifetime mortgage illustration: “How the value of your home could change”

...

Section 11 of a lifetime mortgage illustration: “What fees must you pay?”

...

Section 12 of a lifetime mortgage illustration: “Insurance”

...

Section 13 of a lifetime mortgage illustration: “What happens if you do not want this mortgage any more?”

...

...

Section 14 of a lifetime mortgage illustration: “Additional features”

...

Section 15 of a lifetime mortgage illustration: “Overall cost of this

mortgage”

...

Section 16 of a lifetime mortgage illustration: “Using a mortgage intermediary”

...

After *MCOB* 9.4.132R insert the following provisions. This text is new and it is not underlined.

Section 1 of a home reversion plan illustration: “About this information”

9.4.133 R Under the section heading "About this information", the prescribed text under this heading in the *home reversion plan illustration* must be included.

Section 2 of a home reversion plan illustration: “Which service are we providing you with?”

9.4.134 R (1) Unless (2) applies, under the section heading "Which service are we providing you with?" the prescribed text in the *home reversion plan illustration* under this heading must be included with a "check box" for each statement, one of which must be marked prominently to indicate the level of service provided to the *customer*;

(2) If the level of service described in the *illustration* is provided by another *firm*, (1) may be replaced by the following: under the section heading "Which service are we providing you with?" the following text should be presented as two options with a "check box" for each option, one of which must be marked prominently to indicate the level of service provided to the *customer*: "[name of the *firm*] recommends, having assessed your needs, that you take out this home reversion plan." "[name of the *firm*] is not recommending a particular home reversion plan for you. However, based on your answers to some questions, it is giving you information about this home reversion plan so that you can make your own choice, or find out about other ways in which you may be able to release equity from your home."

Section 3 of a home reversion plan illustration: “What is a home reversion plan?”

9.4.135 R Under the section heading “What is a home reversion plan?”, the prescribed text in the *home reversion plan illustration* under this heading must be included.

Section 4 of a home reversion plan illustration: “What you have told us”

9.4.136 R (1) Under the section heading "What you have told us", the *illustration* must state the minimum information a *firm* must obtain from the *customer*

(apart from details of the plan that the *customer* is interested in, which is in Section 5 of the *illustration*), and can include brief details of any other information that has been obtained from the *customer* and used to produce the *illustration*.

- (2) For an *instalment reversion plan*, where the *customer* requests an additional *illustration* showing a term of their choice, the term chosen by the *customer* must be stated in this section, together with a statement to the effect that the term is the *customer's* choice.
- (3) If the amount on which the *illustration* is based includes the amount that the *customer* wants to release less charges and other payments that have been deducted from the amount to be released:
 - (a) except where there are some fees or charges that have not been deducted, this section must include the following text after the amount to be released: " less £ [insert total amount of fees and other charges deducted from the amount to be released] for fees that have been deducted from the amount to be released - see Section 9 for details."; or
 - (b) where there are other fees or charges that the *customer* must pay that have not been deducted this section must include the following text after the amount to be released: "less £ [insert total amount of fees and other charges deducted from the amount to be released] for fees that have been deducted from the amount to be released. These and the additional fees that you need to pay are shown in Section 9."
- (4) If the amount on which the *illustration* is based includes the amount that the *customer* wants to release less insurance premiums or insurance-related charges that have been deducted from the amount to be released:
 - (a) except where there are other insurance premiums or insurance-related charges that have not been deducted, this section must include the following text after the amount to be released (which may be combined with the prescribed text in (3) if applicable): "less £ [insert amount of premium or charges, or both, to be deducted from the amount to be released] for insurance [premiums] [and] [charges] that have been deducted from the amount to be released - see Section 10 for details."; or
 - (b) where there are other insurance premiums or insurance-related charges, or both, this section must include the following text after the amount to be released (which may be combined with the prescribed text in (3) if applicable): "less £ [insert amount of premium or charges, or both, to be deducted from the amount to be released] for insurance [premiums] [and] [charges] that have been deducted from the amount to be released. These and any additional insurance [premiums] [and] [charges] that you need to pay are shown in Section 10."

- (5) If the amount on which the *illustration* is based does not involve any charges or payments being deducted from the amount to be released, but there are charges that must be paid by the *customer*, Section 4 of the *illustration* must include the following text after the amount to be released: "No fees have been deducted from this amount but the fees you need to pay are shown in Section 9. For details of any insurance charges, see Section 10."
- (6) If the *home reversion plan* on which the *illustration* is based has no charges that must be paid by the *customer*, and no insurance premiums are being deducted from the amount to be released, Section 4 of the *illustration* must include the following text after the amount to be released: "We do not charge any fees for this home reversion plan."

9.4.137 R At the end of Section 4 of the *illustration* a statement must be included making clear that changes to any of the information obtained from the *customer*, and where appropriate to the valuation of the property, could alter the details elsewhere in the *illustration* and encouraging the *customer* to ask for a revised *illustration* in this event.

9.4.138 G An example is: "An independent valuation will be carried out and this, or changes to any of the information that you have given us, could alter the information in this illustration. If this is the case please ask for a revised illustration."

Section 5 of a home reversion plan illustration: "Description of this home reversion plan"

9.4.139 R Under the section heading "Description of this home reversion plan" the *illustration* must:

- (1) state the name of the *reversion provider* providing the *home reversion plan* to which the *illustration* relates (a trading name used by the *reversion provider* may also be stated), and the name, if any, used to market the *home reversion plan*;
- (2) include a statement describing the *home reversion plan*;
- (3) if the *home reversion plan* is linked to an *investment*, and payments required from the *customer* on the *home reversion plan* will be deducted from the income from the *investment*, include a statement that this is the case;
- (4) if the *customer* is obliged to buy any *tied products* under the *home reversion plan*, include the following information:
 - (a) details of the *tied products* required;

- (b) the following text: "You are obliged to take out [insert details of the *tied product(s)*] through [insert name of *reversion provider* or *reversion intermediary*] as a condition of this home reversion plan", and if the *tied product* is an insurance policy, "Please refer to Section 10 of this illustration for further details [of the insurance policies].";
 - (5) state the term or estimated term of the *home reversion plan*;
 - (6) state very briefly any restrictions that apply to the availability of the *home reversion plan* (for example, it is only available to certain types of *customer* or cannot be transferred to another property).
- 9.4.140 R Further information about the *home reversion plan* may be included as long as it does not significantly:
- (1) duplicate information contained elsewhere in the *illustration*; and
 - (2) extend the length of this section.
- 9.4.141 G An example of further information that may be included might be that an "approval in principle" has been granted subject to valuation.
- Section 6 of a home reversion plan illustration: "Benefits"
- 9.4.142 R Under the section heading "Benefits", the *illustration* must include:
- (1) a description of the monetary amount(s), and in a box aligned to the right of the document, the monetary amount(s), that the *customer* will receive as a lump sum and/or as a regular payment;
 - (2) if the *home reversion plan* is linked to an *investment* and the payments required from the *customer* on the *home reversion plan* will be deducted from the income from the *investment*, the monetary amount of the net income the *customer* will receive;
 - (3) if applicable, statements of any other benefits, incentives and guarantees that apply to the *home reversion plan*;
 - (4) an explanation of how the monetary amount that the *customer* will receive was calculated; and
 - (5) if the *home reversion plan* is an *instalment reversion plan*:
 - (a) whether the monetary amount that the *customer* will receive is guaranteed or variable (for example, because it is linked to the performance of another *investment*);
 - (b) an explanation of what happens to the monetary amount(s) not yet paid by the *reversion provider* if the *customer* (and, in the case of a joint plan, the surviving spouse or civil partner) dies; and

- (c) if the monetary amount that the *customer* will receive is subject to the *customer* selling further parts of a qualifying interest in land to the *reversion provider*, whether these further sales are optional or compulsory.

9.4.143 G Examples that may be appropriate to describe what the *customer* will receive are:

- (1) "Subject to the independent valuation, this home reversion plan will provide you with a lump sum of £[x] [or [state number of instalments] lump sums of £[x]].";
- (2) "The amount you are releasing will automatically be used to purchase a [name of linked *investment* product] from [name of provider]. The amount is £[x]."; and
- (3) "Subject to the independent valuation, this home reversion plan will provide you with a monthly payment from the start of your plan for [state period]. This will be £[x].".

9.4.144 G An example that may be appropriate to explain how the amount the *customer* will receive was calculated is: "How we calculate this sum: Your property is worth about £[x]. Taking the information in Section 4 above into consideration, this plan will pay you [x] % [the amount, as a percentage, that the *reversion provider* will pay for the property] of the full market value of any portion of the property you decide to sell. For a lump sum of about £ [x] [insert the amount that the *customer* wants to release from the property], you will need to sell [x]% [state the proportion of the property, as a percentage, that the *customer* needs to sell to release the amount required] of your home. This will leave you with [x]% [state the proportion of the property, as a percentage, that will still be owned by the *customer*] of your property. At current values, this would be worth £[x] though the value of property may rise or fall in the future."

Section 7 of a home reversion plan illustration: "Risks - important things you must consider"

9.4.145 R The *illustration* must include under the heading "Risks - important things you must consider" brief statements and warnings on all material risks involving a *home reversion plan*, including:

- (1) prominently at the beginning of the section: "A home reversion is a complex property transaction. You should seek legal advice to ensure that you fully understand all of the implications for you and your home and for anyone who might otherwise inherit the property.";
- (2) the effect of the *customer* wanting or needing to move home (whether into another property, sheltered accommodation, long-term care or residential care), covering the circumstances in which the *home reversion plan* is portable;

- (3) the effect on the *home reversion plan* of another party moving into the property (for example on marriage or the formation of a civil partnership or where a family member acts as a carer);
- (4) the *reversion provider's* requirements for repair and maintenance of the property, including the *reversion provider's* right (if any) to enter the property to effect essential repairs, and the circumstances in which this may occur;
- (5) a warning that taking out the *home reversion plan* may affect the *customer's* tax and welfare benefits position, that tax and welfare benefits can change and that the *customer* should consider seeking further information from HM Revenue and Customs, Benefits Agency or another source of advice such as a Citizens' Advice Bureau;
- (6) a warning that under a *home reversion plan* the *customer* will cease to own any part of the property sold to the *reversion provider*, and so will neither benefit from any increase in the value of that part nor be able to leave his home to his beneficiaries on his death;
- (7) a warning (where appropriate) that the right to occupy the property will depend on the *customer* fulfilling the terms of the *home reversion plan*;
- (8) that the *illustration* contains a statement about the duration of the *home reversion plan*, and that the *customer* should ensure that the duration will be adequate given the *customer's* circumstances;
- (9) whether the *customer* can, in the future, secure borrowing from any other source on the property (and if applicable a warning that an increasing debt may mean that it may not be possible to borrow more in the future); and
- (10) if the provider is an *unauthorised reversion provider*, a warning that:
 - (a) the provider is not authorised or regulated by the *FSA*, and that key protections under the *regulatory system* will not apply; and
 - (b) the provider is not subject to the jurisdiction of the *Financial Ombudsman Service*, and that the *customer* will not be entitled to refer complaints against the provider to the *Financial Ombudsman Service*.

9.4.146 G For guidance on prominence see *MCOB 2.2.9G*.

9.4.147 R Under the heading "Risks - important things you must consider" the *illustration* must also include the following if they apply:

- (1) for an *instalment reversion plan*, a statement that if the customer dies in the early years of the plan, income payments will cease and therefore the full expected benefits of the plan will not be obtained;
- (2) (a) for an *instalment reversion plan* where there is a regular cash sum payable; and

(b) where:

- (i) the *home reversion plan* is linked to an *investment*; and
- (ii) the payments required from the *customer* on the *home reversion plan* will be deducted from the income from the *investment*; and
- (iii) the *customer* will receive a fixed net income;

a statement that inflation can erode the value of the cash sum over time; and

- (3) for all *home reversion plans*, a statement or warning with regard to any material issue not covered elsewhere in this section of the *illustration*.

Section 8 of a home reversion plan illustration: “What you will have to pay and when”

9.4.148 R The heading of the right-hand column of Section 8 of the *illustration* must state the frequency with which payments must be made by the *customer*. (For example, if payments are to be made on a monthly basis, the heading for this section must be "What you will have to pay and when" and the column must be headed "Monthly payments").

9.4.149 R All the payments in Section 8 must be calculated based on the frequency used for the purposes of the heading in the right-hand column of the section and must be shown in that column.

9.4.150 R Section 8 of the *illustration* must contain the following information:

- (1) a statement at the beginning of the section regarding rent and charges using the following text: "A home reversion plan is not a loan. Once you have paid the fees shown in section 9, you will only have to pay the charges shown below.";
- (2) the amount and frequency of annual rent, if any, to be paid by the *customer*; and
- (3) a description and the amount of other periodic charges to be paid by the *customer*.

9.4.151 R Where the payment due to the *reversion provider* is to be deducted from the income provided by a linked *investment* product (such as an annuity) such that the *customer* receives the net income, the *firm* must make a clear statement to this effect.

Section 9 of a home reversion plan illustration: “What fees must you pay?”

9.4.152 R Under the section heading "What fees must you pay?" the *illustration* must:

- (1) itemise all the fees that the *customer* must pay, excluding any charges for insurance set out in Section 10 of the *illustration*; and

- (2) include a statement regarding taxes and costs using the following text:
"You may have to pay other taxes or costs in addition to any fees shown here."
- 9.4.153 G An example of a fee that would not be included would be a fee payable by the *customer* to insure their property elsewhere (however this would need to be stated in the separate "Insurance" section).
- 9.4.154 R The fees included in this section must be itemised under the relevant sub-headings as follows:
- (1) the fees that are payable by the *customer* to the *reversion provider* must be itemised under the sub-heading "Fees payable to [name of *reversion provider*]";
- (2) the remaining fees must be itemised under the sub-heading: "Other fees"; and
- (3)
- (a) if there are no fees to be itemised in accordance with (1), the sub-heading must be retained and a statement must be included that no fees apply;
- (b) if there are no fees to be itemised in accordance with (2), the sub-heading must be retained and only the text in *MCOB* 9.4.152R(2) applies.
- 9.4.155 R The following information must be provided for each fee included in this section of the *illustration*:
- (1) a description of the fee;
- (2) the amount payable by the *customer* specified in the column on the right-hand side of the section;
- (3) for fees included under the sub-heading "Other fees", to whom the fee is payable;
- (4) when the fee is payable;
- (5) whether or not the fee is refundable, and if so, the extent to which it is refundable;
- (6) which fees (if any) are estimated and based on representative information; and
- (7) if any fee is payable after the start of the *home reversion plan* and subject to change in the future, the amount of that fee, along with a statement that this is the 'current fee'.
- 9.4.156 R (1) If any fees are to be deducted from the amount to be released, this must be stated alongside each fee.

- (2) If the *customer* has the option of deducting from the amount to be released any of the fees included in this section, the following text must be included: "If you wish you can deduct [this/these/the {type of fee}] fee(s) from the amount to be released under this home reversion plan. This will reduce the amount you get to £ [insert amount of the amount to be released minus the fee(s)]. If you want to do this, you should ask for another illustration that shows the effect of this on the amount you will get."

9.4.157 G "Other fees" will include any fee charged by a *reversion intermediary*, or another third party, for advising on or *arranging a home reversion plan*, but not commission or *procurator fees* (which are dealt with in Section 12 of the *illustration*).

9.4.158 R A *reversion provider* must provide a *tariff of charges* to the *customer*, if the *customer* so requests.

Section 10 of a home reversion plan illustration: "Insurance"

9.4.159 R (1) Under the section heading "Insurance" the *illustration* must include details of:

- (a) insurance which is a *tied product*; and
- (b) insurance which is required as a condition of the *home reversion plan* which is not a *tied product*.

(2) Under this section heading a *firm* may also provide details of insurance which is optional for the *customer* to take out.

(3) It must be clear to the *customer* which products he is required to purchase under which circumstances (for example, where both a *tied product* and a *reversion intermediary* are involved, whether the policy must be purchased from the *reversion provider* or the *reversion intermediary*).

9.4.160 R The following information must be included if the *home reversion plan* requires the *customer* to take out insurance that is a *tied product* either through the *reversion provider* or the *reversion intermediary*:

- (1) details of which insurance is a *tied product*;
- (2) the name of the *firm* imposing the requirement for the insurance;
- (3) for how long the *customer* is obliged to purchase the insurance;
- (4) an accurate quotation or a reasonable estimate of any payments the *customer* needs to make for the insurance;
- (5) where a quotation is provided for insurance on the basis of an estimated sum insured, because the actual required sum insured is unknown, the fact that it is estimated should be stated along with the level of cover that has been assumed;

- (6) details of when the *customer's* payments for such insurance change, for example, if premiums are reviewed annually; and
 - (7) where a quotation is not provided, a statement of when and how a quotation will be provided (for example, separately and as soon as possible).
- 9.4.161 G A *firm* must provide a *customer* with an accurate quotation for any *tied products* (see MCOB 5.4.23R). Where the level of cover the *firm* requires the *customer* to take up is known at the outset, then the quotation should reflect that level of cover.
- 9.4.162 R If the *home reversion plan* does not require the *customer* to take out insurance as a *tied product*, a statement must be provided under this section that the *customer* is not obliged to take out insurance through the *reversion provider* or the *reversion intermediary*.
- 9.4.163 R The following information must be included if the insurance required, as a condition of the *home reversion plan*, is not a *tied product*:
- (1) a brief statement of the type of insurance the *firm* requires; a quotation for such insurance may be included in the *illustration*, estimated where necessary; and
 - (2) if a charge is made if the *customer* does not arrange insurance through the *reversion provider* or the *reversion intermediary*, this must be stated, together with the amount of the charge and the frequency with which this charge is payable.
- 9.4.164 R A *firm* may include in the *illustration*, quotations (estimated where necessary) for any insurance products (other than the insurance products covered elsewhere in the *illustration*) that the *firm* issuing the *illustration* wishes to sell to the *customer*.
- 9.4.165 R
- (1) If any quotations for insurance are included in the *illustration* it:
 - (a) must include a brief description of the type of insurance;
 - (b) must include the total price to be paid by the *customer* in a column on the right hand side of the *illustration* under the heading "[insert frequency of payments quoted] payments"; and
 - (c) may refer the *customer* to the relevant insurance product disclosure documentation.
 - (2) If the *customer* has asked to deduct any insurance premiums or insurance-related charges from the amount released, the *illustration* must state that this is the case.
- 9.4.166 G The terms on which an insurance premium has been calculated should be presented to the *customer* in the format determined by the relevant regulatory requirements.

Section 11 of a home reversion plan illustration: “What happens if you do not want this home reversion plan any more?”

- 9.4.167 R Under the heading "What happens if you do not want this home reversion plan any more?", the *illustration* must set out whether the *customer* can cancel the *home reversion plan* and if so, explain any relevant conditions attached and costs.

Section 12 of a home reversion plan illustration: “Using a home reversion intermediary”

- 9.4.168 R Where the *illustration* is issued to a *customer* by, or on behalf of, a *reversion intermediary* Section 12 "Using a home reversion intermediary" must be included in the *illustration* and must include the following:

- (1) a clear statement of the amount payable (either directly or indirectly) by the *reversion provider* to the *reversion intermediary*, or to any third parties; and
- (2) the name of the *reversion provider* who will make the payment, the name of the *reversion intermediary* and the names of any third parties who will be paid.

- 9.4.169 R If the amount payable by the *reversion provider* to the *reversion intermediary* and to third parties is £250 or less, the *reversion intermediary* need only state that the amount of the payment is "no more than £250", unless the *customer* requests the actual amount.

- 9.4.170 R If the *reversion intermediary* will pass to the *customer* all or part of the amount payable to the *reversion intermediary* by the *reversion provider*, that fact may be stated in this section, along with the amount payable to the *customer*.

- 9.4.171 R If the *reversion provider* will make no payment to the *reversion intermediary* or any third party, this section may state that the *reversion intermediary* will receive no payment.

- 9.4.172 R The amount disclosed as payable to the *reversion intermediary* or third parties must include, but is not limited to:

- (1) any *procurator fee*; and
- (2) a cash value for any material non-cash inducements that the *reversion provider* provides, whether payable directly or indirectly.

- 9.4.173 G Any material inducements provided by a *reversion provider*, whether directly or indirectly, to a *reversion intermediary* or third party (unless the payment only reflects the cost of outsourcing work relating to the processing of home reversion applications by a *firm* unconnected to the *reversion intermediary*) must be quantified in cash terms (see *MCOB 2.3.7R*). This enables the cash values to be included in the *illustration*.

- 9.4.174 G An example of a statement which would comply with *MCOB 9.4.168R* would

be: "[name of *reversion provider*] will pay [name of *reversion intermediary*] £[x] in cash and benefits, if you proceed with this home reversion plan."

Contact details

- 9.4.175 R This section must:
- (1) follow Section 11 "What happens if you do not want this home reversion plan any more?", unless the *illustration* is issued by a *reversion intermediary*, in which case it must follow Section 12 "Using a home reversion intermediary"; and
 - (2) include the name, address and contact point of the *firm* providing the *illustration*.
- 9.4.176 G An example would be: "If you wish to discuss this home reversion plan illustration, please contact [name of individual] at [address] or call [him/her] on [telephone number]."

The following text is amended as indicated.

9.5 Disclosure at the offer stage for ~~lifetime mortgages~~ equity release transactions

- 9.5.1 R (1) *MCOB* 6.1 to *MCOB* 6.6 (with the modifications stated in *MCOB* 9.5.2R to *MCOB* 9.5.4R) apply to an *mortgage lender equity release provider* where the ~~*regulated mortgage contract home finance transaction*~~ is an *regulated lifetime mortgage contract equity release transaction*, except that those provisions that by their nature are only relevant to regulated mortgage contracts do not apply to home reversion plans (see *MCOB* 9.1.2AG).
- (2) The table in *MCOB* 9.5.2R shows how the relevant *rules* and *guidance* in *MCOB* 6 must be modified by replacing the cross-references with the relevant cross-references to *rules* and *guidance* in *MCOB* 9.4, and *MCOB* 9.5.
- (3) The table in *MCOB* 9.5.3R replaces certain *rules* and *guidance* in *MCOB* 6 with *rules* and *guidance* from this section.
- (4) The terms and expressions in the *rules* and *guidance* in *MCOB* 6 that by their nature are only connected to *regulated mortgage contracts* must be replaced with the appropriate equivalent terms and expressions for *home reversion plans* (see *MCOB* 9.3.1AG).

...

- 9.5.4 R The *illustration* provided as part of the *offer document* must meet the requirements of *MCOB* 9.4, with the following modifications:
- (1) the *illustration* must be suitably adapted and revised to reflect the fact

that the *firm* is making an offer to a *customer* and updated to reflect changes to, for example, for a lifetime mortgage the interest rate, charges, the exchange rate or the APR at the date the *illustration* is issued;

...

- (5) ~~MCOB 9.4.18R~~ (Section 1: 'About this information') is replaced by the following: "Section 1: 'About this offer document'. Under the section heading 'About this offer document', the following text must be included:
- (a) "You are not bound by the terms of this offer document until [insert relevant circumstances, including the names of any documents that must be signed. For example "you have signed the legal charge and the funds are released for your lifetime mortgage" or "you have signed the agreement to sell your property to the reversion provider".]. We are required by the Financial Services Authority (FSA) - the independent watchdog that regulates financial services - to provide you with this offer document.";
 - (b) (unless ~~MCOB 6.6.1R~~ applies the offer document is being provided in place of an illustration) "You should compare this offer document with the key facts illustration given to you before you applied for this [lifetime mortgage] [home reversion plan], to see how the details may have changed.";
- (6) Unless (b) applies, ~~MCOB 9.4.19R~~ (Section 2: 'Which service are we providing you with') is replaced with the following: "Section 2: 'Which service did we provide you with?' either:
- (a) ~~under the section heading 'Which service did we provide you with?'~~ The heading for Section 2 is replaced with 'Which service did we provide you with?' and the following text should be presented as two options each with a 'check box', one of which must be marked prominently to indicate the level of service provided to the *customer*: "We have recommended, having assessed your needs, that you take out this [lifetime mortgage] [home reversion plan]." "We have not recommended a particular [lifetime mortgage] [home reversion plan] for you. You must make your own choice whether to accept this [lifetime-mortgage] [home reversion] offer."; or
 - (b) if the service described in ~~MCOB 9.4.19R~~ (Section 2: '~~Which service are we providing you with?~~') of the earlier illustration was provided by another firm, MCOB 9.4.19R the heading for Section 2 is replaced by ~~the following:~~ "Section 2: 'Which service were you provided with?' Under the section heading '~~Which service were you provided with?~~' and the following text should be presented as two options each with a 'check box' one of which must be marked prominently to indicate the level of

service provided to the *customer*: "[name of firm] recommended that you take out this [lifetime mortgage] [home reversion plan]." "[name of firm] did not recommend a particular [lifetime mortgage] [home reversion plan], for you. You must make your own choice whether to accept this [mortgage] [home reversion] offer.";

(7) the fees recorded in the *illustration* that is part of the *offer document* ~~in accordance with MCOB 9.4.65R(1)~~ must include any fees paid or payable by the *customer*;

(8) ~~MCOB 9.4.68R(5) is replaced by the following:~~ "(where the fee is payable or has been paid to the *mortgage lender*), whether or not the fee is refundable, and if so, the extent to which it is refundable" any requirements to disclose whether a fee is refundable must be read as including fees that have already been paid;

...

(10) for a lifetime mortgage:

(a) ...

~~(11)~~ (b) ...

~~(12)~~ (c) ...

9.5.5 R For home reversion plans, the firm must provide the customer with copies of the valuation report for the property and the terms of the home reversion plan including the terms on which he will occupy the property, together with the offer document.

9.6 Disclosure at the start of the contract and after sale for ~~lifetime mortgages~~ equity release transactions

9.6.1 R (1) (a) ~~MCOB 7.1 to MCOB 7.3, MCOB 7.5 and MCOB 7.6 (with the modifications stated in MCOB 9.6.2R to MCOB 9.6.4R as modified by this section)~~ apply to a *firm* where the ~~regulated mortgage contract~~ home finance transaction is a regulated lifetime mortgage. contract.

(b) MCOB 7.1 to MCOB 7.3 (as modified by this section) apply to a firm where the home finance transaction is a home reversion plan, except that those provisions that by their nature are only relevant to regulated mortgage contracts do not apply to home reversion plans (see MCOB 9.1.2AG).

(3) ...

...

(5) The terms and expressions in MCOB 7 that by their nature are only connected to regulated mortgage contracts must be replaced with the

appropriate equivalent terms and expressions for *home reversion plans* (see MCOB 9.3.1AG).

...

Table of rules in *MCOB 7* which do not apply in relation to ~~*regulated lifetime mortgage contracts*~~:

...

9.7 Disclosure at the start of the contract: lifetime mortgages

...

9.8 Disclosure after sale: lifetime mortgages

...

After *MCOB 9.8* insert the following provisions. This text is new and it is not underlined.

9.9 Disclosure after sale: instalment reversion plans

Provision of statements

- 9.9.1 R (1) In relation to an *instalment reversion plan*, a *firm* must provide the *customer* with a statement at least once a year (or, in relation to the first statement, within the first 13 months of the plan term):
- (a) covering the *instalment reversion plan* and any *tied product* purchased through the *firm*; and
 - (b) giving information of any other product purchased through the *firm* where the payments for those products are combined with amounts released under the *instalment reversion plan*.
- (2) A *firm* need not provide a statement if it has provided an *offer document* to the *customer* in respect of the *instalment reversion plan* within the previous year.
- 9.9.2 R Where a *tied product* is operated separately from the *instalment reversion plan*, for example where the premiums on a tied insurance product are not combined with amounts released under the *instalment reversion plan*, the statement relating to the *tied product* may be provided in a separate communication.
- Annual statement: content
- 9.9.3 R The statement must contain:
- (1) details of the following transactions during the period since the last statement (or, where it is the first statement, since the *customer*

entered into the *instalment reversion plan*):

- (a) the date and amount of each payment made by the *reversion provider*; and
 - (b) any amounts charged under the *instalment reversion plan* during the statement period, including fees and any amounts due in relation to *tied products*;
- (2) information at the date the statement is issued on:
- (a) the amount owed by the *reversion provider* to the *customer* under the *instalment reversion plan*;
 - (b) if the amount to be received by the *customer* under the *instalment reversion plan* is linked to the performance of another investment, the amount to be received (or estimated amount likely to be received) by the *customer*;
 - (c) the actual remaining term of the *instalment reversion plan* (but if the term of the *instalment reversion plan* is open-ended this should be clearly stated);
 - (d) where applicable, the date on which the requirement for the *customer* to purchase any *tied products* from the *firm* ends; and
 - (e) the proportion of the property that is owned by the *reversion provider* and *reversion occupier* respectively.

Annual statement: additional content if tariff of charges has changed

- 9.9.4 R If the *tariff of charges* has changed since the last annual statement was sent to the *customer* (or, where it is the first statement, since the *customer* entered into the *instalment reversion plan*) and a *firm* has not already sent a revised *tariff of charges*, it must include one with the annual statement.

Event-driven information: material changes

- 9.9.5 R A *firm* must give the customer reasonable notice of any material change by the *firm* to the terms of the *instalment reversion plan*, where the change is permitted without the *customer's* prior consent.

Responsibilities of reversion providers and administrators

- 9.9.6 R The *reversion administrator* and *reversion provider* may agree who will be responsible for producing and providing to the *customer* the statement and information required by this section.
- 9.9.7 R The *reversion administrator* is solely responsible for producing and providing to the *customer* the information required by this section if the provider is an *unauthorised reversion provider*.

Further releases



- 9.9.8 R If the *customer* wants to release further equity from the property through a *home reversion plan*, the *firm* must treat this transaction as a new *home reversion plan*, even if the parties to the arrangement are the same.

After *MCOB* Annex 1R insert the following provisions. This text is new and it is not underlined.

MCOB 9 Annex 2R

The illustration: table of contents, prescribed text and prescribed section headings and sub-headings.

1. This annex forms part of *MCOB* 9.4.2R.
2. Text in square brackets indicates instructions that must not be included in the *illustrations* provided to *customers*.

	<p style="font-size: 1.2em;">about this home reversion plan</p>
<p>Personalised information on a home reversion plan for [insert <i>customer's</i> name (see <i>MCOB</i> 9.4.17R(1))]</p> <p>Date produced: [insert date (see <i>MCOB</i> 9.4.17R(2))]</p> <p>[Insert details of how long the <i>illustration</i> is valid for, and, if appropriate, when the plan needs to commence by (see <i>MCOB</i> 9.4.17R(3))]</p>	 Alpha Beta Properties

This is not a legally binding offer of a home reversion plan and it does not oblige [insert name of the *reversion provider*] to provide you with the home reversion plan described in this illustration.

1. About this information
<p>We are required by the Financial Services Authority (FSA) - the independent watchdog that regulates financial services - to provide you with this illustration.</p> <p>All firms selling home reversion plans are required to give you illustrations like this one, containing similar information presented in the same way.</p> <p>Ask for other illustrations if you want to compare this home reversion plan with other products designed to release equity from your home.</p> <p>The FSA provides useful information on ways of releasing equity from your home in a</p>

booklet called 'Raising money from your home'. You can get this free through the FSA website www.fsa.gov.uk/consumer or by calling 0845 456 1555.

2. Which service are we providing you with?

We recommend, having assessed your needs, that you take out this home reversion plan.

We are not recommending a particular home reversion plan for you. However, based on your answers to some questions, we are giving you information about this home reversion plan so that you can make your own choice or find out about other ways in which you may be able to release equity from your home.

3. What is a home reversion plan?

How home reversions work

- A home reversion is an arrangement designed to run for the rest of your life or until the occurrence of certain events. You sell all or part of your home to give you a lump sum and/or an income. **You no longer own your home** (or the part of it that you have sold) but you have the right to live there, for the rest of your life or until the occurrence of certain events, [insert capacity in which the *customer* will occupy the premises, e.g. “as the tenant of the firm or person who bought it”]. We call this person or firm “the reversion provider”. At the end of the plan (this is explained below), the property is put up for sale by the provider. If you sold only part of your home, the value of the part you did not sell is paid to you or your estate.
- The amount you receive for your property, or the portion of it that you sell, will normally be less than its market value. This will reflect factors such as your age, the value of your property and how much property prices are expected to change in the future.
- You may be required to pay rent. This is usually a token sum but it may be more.

Income Plans

- Some home reversions give you an income instead of, or as well as, a lump sum. If an income option is available, your adviser will tell you how it would work and how much you would receive and for how long.

When does a home reversion plan end?

- This depends on the terms of the plan but will usually include death or where you (or, in the case of a joint plan, the surviving spouse) move out permanently, for example into

long-term residential care. The property will be put up for sale by the provider and the value of any part you do not sell to the provider will be paid to you or your estate. See also "Cancelling a home reversion", below.

Moving home

- Not all home reversion plans can be transferred to a new property, if you should want to move home in the future. Section 5 will tell you if this plan can be transferred. You may incur costs with such a transfer, such as fees for a solicitor or surveyor. If you think you may want to move home in the future, check to see if the plan can be transferred before taking out the plan.

Cancelling a home reversion plan

- A home reversion plan is designed to run for the rest of your life or until the occurrence of certain events. However, if you decide that you no longer want the plan, it may be possible to buy back the property but this is likely to be at the full market rate at the time and may cost you more than you received for it under the reversion plan. Section 11 will tell you if you can buy back your property.

4. What you have told us

See MCOB 9.4.136R – MCOB 9.4.138G

5. Description of this home reversion plan

See MCOB 9.4.139R – MCOB 9.4.141G

6. Benefits

See MCOB 9.4.142R – MCOB 9.4.144G

£X

7. Risks -important things that you must consider

See MCOB 9.4.145R – MCOB 9.4.147R

8. What you will have to pay and when	[insert frequency of payments – see <i>MCOB 9.4.148R</i>]
See <i>MCOB 9.4.148R – MCOB 9.4.151R</i>	£X

9. What fees must you pay?	Fee amount
See <i>MCOB 9.4.152R – MCOB 9.4.158R</i>	[insert amount of each fee]

10. Insurance	[insert frequency of payments for premium quoted payments]
See <i>MCOB 9.4.159R– MCOB 9.4.166G</i>	£X

11. What happens if you do not want this home reversion plan any more?
See <i>MCOB 9.4.167R</i>

12. Using a home reversion intermediary
<u>This section is required only when the <i>illustration</i> is provided to a <i>customer</i> by a <i>reversion intermediary</i>. If the <i>illustration</i> is provided by a <i>reversion provider</i>, this section must be removed.</u>
See <i>MCOB 9.4.168R – MCOB 9.4.174G</i>

Contact details

See *MCOB 9.4.175R* and *MCOB 9.4.176G*

Annual percentage rate

10.1 Application

10.1.1 R This chapter applies to a *firm* which, under *rules* elsewhere in *MCOB*, is required to calculate an *annual percentage rate of charge (APR)* or is required to use an approach equivalent to that set out in this chapter in calculating a comparative cost measure equivalent to an APR.

...

Responsible lending, and responsible financing of home purchase plans

11.1 Application

Who?

11.1.1 R This chapter applies to a *firm* in a category listed in column (1) of the table in *MCOB* 11.1.2 in accordance with column (2) of that table.

11.1.2 R Table

This table belongs to *MCOB* 11.1.1R

(1) Category of firm	(2) Applicable section
...	...
<u>home purchase provider</u>	<u>MCOB 11.1, MCOB 11.2, MCOB 11.3.1R(1) and MCOB 11.3.2R</u>

What?

11.1.3 R This chapter applies if a *firm*:

(1) *enters into a regulated mortgage contract or home purchase plan* with a *customer*; or

(2) makes a further advance or varies an existing *regulated mortgage contract or home purchase plan* to make a further advance to a *customer*.

11.2 Purpose

11.2.1 G ~~Principle 6 requires a firm to pay due regard to the interests of its customers and treat them fairly.~~ This chapter reinforces *Principle 6* by requiring a firm in the circumstances described in *MCOB 11.1.3R* to take account of a customer's ability to repay before deciding to enter into a ~~regulated mortgage contract~~, or make a further advance on, a *regulated mortgage contract* or *home purchase plan*. ...

11.3 Responsible lending, and responsible financing of home purchase plans

Customer's ability to pay

11.3.1 R (1) A firm must be able to show that before deciding to enter into a ~~regulated mortgage contract with a customer~~, or making a further advance on, a *regulated mortgage contract* or *home purchase plan*, account was taken of the customer's ability to repay.

(2) A ~~firm~~ *mortgage lender* must make an adequate record to demonstrate that it has taken account of the customer's ability to repay ...

Self-certification of income

11.3.2 R In taking account of a customer's ability to repay a loan for the purposes of ~~MCOB 11.3.1R(1)~~, a firm may rely upon self-certification of income ...

...

Responsible lending policy

11.3.4 R (1) A ~~firm~~ *mortgage lender* must put in place, and operate in accordance with, a written policy setting out the factors it will take into account in assessing a customer's ability to repay.

(2) A ~~firm~~ *mortgage lender* must make and keep up-to-date an adequate record of the policy in (1). When the policy is changed, a record of the previous policy must be retained for a year from the date of change.

...

Charges

12.1 Application

12.1.1 R Who?

This chapter applies to a firm in a category listed in column (1) of the table in *MCOB 12.1.2R* in accordance with column (2) of that table.

12.1.2 R This table belongs to *MCOB 12.1.1R*

(1) Category of firm	(2) Applicable section
<i>mortgage lender</i>	whole chapter except <i>MCOB 12.1.6R</i> and <i>MCOB 12.7</i>
<i>mortgage adviser</i> <i>mortgage arranger</i>	<i>MCOB 12.1</i> (except <i>MCOB 12.1.6R</i>), <i>MCOB 12.2</i> and <i>MCOB 12.5.2R</i>
<i>mortgage administrator</i> a firm that was a <i>mortgage lender</i> or <i>mortgage administrator</i> before the sale of the <i>repossessed</i> property	<i>MCOB 12.1</i> (except <i>MCOB 12.1.6R</i>), <i>MCOB 12.2</i> , <i>MCOB 12.4</i> and <i>MCOB 12.5.2R</i>
<i>home purchase provider</i> <i>home purchase adviser</i> <i>home purchase arranger</i> <i>home purchase administrator</i> a firm that was a <i>home purchase provider</i> or <i>home purchase administrator</i> before the sale of a <i>repossessed</i> property	<i>MCOB 12.1.1R</i> to <i>MCOB 12.1.3R</i> and <i>MCOB 12.7</i>
<i>reversion provider</i>	<i>MCOB 12.1</i> , <i>MCOB 12.2</i> and <i>MCOB 12.5.1R</i> to <i>MCOB 12.5.3G</i>
<i>reversion adviser</i> <i>reversion arranger</i> <i>reversion administrator</i> a firm that was a <i>reversion provider</i> or <i>reversion administrator</i> before the termination of a <i>home reversion plan</i>	<i>MCOB 12.1</i> , <i>MCOB 12.2</i> , <i>MCOB 12.5.2R</i> and <i>MCOB 12.5.3G</i>

What?

12.1.3 R This chapter applies where a *firm*:

- (1) *enters into*, or makes a further advance on, a ~~*regulated mortgage contraethome finance transaction*~~; or
- (2) *administers a regulated mortgage contraethome finance transaction*; or
- (3) *arranges or advises on a regulated mortgage contraethome finance*

transaction or a variation to the terms of a *regulated mortgage contract* or *home finance transaction*.

12.1.4 R The arrears charges and excessive charges requirements in ~~MCOB 12.4 (Arrears charges)~~ and ~~MCOB 12.5 (Excessive charges)~~ this chapter will continue to apply to a *firm* after a *regulated mortgage contract* has come to an end following the sale of a *repossessed* property. The excessive charges requirements will continue to apply to a *firm* after a *home reversion plan* has ended. ...

12.1.5 G The *FSA* will expect a *firm* to ensure that charges made to a *customer* arising from the sale of a *repossessed* property and charges arising in relation to a *mortgage sale shortfall debt* are not excessive and are subject to the same considerations as apply with respect to *arrears* charges under this chapter.

12.1.6 R This chapter does not apply to a *firm* carrying on *reversion activities* in respect of a *customer* acting in his capacity as an *unauthorised reversion provider*.

12.2 Purpose

12.2.1 G (1) ... A *firm* is also under an obligation, as a consequence of ~~MCOB 5 (Pre application disclosure)~~, ~~MCOB 6 (Disclosure at the offer stage)~~, ~~MCOB 7 (Disclosure at start of contract and after sale)~~ and ~~MCOB 9 (Lifetime mortgages: product disclosure)~~ this sourcebook's disclosure requirements, to make charges transparent to *customers*.
...

(2) The level of charges under a *regulated mortgage contract* or *home reversion plan* is not typically a matter for regulation. However, ... This chapter considers four specific circumstances, where:

...

(c) the charges (including rates of interest) imposed on a *customer* under a *regulated mortgage contract* or *home reversion plan* are excessive and contrary to the *customer's* interests; and

(d) the charges made to a *customer* in connection with a *firm* ~~entering into or making a further advance on a regulated mortgage contract~~ or ~~administering a regulated mortgage contract~~, or ~~arranging or advising on a regulated mortgage contract~~ or a variation to the terms of a *regulated mortgage contract*, making a further advance on, administering, arranging or advising on a regulated mortgage contract or home reversion plan, or arranging or advising on a variation to the terms of a regulated mortgage contract or home reversion plan are excessive.

...

12.3 Early repayment charges: regulated mortgage contracts

...

12.4 Arrears charges: regulated mortgage contracts

...

12.5 Excessive charges: regulated mortgage contracts and home reversion plans

12.5.1 R A *firm* must ensure that any *regulated mortgage contract* or *home reversion plan* that it *enters into* does not impose, and cannot be used to impose, excessive charges upon a *customer*.

12.5.2 R A *firm* must ensure that its charges to a *customer* in connection with the *firm entering into* ~~or making a further advance on a regulated mortgage contract or administering a regulated mortgage contract or arranging or advising on a regulated mortgage contract~~ or a variation to the terms of a *regulated mortgage contract*, making a further advance or further release on, *administering, arranging or advising on a regulated mortgage contract or home reversion plan, or arranging or advising on a variation to the terms of a regulated mortgage contract or home reversion plan* are not excessive.

...

12.5.4 G ~~*Firms*~~ *Mortgage lenders* are also subject to requirements relating to responsible lending (see *MCOB 11*).

...

After MCOB 12.6 insert the following new section. The inserted text is not underlined.

12.7 Home purchase plans

Charges

12.7.1 G The *FSA* believes that *Principle 7* requires charges imposed by a *firm* on *customers* to be transparent and that imposing unfair or excessive charges is inconsistent with *Principle 6*.

Note: A *firm* should also have regard to its obligations under the *Unfair Terms Regulations* and may find material on the *FSA* website concerning the *FSA's* consumer protection powers useful.

...

Arrears and repossessions: regulated mortgage contracts and home purchase plans

13.1 Application

Who?

13.1.1 R This chapter applies to a *firm* in a category listed in column (1) of the table in *MCOB 13.1.2R* in accordance with column (2) of that table.

13.1.2 R Table: This table belongs to *MCOB 13.1.1R*

(1) Category of firm	(2) Applicable section
<i>mortgage lender</i> , and a <i>firm</i> that was a <i>mortgage lender</i> before the sale of a <i>repossessed</i> property	<i>MCOB 13.1 – MCOB 13.3</i> , except for <i>MCOB 13.3.9R</i> and <i>MCOB 13.3.114G</i>
<i>mortgage administrator</i> , and a <i>firm</i> that was a <i>mortgage administrator</i> before the sale of a <i>repossessed</i> property	whole chapter <u>except for</u> <i>MCOB 13.8</i>
<u><i>home purchase provider</i>, and a <i>firm</i> that was a <i>home purchase provider</i> before the sale of a <i>repossessed</i> property</u>	As for a <i>mortgage lender</i>
<u><i>home purchase administrator</i>, and a <i>firm</i> that was a <i>home purchase administrator</i> before the sale of a <i>repossessed</i> property</u>	As for a <i>mortgage lender</i> , plus: <i>MCOB 13.6</i> and <i>MCOB 13.8</i> ; and <i>MCOB 13.4</i> and <i>MCOB 13.5</i> in accordance with <i>MCOB 13.8</i>

What?

13.1.3 R This chapter applies with respect to *administering a regulated mortgage contract*, *administering a home purchase plan* and administering a *mortgagesale shortfall-debt*.

13.1.4 R The requirements in ~~*MCOB 13*~~ this chapter will continue to apply to a *firm* after a *regulated mortgage contract* or *home purchase plan* has come to an end following the sale of a *repossessed* property. References in this chapter to "*customer*" will include references to a former *customer* as appropriate.

13.1.5 G The *FSA* expects a *firm* to treat a ~~*mortgagesale shortfall-debt*~~ in the same way that it treats a payment shortfall.

...

13.1.7 G If a *firm* has entered into more than one *regulated mortgage contract* or *home purchase plan* with the same *customer* ~~secured on~~ relating to the same property, the *firm* may treat them all of the ~~*regulated mortgage contracts*~~ as

one for the purposes of ~~MCOB 13~~this chapter.

13.2 Purpose

13.2.1 G ~~Principle 6 requires a firm to pay due regard to the interests of customers and treat them fairly.~~ This chapter amplifies ~~this principle~~Principle 6 in respect of the information and service provided to *customers* who have payment difficulties or face a ~~mortgage sale shortfall debt~~.

13.2.2 G There may be occasions where a *customer* enters into a *regulated mortgage contract* or home purchase plan with no intention of meeting his payment obligations. Where the intention is to defraud, this chapter does not prevent early action to recover ~~the debt~~sums due.

13.3 Dealing fairly with customers in arrears: policy and procedures

13.3.1 R (1) A *firm* must deal fairly with any *customer* who:

(a) is in *arrears* on a *regulated mortgage contract* or home purchase plan; ~~or~~

(b) has a ~~mortgage sale shortfall debt~~; or

(c) is otherwise in breach of a home purchase plan.

(2) ...

Policy and procedures: content

13.3.2 E (1) A *firm* should ensure that its written policy and procedures include:

(a) using reasonable efforts to reach an agreement with a *customer* over the method of repaying any payment shortfall or ~~mortgage sale shortfall debt~~, in the case of the former having regard to the desirability of agreeing with the *customer* an alternative to taking possession of the property;

(b) liaising, if the *customer* makes arrangements for this, with a third party source of advice regarding the payment shortfall or ~~mortgage sale shortfall debt~~;

(c) adopting a reasonable approach to the time over which the payment shortfall or ~~mortgage sale shortfall debt~~ should be repaid, having particular regard to the need to establish, where feasible, a payment plan which is practical in terms of the circumstances of the *customer*;

...

- (2) Contravention of ~~MCOB 13.3.2E(1)~~ may be relied on as tending to show contravention of *MCOB 13.3.1R(2)*.

...

- 13.3.4 G In relation to using reasonable efforts to reach an agreement with a customer over the method of repaying any payment shortfall or sale shortfall~~MCOB 13.3.2E(1)(a)~~, *customers*:
- (1) should be given a reasonable period of time to consider any proposals for payment that are put to them; in addition, and depending on the individual circumstances, a *firm* may wish to do one or more of the following in relation to the regulated mortgage contract or home purchase plan with the agreement of the *customer*:
- (a) extend ~~the~~its term of the ~~regulated mortgage contract~~; or
- (b) change ~~the~~its type of the ~~regulated mortgage contract~~; or
- (c) defer payment of interest due on the *regulated mortgage contract* or ~~mortgage shortfall debt~~ of sums due under the home purchase plan (including, in either case, on any sale shortfall); or
- (d) treat the payment shortfall as if it was part of the original amount provided~~borrowed~~;
- (2) should be given adequate information to understand the implications of any proposed arrangement; one approach may be to provide information on the new terms in line with the ~~requirements for annual statements (see MCOB 7.5.3R)~~annual statement provisions.
- 13.3.5 G ~~MCOB 13.3.2E(1)(a) means that a firm~~In relation to using reasonable efforts to reach an agreement with a customer over the method of repaying any payment shortfall or sale shortfall, a mortgage lender should not automatically capitalise *arrears*.
- 13.3.6 G In relation to ~~MCOB 13.3.2E(1)(e)~~adopting a reasonable approach to the time over which the payment shortfall or sale shortfall should be repaid, the *FSA* takes the view that the determination of a reasonable repayment period will depend upon the individual circumstances. In appropriate cases this will mean that repayments are arranged over the remaining term ~~of the regulated mortgage contract~~.
- 13.3.7 G In relation to ~~MCOB 13.3.2E(1)(d)~~granting a customer's request for a change to the payment date, a term ~~in a regulated mortgage contract~~ that purported to allow a *firm* to change the payment date unilaterally might in any event contravene the *Unfair Terms Regulations*.

13.3.8 G *Firms* that propose to outsource aspects of *customer* relationships (including ~~debt collection of debts or any other sums due~~) should note that, ~~as set out in SYSC 3.2.4G(1), a firm cannot contract out its regulatory obligations and the FSA will continue to hold them responsible for the way in which this work is carried on.~~

Record keeping: arrears and repossessions

13.3.9 R (1) A ~~firm~~ *mortgage lender or administrator* must make and retain an adequate record of its dealings with a *customer* whose account is in *arrears* or who has a ~~mortgage sale shortfall debt~~, which will enable the *firm* to show its compliance with ~~MCOB 13.4 (Arrears: provision of information to the customer), MCOB 13.5 (Dealing with a customer in arrears or with a mortgage shortfall) and MCOB 13.6 (Repossessions)~~ this chapter.

(2) A ~~firm~~ *mortgage lender or administrator* must retain the record required by (1) for a year from the date on which the relevant payment shortfall or ~~mortgage sale shortfall debt~~ was cleared.

...

13.4 Arrears: provision of information to the customer of a regulated mortgage contract

...

13.5 Dealing with a customer in arrears or with a ~~mortgage sale shortfall debt~~ on a regulated mortgage contract

Statements of charges

13.5.1 R Where an account is in *arrears*, and the payment shortfall or ~~mortgage sale shortfall debt~~ is attracting charges, a *firm* must ...

13.5.2 G ...

(3) ... the *firm* will still need to send the *customer* a written statement ~~in accordance with MCOB 13.5.1R~~ if the payment shortfall or ~~mortgage sale shortfall debt~~ is attracting charges.

(4) ...

...

13.6 Repossessions

13.6.1 R A *firm* must ensure that, whenever a property is *repossessed* (whether voluntarily or through legal action) and it administers the *regulated mortgage contract* or home purchase plan in respect of that property, steps are taken to:

- (1) ...
- (2) obtain the best price that might reasonably be paid, taking account of factors such as market conditions as well as the continuing increase in the amount owed by the *customer* ~~under the regulated mortgage contract~~.

...

If the proceeds of sale are less than the ~~debt~~amount due

13.6.3 R A *firm* must ensure that, as soon as possible after the sale of a *repossessed* property, if the proceeds of sale are less than the amount ~~of the customer's debt~~due under the regulated mortgage contract or home purchase plan, the *customer* is informed in a *durable medium* of:

- (1) the mortgagesale shortfall-debt; and
- (2) where relevant, the fact that the mortgagesale shortfall-debt may be pursued by another company (for example, a mortgage indemnity insurer).

13.6.4 R (1) If the decision is made to recover the mortgagesale shortfall-debt, the *firm* must ensure that the *customer* is notified of this intention.

(2) The notification referred to in (1) must take place within five years of the date of the sale (if the regulated mortgage contract or home purchase plan is subject to Scottish law) or within six years (in all other cases).

13.6.5 G ~~MCOB 13.6.4R does not require a firm~~A firm is not required to recover a mortgagesale shortfall-debt. A *firm* may not wish to recover the mortgagesale shortfall-debt in some situations, for example where the sums involved make action for recovery unviable.

If the proceeds of sale are more than the ~~debt~~amount due

13.6.6 R A *firm* must ensure that, on the sale of a *repossessed* property, if the proceeds of sale are more than the amount ~~of the customer's debt~~due under the regulated mortgage contract or home purchase plan, reasonable steps are taken, as soon as possible after the sale, to inform the *customer* in a *durable medium* of the surplus and, subject to the rights of any subsequent mortgage or charge holders, to pay it to him.

...

After MCOB 13.7 insert the following new section. The inserted text is not underlined.

13.8 Home purchase plans

Dealing fairly with customers in arrears: policy and procedures

Note: The rules on establishing and applying a policy and procedures for dealing fairly with *customers in arrears* apply (see *MCOB 13.3*).

Arrears: provision of information to the customer

13.8.1 R If a *customer* falls into *arrears*, a *firm* must provide the *customer* with adequate information about the *arrears* in a *durable medium*:

- (1) as soon as practicable after becoming aware of that fact;
- (2) at quarterly intervals; and
- (3) before commencing action for *repossession*.

13.8.2 G A *firm* may want to refer to the provisions on the information to be provided to a mortgage customer in relation to *arrears* for guidance (see *MCOB 13.4* and *MCOB 13.5*).

Repossessions

Note: The rules regarding repossessions apply (see *MCOB 13.6*).

MCOB Transitional Provisions

MCOB TP 1.1

Rows 1 – 8 are deleted. Insert the following text.

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

3	[deleted]		[deleted]	Expired	[deleted]
4	[deleted]		[deleted]	Expired	[deleted]
5	[deleted]		[deleted]	Expired	[deleted]
6	[deleted]		[deleted]	Expired	[deleted]
7	[deleted]		[deleted]	Expired	[deleted]
8	[deleted]		[deleted]	Expired	[deleted]
9	...	...	...	...	...
10	...	...	...	...	...

MCOB TP 2

Transitional Provisions for home purchase plans and home reversion plans

<u>(1)</u>	<u>(2) Material to which the transitional provision applies</u>	<u>(3)</u>	<u>(4) Transitional provision</u>	<u>(5) Transitional provision: dates in force</u>	<u>(6) Handbook provision: coming into force</u>
<u>1</u>	<u>Every rule in MCOB unless the context otherwise requires and subject to any more specific transitional provision relating to the matter.</u>	<u>R</u>	<u>(1) If, in relation to home purchase activities, reversion activities, or the communication of a financial promotion of a home purchase plan or home reversion plan, the application of any provision in MCOB is dependent on the occurrence of a series of events, the provision applies with respect to the events that occur on or after 6 April 2007.</u>	<u>From 6 April 2007 for six months.</u>	<u>6 April 2007</u>
<u>2</u>		<u>G</u>	<u>(1) For example, if a customer submits an application for a home</u>		

			<p><u>purchase plan or a home reversion plan before 6 April 2007, a firm responding to that application on or after 6 April 2007 will not be required to comply with the relevant disclosure requirements in MCOB 5. However, the firm will have to comply with the requirements in MCOB when taking any further action (such as issuing an offer) regarding the application on or after 6 April 2007.</u></p> <p><u>(2) In relation to a home reversion plan, an offer document may have to be issued under transitional provision 1R even though no illustration has been given out (because that part of the transaction occurred before 6 April 2007). In such cases, the suitably adapted illustration required as part of an offer document would need to omit:</u></p> <p><u>(a) the required text regarding comparing the offer document with the illustration previously given to the customer (see MCOB 6.4.4R(4)(b)); and</u></p> <p><u>(b) Section 2 of the illustration entirely.</u></p>		
<u>3</u>		<u>G</u>	<p><u>MCOB applies to home purchase plans and home reversion plans entered into on or after 6 April 2007. PERG 14 contains guidance on the variation of plans entered into before 6 April 2007.</u></p>		

4	<u>MCOB 3.8A.3R(1)</u>	R	(1) <u>A non-real time financial promotion of a home reversion plan communicated:</u> (a) <u>in a directory (or similar publication) that is updated annually;</u> (b) <u>otherwise than in (a); on or after 6 April 2007 where the deadline for submission for communication was before that date does not need to describe a home reversion plan as a 'home reversion plan'.</u>	(1)(a) <u>from the later of 6 April 2007 or the date of first communication, for one year;</u> (1)(b) <u>from 6 April 2007 for three months.</u>	<u>6 April 2007</u>
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...

MCOB Schedule 1

Record keeping requirements

...

Handbook reference	Subject of record	Contents of record	When record must be made	Retention period
...
<i>MCOB 8.5.22R(1)(a)</i>	Suitability	Details of the customer information obtained, including the <i>customer's</i> needs and circumstances, for the purpose of assessing the suitability of a <i>regulated lifetime mortgage contract equity release transaction</i>	When the <i>personal recommendation</i> is made	Three years
...

<p><i>MCOB 9.3.1R</i></p>	<p>Each <i>illustration</i> a <i>firm</i> issues to a <i>customer</i> where the <i>customer</i> applies for that particular <i>regulated lifetime mortgage contract equity release transaction</i></p>	<p>The Key-keyfacts illustrations (KFI) issued</p>	<p>The date the <i>customer</i> applies for the particular <i>regulated lifetime mortgage contract equity release transaction</i></p>	<p>One year</p>
<p><i>MCOB 9.3.1R</i></p>	<p>Each KFI retained</p>	<p>Detail of: the date the KFI was issued; the date on which the <i>customer</i> applied for the <i>regulated lifetime mortgage contract equity release transaction</i>; and the medium through which the KFI was issued</p>	<p>The date the <i>customer</i> applies for the particular <i>regulated lifetime mortgage contract equity release transaction</i></p>	<p>One year</p>
<p>...</p>	<p>...</p>	<p>...</p>	<p>...</p>	<p>...</p>

Annex B

Amendments to the Mortgages and Home Finance: Conduct of Business sourcebook (MCOB)

All references in the provisions of MCOB in column (1) of the following table to the expression (or a related expression) in column (2) are changed to the expression (or the equivalent related expression) in column (3).

(1)	(2)	(3)
1.2.11G	<i>qualifying credit promotions</i>	<i>financial promotion of qualifying credit or of a home reversion plan</i>
3.1.8G	<i>qualifying credit promotion</i>	<i>financial promotion of qualifying credit</i>
3.1.9R	<i>qualifying credit promotion</i>	<i>financial promotion</i>
3.1.12G	<i>qualifying credit promotion</i>	<i>financial promotion of qualifying credit</i>
3.2.1G	<i>qualifying credit promotion</i>	<i>financial promotion of qualifying credit</i>
3.2.2G	<i>qualifying credit promotion</i>	<i>financial promotion</i>
3.2.5R	<i>qualifying credit promotion</i>	<i>financial promotion</i>
3.2.7R	<i>qualifying credit promotion</i>	<i>financial promotion</i>
3.2.8G	<i>qualifying credit promotion</i>	<i>financial promotion</i>
3.3.5R	<i>qualifying credit promotion</i>	<i>financial promotion of qualifying credit</i>
3.3.6R	<i>qualifying credit promotion</i>	<i>financial promotion</i>
3.3.7R	<i>qualifying credit promotion</i>	<i>financial promotion</i>
3.5.3G	<i>qualifying credit promotion</i>	<i>financial promotion</i>
3.5.4G	<i>qualifying credit promotion</i>	<i>financial promotion</i>
3.5.5R	<i>real time qualifying credit promotion</i>	<i>real time financial promotion</i>
	<i>qualifying credit promotion</i>	<i>financial promotion</i>
3.5.6R	<i>qualifying credit promotion</i>	<i>financial promotion</i>
3.6.1R	<i>non-real time qualifying credit promotion</i>	<i>non-real time financial promotion</i>

3.6.3R	<i>non-real time qualifying credit promotion</i>	<i>non-real time financial promotion</i>
3.6.4E	<i>non-real time qualifying credit promotion</i>	<i>non-real time financial promotion</i>
	<i>qualifying credit promotion</i>	<i>financial promotion of qualifying credit</i>
3.6.5G	<i>non-real time qualifying credit promotion</i>	<i>non-real time financial promotion</i>
	<i>qualifying credit promotion</i>	<i>financial promotion</i>
3.6.8R	<i>qualifying credit promotion</i>	<i>financial promotion</i>
3.6.9R	<i>non-real time qualifying credit promotion</i>	<i>non-real time financial promotion</i>
3.6.10G	<i>non-real time qualifying credit promotion</i>	<i>non-real time financial promotion</i>
3.6.11R	<i>non-real time qualifying credit promotion</i>	<i>non-real time financial promotion</i>
3.6.15R	<i>non-real time qualifying credit promotion</i>	<i>non-real time financial promotion</i>
3.6.17R	<i>non-real time qualifying credit promotion</i>	<i>non-real time financial promotion</i>
3.6.18G	<i>non-real time qualifying credit promotion</i>	<i>non-real time financial promotion</i>
3.6.21G	<i>qualifying credit promotion</i>	<i>financial promotion</i>
3.6.22R	<i>non-real time qualifying credit promotion</i>	<i>non-real time financial promotion</i>
3.6.24G	<i>qualifying credit promotion</i>	<i>financial promotion</i>
3.6.25R	<i>non-real time qualifying credit promotion</i>	<i>non-real time financial promotion of qualifying credit</i>
3.6.26R	<i>non-real time qualifying credit promotion</i>	<i>non-real time financial promotion of qualifying credit</i>
3.6.27R	<i>non-real time qualifying credit promotion</i>	<i>non-real time financial promotion of qualifying credit</i>
3.7.1R	<i>unsolicited real time qualifying credit promotion</i>	<i>unsolicited real time financial promotion</i>

	<i>real time qualifying credit promotion</i>	<i>real time financial promotion</i>
	<i>solicited real time qualifying credit promotion</i>	<i>solicited real time financial promotion</i>
	<i>qualifying credit promotion</i>	<i>financial promotion</i>
3.7.2G	<i>real time qualifying credit promotion</i>	<i>real time financial promotion</i>
3.7.4G	<i>unsolicited real time qualifying credit promotion</i>	<i>unsolicited real time financial promotion</i>
	<i>qualifying credit promotion</i>	<i>financial promotion</i>
	<i>solicited real time qualifying credit promotion</i>	<i>solicited real time financial promotion</i>
3.8.1G	<i>unsolicited real time qualifying credit promotion</i>	<i>unsolicited real time financial promotion of qualifying credit</i>
	<i>solicited real time qualifying credit promotion</i>	<i>solicited real time financial promotion</i>
	<i>qualifying credit promotion</i>	<i>financial promotion</i>
3.8.2R	<i>real time qualifying credit promotion</i>	<i>real time financial promotion of qualifying credit</i>
	<i>qualifying credit promotion</i>	<i>financial promotion</i>
3.8.4G	<i>real time qualifying credit promotion</i>	<i>real time financial promotion of qualifying credit</i>
	<i>qualifying credit promotion</i>	<i>financial promotion</i>
3.9.1R	<i>non-real time qualifying credit promotion</i>	<i>non-real time financial promotion of qualifying credit or of a home reversion plan</i>
	<i>qualifying credit promotion</i>	<i>financial promotion</i>
3.9.3R	<i>qualifying credit promotion</i>	<i>financial promotion</i>
3.9.4G	<i>qualifying credit promotion</i>	<i>financial promotion</i>
3.9.5R	<i>non-real time qualifying credit promotion</i>	<i>non-real time financial promotion</i>
	<i>qualifying credit promotion</i>	<i>financial promotion</i>

3.10.1R	<i>non-real time qualifying credit promotion</i>	<i>non-real time financial promotion of qualifying credit or of a home reversion plan</i>
	<i>qualifying credit promotion</i>	<i>financial promotion</i>
3.10.2G	<i>qualifying credit promotion</i>	<i>financial promotion</i>
3.10.3G	<i>qualifying credit promotion</i>	<i>financial promotion</i>
3.11.2R	<i>real time qualifying credit promotion</i>	<i>real time financial promotion of qualifying credit</i>
3.11.3R	<i>qualifying credit promotion</i>	<i>financial promotion of qualifying credit</i>
3.11.4G	<i>qualifying credit promotion</i>	<i>financial promotion</i>
3.11.5R	<i>non-real time qualifying credit promotion</i>	<i>non-real time financial promotion</i>
3.12.1G	<i>qualifying credit promotion</i>	<i>financial promotion</i>
3.12.3G	<i>qualifying credit promotion rules</i>	<i>financial promotion rules</i>
	<i>qualifying credit promotion</i>	<i>financial promotion</i>
	<i>real time qualifying credit promotion</i>	<i>real time financial promotion</i>
	<i>non-real time qualifying credit promotion</i>	<i>non-real time financial promotion</i>
3.12.5G	<i>qualifying credit promotion rules</i>	<i>financial promotion rules</i>
5.4.16G	<i>qualifying credit promotion</i>	<i>financial promotion</i>
10.3.8R	<i>qualifying credit promotion</i>	<i>financial promotion</i>
Sch 1.3G	<i>qualifying credit promotion</i>	<i>financial promotion</i>

**INTEGRATED REGULATORY REPORTING (CREDIT INSTITUTIONS AND
INVESTMENT FIRMS) INSTRUMENT 2006**

Powers exercised

- A. The Financial Services Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):
- (1) section 138 (General rule-making power);
 - (2) section 156 (General supplementary powers); and
 - (3) section 157(1) (Guidance).
- B. The rule-making powers listed above are specified for the purpose of section 153(2) (Rule-making instruments) of the Act.

Commencement

- C. (1) Annex A, Annex B and Annex C (Part 1 – 5) of this instrument come into force on 1 January 2007.
- (2) Annex C (Part 6) of this instrument comes into force on 21 January 2008.

Amendments to the Handbook

- D. The modules of the FSA’s Handbook of rules and guidance listed in column (1) below are amended in accordance with the Annexes to this instrument listed in column (2).

(1)	(2)
Glossary of definitions	Annex A
Interim Prudential sourcebook for Banks (IPRU(BANK))	Annex B
Supervision manual (SUP)	Annex C

Citation

- E. This instrument may be cited as the Integrated Regulatory Reporting (Credit Institutions and Investment Firms) Instrument 2006.

By order of the Board
25 October 2006

Annex A

Amendments to the Glossary of definitions

In this Annex, underlining indicates new text.

...

data element A discrete fact or individual piece of information relating to a particular field within a *data item* required to be submitted to the FSA by a *firm* or other regulated entity.

data item One or more related *data elements* that are grouped together into a prescribed format and required to be submitted by a *firm* or other regulated entity under SUP 16 or provisions referred to in SUP 16.

data set One or more *data items* relating to the same *regulated activity*.

...

Annex B

Amendments to the Interim Prudential sourcebook for Banks (IPRU (BANK))

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

GN Section 3

3.5 Definitions

...	...
participation	...
<u>permission</u>	<u>See definition in the <i>Glossary</i></u>
...	...

LM: Section 1

MISMATCH LIQUIDITY

1 INTRODUCTION

1.1 Legal sources

3 ...
The Banking Consolidation Directive (formerly the Second Banking Co-ordination Directive) requires the FSA as host supervisor to monitor, in co-operation with the relevant home supervisor, the liquidity of UK branches of credit institutions incorporated in other EEA countries. This covers all such branches, regardless of whether or not they have a deposit-taking permission in the UK.

1.2 Application

4 This chapter applies to ~~all banks authorised for the purposes of the Act except EEA banks that do not have a branch in the UK~~ in the manner set out in 1.1. In respect of EEA banks that have a branch in the UK but do not have a UK deposit-taking permission, only Sections 1, 2, 3, 4.2, 9.1 and 10 of the chapter apply. In respect of all ~~to~~-EEA banks and overseas banks with a branch in the UK, the chapter (or applicable sections of it) only applies in relation to the liquidity of those branches and not the bank as a whole.

1. (a) ~~For UK-incorporated banks, the present reporting form (LR), is completed on a solo basis, including any overseas branches. Where a bank ...~~
 - (i) ...
 - (b) Branches of EEA banks that do not have a deposit-taking permission in the UK are subject to some of the provisions of this chapter but are not subject to the liquidity mismatch guidelines set out in sections 4 to 8. The FSA monitors the liquidity of such branches by requiring

them to submit Form LR. Such branches may apply for a ‘global concession’ in accordance with section 4.2.

...

LM: Section 2

2 RATIONALE

...

2.2 How the FSA monitors liquidity

...

8 In the majority of cases the FSA monitors a bank’s liquidity position through the maturity mismatch approach.

(a) ...

(b) The FSA does not apply the full maturity mismatch approach to branches of EEA banks that do not have a deposit-taking permission in the UK, but instead monitors their liquidity via the Form LR.

LM: Section 3

3 MAIN FEATURES OF THE LIQUIDITY POLICY

...

3.1 Main prudential policies applying to banks

...

See s9.3 4 A bank that is subject to liquidity mismatch guidelines should notify the FSA of any breaches of ~~its liquidity mismatch~~ those guidelines as soon as they occur.

3.2 A bank’s reporting obligations

See s9.2 5 A bank that has a deposit-taking permission in the UK must report its liquidity position quarterly on the Form LR or more frequently as required by the FSA.

See Supervision Manual, Chapter 16

See 6 An EEA bank with a branch in the UK that does not have a UK deposit-taking permission must report its liquidity position quarterly on the Form LR, or more frequently as required by the FSA.

Supervision Manual, Chapter 16

...

LM: Section 10

10 POLICY STATEMENTS

- ...
- 5 Except in the case of an EEA bank with a branch in the UK that does not have a UK deposit-taking permission, a A-liquidity policy statement should also cover a bank's agreed guidelines, its retail/ wholesale split and any behavioural or materiality adjustments.
- ...

LS: Section 3

5 MONITORING LIQUIDITY

5.2 Monitoring and reporting performance of sterling stock liquidity

- 2 A sterling stock liquidity bank should monitor its liquidity position on an inter-day basis. Any breaches of the wholesale sterling net outflow limit, the sterling stock 'floor' or the sterling stock liquidity ratio should be immediately reported to the FSA and a completed, contemporaneous form SLR1 sent to the firm's usual supervisory contact at the FSA detailing the liquidity breach.
- ...

Annex C

Amendments to the Supervision manual (SUP)

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

Part 1

Amendments to SUP Transitional provisions TP1

...

12 J	(1)	<u>SUP 16.7.24, 16.7.25 and 16.7.25A, SUP 16.7.27 and 16.7.27A</u>	R	<u>A securities and futures firm that is a BIPRU investment firm is not required to submit the Annual Reporting Statement, the Annual Reconciliation and the Consolidated Supervision Return under SUP 16.7.25R and SUP 16.7.27R (as appropriate).</u>	<u>1 January 2007 to 31 December 2007</u>	<u>Commencement and 1 January 2007</u>
	(2)	<u>SUP 16.7.35, SUP 16.7.36 and 16.7.36 A</u>	R	<u>An investment management firm that is a BIPRU investment firm is not required to submit the Annual Financial Return, the Consolidated Supervision Return and the Consolidated Financial Resources Return under SUP 16.7.36R.</u>	<u>1 January 2007 to 31 December 2007</u>	<u>Commencement and 1 January 2007</u>
	(3)	<u>SUP 16.7.67, SUP 16.7.68 and SUP 16.7.68A</u>	R	<u>A UCITS investment firm is not required to submit the Consolidated Supervision Return under SUP 16.7.68R.</u>	<u>1 January 2007 to 31 December 2007</u>	<u>13 February 2004 and 1 January 2007</u>
	(4)	<u>SUP 16.7.76, 16.7.77 and 16.7.77 A</u>	R	<u>A personal investment firm that is a BIPRU investment firm is not required to submit the Consolidated Supervision Return under SUP 16.7.77R.</u>	<u>1 January 2007 to 31 December 2007</u>	<u>1 April 2005 and 1 January 2007</u>
	(5)	<u>SUP 16.7.16 and SUP 16.7.17</u>	R	<u>A building society will not be required to submit reports MFS1, MFS1 Supp, MFS2 and QFS2 for reporting dates after 1 January 2008</u>	<u>From 1 January 2008</u>	<u>Commencement</u>

Part 2

Amendments to SUP 16.1-16.7

...

- 16.3.7 R A ~~written~~ report or data item must:
- (1) give the *firm's* FSA firm reference number (or all the *firms'* FSA firm reference numbers in those cases where a report is submitted on behalf of a number of firms, as set out in SUP 16.3.25 G); and
 - (2) if submitted in paper form, be submitted with the cover sheet contained in SUP16 Ann 13R fully completed.

...

- 16.3.9 R Method of submission of reports (see SUP 16.3.8 R)

Method of delivery	
6.	Online submission via the FSA's website at www.fsa.gov.uk
7.	<u>Electronic submission via the Early Reporting System available from</u>

...

- 16.3.25 G If this chapter requires the submission of a report or data item covering a *group*, a single report or data item may be submitted, and so satisfy the requirements of all *firms* in the *group*. Such a report or data item should contain the information required from all of them, meet all the relevant due dates and indicate all the *firms* on whose behalf it is submitted; if necessary a separate covering sheet should list the *firms* on whose behalf a report or data item is submitted.

Nevertheless, the requirement to provide a report or data item, and the responsibility for the report or data item, remains with each *firm* in the *group*. However, reporting requirements that apply to a *firm*, by reason of the *firm* being a member of a *financial conglomerate*, are imposed only on one member of the *financial conglomerate* (see, for example, SUP 16.7.82R).

...

16.7.7 R A *UK bank* must submit reports in accordance with *SUP 16.7.8 R* and *SUP 16.7.8A R*

...

16.7.8A R Table financial reports from a *UK bank*

<u>Content of report</u>	<u>Form</u>	<u>Frequency</u>	<u>Due date</u>
<u>Key data (see note 1)</u>	<u>FSA009</u> <u>(Note</u> <u>2)</u>	<u>As for BSD3 under</u> <u><i>SUP 16.7.8 R.</i></u>	<u>As for BSD3 under</u> <u><i>SUP 16.7.8 R.</i></u>
<u>Non- EEA sub-</u> <u>group (Note 3)</u>	<u>FSA028</u> <u>(Note</u> <u>2)</u>	<u>Half yearly</u>	<u>30 business days</u> <u>after period end</u>

Note 1 A *UK bank* that calculates its capital requirements on a consolidated basis (see *IPRU(BANK) GN 3.3.13R(2)* and *IPRU(BANK) CS 4*) must also complete this return on a consolidated basis.

Note 2 Reports beginning FSA*** are contained within *SUP 16 Annex 24 R*

Note 3 This will be applicable to firms that report 'yes' in *data element 16A* in FSA009 on the reporting date. *Firms'* attention is drawn to *SUP 16.3.25 G* regarding a single submission for all *firms* in the *group*.

16.7.13 R Method of submission

A bank, other than an EEA bank with permission for cross-border services only, must submit the reports described in *SUP 16.7.8 R*, *SUP 16.7.8A R*, *SUP 16.7.10 R* and *SUP 16.7.12 R* to the following:

(1) BSD3, LE3, LR, SLR1, B7 and M1 to: The Financial Statistics Division Domestic Banking Group (HO-4) Bank of England Threadneedle Street London EC2R 8AH;

(2) FSA009 and FSA028 by electronic submission via the Early Reporting System available from or through the FSA's website;

(3) all other reports to the bank's usual supervisory contact at the address in *SUP 16.3.10 G*.

The Bank of England acts only as the agent of the FSA with regard to reports in (1).

...

16.7.16 R A *building society* must submit reports in accordance with *SUP 16.7.17 R* and *SUP 16.7.17A R*

...

16.7.17 R Table financial reports from a *building society*

A

<u>Content of report</u>	<u>Form</u>	<u>Frequency</u>	<u>Due date</u>
--------------------------	-------------	------------------	-----------------

Key data (see note 1) FSA009 As for QFS1 under As for QFS1 under
 (Note 2) SUP 16.7.16R SUP 16.7.16R
 Note 1 A building society with subsidiary undertakings at the reporting date that are included within the Group figures on the QFS1 will have to submit one report on a society only basis and one on a Group basis.

Note 2 Reports beginning FSA*** are contained within SUP 16 Annex 24 R

16.7.19 R Method of submission

A building society must submit:

(1) the reports in SUP 16.7.17 R (other than the "Analysis of interest rate risk gap") either:

(a) by means of the Remote Data Entry system supplied by the FSA (and previously by the Building Societies Commission); or, should this be inoperable,

(b) by post or fax to the address in SUP 16.3.10 G using:

- (ai) the corresponding forms available from the FSA's website; or
- (bii) its own version of the FSA's specified forms, provided that version is equivalent in terms of content and layout; and

(2) FSA009 in SUP 16.7.17A R by electronic submission via the Early Reporting System available from or through the FSA's website.

Notwithstanding a paper submission in accordance with (2)(b), once the Remote Data Entry system is operable again, the reports must be submitted by its means.

...

16.7.24 R A securities and futures firm which is a category A or B firm or a broad scope firm must submit reports to the FSA in accordance with SUP 16.7.25 R and SUP 16.7.25A R.

16.7.25 R Table financial reports from a securities and futures firm which is a category A or B firm or a broad scope firm

<u>Content of report</u>	<u>Form</u>	<u>Frequency</u>	<u>Due date</u>
<u>Key data</u>	<u>FSA009</u> (Note 1)	<u>Monthly, in line with Monthly reporting statement in SUP 16.7.25 R</u>	<u>As for Monthly reporting statement in SUP 16.7.25 R</u>
<u>Key data (Consolidated) (Note 2)</u>	<u>FSA009</u> (Note 1)	<u>Half yearly, in line with Consolidated supervision return in SUP 16.7.25 R</u>	<u>As for Consolidated supervision return in SUP 16.7.25 R</u>
<u>Non- EEA sub-group (Note 3)</u>	<u>FSA028</u> (Note 1)	<u>Half yearly</u>	<u>30 business days after period end</u>

Note 1 Reports beginning FSA*** are contained within SUP 16 Annex 24 R
Note 2 Only for category A and B firms which are subject to the consolidation rules set out in IPRU (INV) Chapter 14. These firms must complete an FSA009 setting out the consolidated position in addition to a non-consolidated version.
Note 3 This will be applicable to firms that report 'yes' in data element 16A in FSA009 on the reporting date. Firms' attention is drawn to SUP 16.3.25 G regarding a single submission for all firms in the group.

...

16.7.26 R A securities and futures firm which is a category C or D firm or an arranger or venture capital firm must submit reports to the FSA in accordance with SUP 16.7.27 R and, in the case of a securities and futures firm which is an ISD investment firm, SUP 16.7.27A R.

16.7.27 R Table financial reports from a securities and futures firm which is an ISD
A investment firm

<u>Content of report</u>	<u>Form</u>	<u>Frequency</u>	<u>Due date</u>
<u>Key data</u>	<u>FSA009</u> <u>(Note 1)</u>	<u>Quarterly in line</u> <u>with Quarterly</u> <u>reporting statements</u> <u>in SUP 16.7.27 R</u>	<u>As for Quarterly</u> <u>reporting</u> <u>statements in SUP</u> <u>16.7.27 R</u>
<u>Key data</u> <u>(Consolidated)</u> <u>(Note 2)</u>	<u>FSA009</u> <u>(Note 1)</u>	<u>Half yearly, in line</u> <u>with Consolidated</u> <u>Supervision Return</u> <u>in SUP 16.7.27 R</u>	<u>As for Consolidated</u> <u>Supervision Return</u> <u>in SUP 16.7.27 R</u>
<u>Non- EEA sub-</u> <u>group (Note 3)</u>	<u>FSA028</u> <u>(Note 1)</u>	<u>Half yearly</u>	<u>30 business days</u> <u>after period end</u>

Note 1 Reports beginning FSA*** are contained within SUP 16 Annex 24 R
Note 2 Only for category C firms which are subject to the consolidation rules set out in IPRU (INV) Chapter 14. These firms must complete an FSA009 setting out the consolidated position in addition to a non-consolidated version.
Note 3 This will be applicable to firms that report 'yes' in data element 16A in FSA009 on the reporting date. Firms' attention is drawn to SUP 16.3.25 G regarding a single submission for all firms in the group.

...

16.7.31 R A securities and futures firm must submit:
 (1) the reports in SUP 16.7.25 R and SUP 16.7.27 R in accordance with, and in the same format as:
 (1a) the forms contained in SUP 16 Ann 10 R, and as required by section 6 of that annex; and
 (2b) the form contained in SUP 16 Ann 20 R, and having regard to SUP 16 Ann 21 G; and
 (2) the reports in SUP 16.7.25A R and SUP 16.7.27A R in accordance with

and in the same format as the *data items* contained in SUP 16 Annex 24 R, and having regard to SUP 16 Annex 25 G.

- 16.7.32 G *Guidance* notes for the completion of the reports and *data items* are contained in SUP 16 Annex 11 and SUP 16 Annex 25 G respectively.
- 16.7.33 R (1) Any report in SUP 16.7.23 R to SUP 16.7.30 R submitted to the FSA by a *securities and futures firm* must be signed by two authorised signatories satisfying the requirements of SUP 16.7.33 R(2), except for:
- (a) the audited accounts of a subsidiary of the *firm* and the *firm's* audited annual financial statements;
 - (b) other reports where the *firm* is a *sole trader*, when only one authorised signatory is required; and
 - (c) reports submitted in accordance with (3) and (5).
- (2) An authorised signatory must be:
- (a) for a *body corporate*, a *director*;
 - (b) for a *partnership*, a *partner* who is an *approved person* of the *firm*;
 - (c) for a *sole trader*, the proprietor.
- (3) A *firm* must use the FiRSt 5.0 software package made available to *firms* by the FSA (and previously by the SFA) to submit the following reports:
- (a) annual reporting statement;
 - (b) monthly reporting statement;
 - (c) quarterly reporting statement; and
 - (d) consolidated reporting statement.
- (4) Reports in (3) must be submitted to the FSA in accordance with the methods permitted by FiRSt 5 software. All other reports in SUP 16.7.24 R to SUP 16.7.30 R (apart from those in (5)) must be sent to the address given in SUP 16.3.10 G.
- (5) Reports in SUP 16.7.25A R and SUP 16.7.27A R must be submitted electronically via the Early Reporting System available from or through the FSA's website in the same format as set out in SUP 16 Annex 24 R, having regard to SUP 16 Annex 25 G.
- 16.7.35 R Investment management firms
- An *investment management firm* which is not one of the types of *firm* specified in SUP 16.7.37 R must submit reports to the FSA in accordance with SUP 16.7.36 R and, in the case of an *investment management firm* that

is an *ISD firm* as defined in IPRU(INV) 5, SUP 16.7.36A R.

16.7.36 A	R	<u>Table financial reports from an investment management firm that is an ISD firm, as defined in IPRU(INV) 5</u>		
		<u>Content of report</u>	<u>Form</u>	<u>Frequency</u>
		<u>Key data</u>	<u>FSA009</u> <u>(Notes 1)</u>	<u>In line with</u> <u>Quarterly or</u> <u>Monthly Financial</u> <u>Returns applicable</u> <u>to the firm in SUP</u> <u>16.7.36 R</u>
		<u>Key data</u> <u>(Consolidated) (Note</u> <u>2)</u>	<u>FSA009</u> <u>(Note 1)</u>	<u>Half yearly in line</u> <u>with Consolidated</u> <u>Supervision Return</u> <u>applicable to the</u> <u>firm in SUP</u> <u>16.7.36 R</u>
		<u>Key data</u> <u>(Consolidated) (Note</u> <u>3)</u>	<u>FSA009</u> <u>(Note 1)</u>	<u>Half yearly in line</u> <u>with Consolidated</u> <u>Financial</u> <u>Resources Return</u> <u>applicable to the</u> <u>firm in SUP</u> <u>16.7.36 R</u>
		<u>Non- EEA sub-</u> <u>group (Note 4)</u>	<u>FSA028</u> <u>(Note 1)</u>	<u>Half yearly</u> <u>30 business days</u> <u>after period end</u>

Note 1 Reports beginning FSA*** are contained within SUP 16 Annex 24 R

Note 2 Only for firms subject to IPRU(INV) Chapter 14. These firms must complete an FSA009 setting out the consolidated position in addition to a non-consolidated version.

Note 3 Only for firms subject to IPRU(INV) 5.7.1(1) R. These firms must complete an FSA009 setting out the consolidated position in addition to a non-consolidated version.

Note 4 This will be applicable to firms that report ‘yes’ in data element 16A in FSA009 on the reporting date. Firms’ attention is drawn to SUP 16.3.25 G regarding a single submission for all firms in the group.

...

16.7.38 R An investment management firm must submit the reports in:

(1) SUP 16.7.36 R in accordance with, and in the same format as:

(1a) the forms contained in SUP 16 Ann 5R, and as required by section 4 of that annex; and

(2b) the forms contained in SUP 16 Ann 20R, and having regard to SUP 16 Ann 21G; and

(2) SUP 16.7.28A R in accordance with the format set out in SUP 16 Annex 24 R and electronically via the Early Reporting System available from or through the FSA's website.

...

16.7.67 R UCITS Management Companies

A UCITS management company must submit reports to the FSA in accordance with SUP 16.7.68 R and, in the case of an UCITS investment firm, SUP 16.7.68A R.

16.7.68 R Table financial reports from an UCITS investment firm
A

<u>Content of report</u>	<u>Form</u>	<u>Frequency</u>	<u>Due date</u>
<u>Key data (see note 1)</u>	<u>FSA009 (Note 1)</u>	<u>Quarterly in line with the Quarterly Financial Return in SUP 16.7.68R</u>	<u>As for Quarterly Financial Return in SUP 16.7.68R</u>
<u>Non-EEA sub-group (Note 2)</u>	<u>FSA028 (Note 1)</u>	<u>Half yearly</u>	<u>30 business days after period end</u>

Note 1 Reports beginning FSA*** are contained within SUP 16 Annex 24 R
Note 2 This will be applicable to firms that report 'yes' in data element 16A in FSA009 on the reporting date. Firms' attention is drawn to SUP 16.3.25 G regarding a single submission for all firms in the group.

...

16.7.69 R *A UCITS management company must submit the reports in:*

- (1) *SUP 16.7.68 R in accordance with, and in the same format as:*
 - (1a) *the forms contained in SUP 16 Annex 16, and as required by section 3 of that annex; and*
 - (2b) *the form contained in SUP 16 Annex 20, and having regard to SUP 16 Annex 21; and*
- (2) SUP 16.7.68A R in accordance with the format set out in SUP 16 Annex 24 R and electronically via the Early Reporting System available from or through the FSA's website.

...

16.7.76 R *A firm not subject to other reporting requirements in SUP 16.7.1 G - SUP 16.7.75 R (nor to reporting requirements in IPRU(INS) or IPRU(FSOC)):*

- (1) ...
- (2) *which is a, personal investment firm;*

must submit reports to the *FSA* in accordance with *SUP* 16.7.77 R.

A firm which is a category A1, A2 or A3 *personal investment firm* must also submit *data items* in accordance with *SUP* 16.7.77A R.

16.7.77 R Table financial reports from a *personal investment firm*
A

<u>Content of report</u>	<u>Form</u>	<u>Frequency</u>	<u>Due date</u>
<u>Key data</u>	<u>FSA009</u> <u>(Note 1</u> <u>and 2)</u>	<u>In line with</u> <u>financial</u> <u>information</u> <u>submission</u> <u>requirements</u> <u>applicable to the</u> <u><i>firm</i> as set out in</u> <u>Note 3 of <i>SUP</i></u> <u>16.7.77 R.</u>	<u>As for due dates</u> <u>applicable to the</u> <u><i>firm</i> as set out in</u> <u>Note 3 of <i>SUP</i></u> <u>16.7.77R.</u>
<u>Key data</u> <u>(Consolidated)</u> <u>(Note 3)</u>	<u>FSA009</u> <u>(Note 1</u> <u>and 2)</u>	<u>Half yearly, in line</u> <u>with Consolidated</u> <u>Supervision Return</u> <u>applicable to the</u> <u><i>firm</i> under <i>SUP</i></u> <u>16.7.77 R</u>	<u>As for Consolidated</u> <u>Supervision Return</u> <u>under <i>SUP</i></u> <u>16.7.77R</u>
<u>Non- EEA sub-</u> <u>group (Note 4)</u>	<u>FSA028</u> <u>(Note 1</u> <u>and 2)</u>	<u>Half yearly</u>	<u>30 <i>business days</i></u> <u>after period end</u>

Note 1 Reports beginning FSA*** are contained within *SUP* 16 Annex 24 R

Note 2 FSA009 and FSA028 must be submitted electronically via the Early Reporting System available from or through the FSA's website.

Note 3 Only for a category A1, A2 or A3 *personal investment firm* if it is a member of a *group* and is subject to the consolidation *rules* set out in *IPRU (INV)* Chapter 14. These *firms* must complete an FSA009 setting out the consolidated position in addition to a non-consolidated version.

Note 4 This will be applicable to firms that report ‘yes’ in data element 16A in FSA009 on the reporting date. Firms’ attention is drawn to *SUP* 16.3.25 G regarding a single submission for all firms in the group

...

Part 3

Amendments to SUP 16 Annexes

SUP 16 Ann 2G

...

Large Exposures (Form LE3)

Introduction

For all reporting dates after 31 December 2006, the Large Exposures Capital Base (LECB) or its equivalent will be calculated on a different basis. Please see the section below headed Large Exposures Capital Base (LECB).

...

Large Exposures Capital Base (LECB)

For reporting dates up to and including 31 December 2006, you ~~You~~ should calculate the capital base used as the basis for monitoring and controlling large exposures in the same way as that used for capital adequacy monitoring ie the sum of allowable Tier 1 and Tier 2 capital less any deductions. ... to identify exposures that should have been pre-notified to us.

For the first reporting date after 31 December 2006 for firms that are reporting on an unconsolidated or solo-consolidated basis (or the first two reporting dates in the case of consolidated reporting), firms should use the LECB that had been agreed with the FSA and was in force at 31 December 2006. Thereafter, instead of the LECB, firms should report, in its place, the figure of capital resources, calculated in accordance with BIPRU 10.5.2, and reported to the FSA as data element 22A of FSA009, for the reporting date preceding the current reporting date. In that way, the capital resources figure will be continually updated. In the case of reports on a consolidated basis, the capital resources figure will only change half yearly. References to LECB should be regarded as referring to this capital resources figure once firms are reporting on this basis.

For reporting dates up to and including 31 December 2006, where ~~Where~~ you have agreed holdings of tradeable securities subject to 'soft' limits with us, you may use an adjusted capital base incorporating Tier 3 capital to measure these exposures against. However, you should report this adjusted capital base in Part 8.

For the first reporting date after 31 December 2006 on a solo or unconsolidated basis (or first two reports in the case of a consolidated report), firms should use the adjusted capital base incorporating Tier 3 capital that was in force at 31 December 2006. Thereafter, instead of that adjusted capital base, firms should report, in its place, the figure of capital resources, calculated in accordance with BIPRU 10.5.3, and reported to the FSA as data element 22A of FSA009, for the reporting date preceding the current reporting date.

...

SUP 16 Ann 4G

...

Building society; quarterly statement QFS1

...

Section L: Exposure analysis: Large exposures – Group

...

1 Basis for reporting Large Exposures on Table L

...

(ii) For reports up to and including 31 December 2006, the measure of own funds to be used in the large exposure calculation is the Group (consolidated) amount of Capital Available at the quarter end as reported in table D, line item D4, column 4 (taking account of any exclusions from consolidation that may be required, as referred to in the Solvency P/G).

For the first reporting date after 31 December 2006, firms should use the Group (consolidated) amount of Capital Available at the quarter end as reported in table D, line item D4, column 4 (taking account of any exclusions from consolidation that may be required, as referred to in the Solvency P/G) of the QFS1 reported at the previous reporting date. Thereafter, firms should instead use the figure of capital resources for the group, calculated in accordance with BIPRU 10.5.2, and reported to the FSA as data element 24A of FSA009 for the reporting date preceding the current reporting date. References to own funds should be regarded as referring to this capital resources figure once firms are reporting on this basis.

...

SUP 16 Annex 5R

QUARTERLY FINANCIAL DETAILS

QFS5

...

4. LARGE EXPOSURES (ISD Firms only)

Provide details of all Large Exposures outstanding at the end of the period (73)

Counterparty	Value of Exposure	Percentage of Own Funds***	Nature of Item <i>(eg Accrued fees, billed fees, settlement balance etc)</i>
---------------------	--------------------------	---------------------------------------	------------------------------------------------------------------------------------------------

* *Delete whichever is not applicable*

** *Consider by reference to Part IV Permission Statement*

*** For the first reporting date after 31 December 2006, BIPRU investment firms should use the own funds figure that was used on their 31 December 2006 report, or the last report prior to that date if their reporting date is different. Thereafter, instead of the own funds figure, firms should use the figure of capital resources, calculated in accordance with BIPRU 10.5.2R and reported to the FSA as data element 22A in FSA009 for the reporting date preceding the current reporting date.

SUP 16 Ann 11G

...

SUP 16 Ann 11G section 4

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

I Summary of reporting requirements

(1) An exposure

...

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

For the first reporting date after 31 December 2006 for firms reporting on a solo basis (or the first two reporting dates in the case of a report on a consolidated basis), firms should use the own funds figure that was used on their 31 December 2006 report, or the last report prior to that date if their reporting cycle is different. Thereafter, instead of the own funds figure (or financial resources and own funds figures), firms should use the figure of capital resources, calculated in accordance with BIPRU 10.5.2, and reported to the FSA as data element 22A of FSA009 for the reporting date preceding the current reporting date. In that way, the capital resources figure will be continually updated. In the case of reports on a consolidated basis, the capital resources figure will only change half yearly. References to own funds, for large exposures purposes, should be regarded as referring to this capital resources figure once firms are reporting on this basis.

...

II The reporting form (LEM) – General, coverage and layout

General

...

Coverage and Layout of Forms LEM 1 and 2

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

Details of own fund/financial resources as at the reporting date should be reported on the front cover of forms LEM 1 and LEM 2 up to and including 31 December 2006. For the first reporting date after 31 December 2006 in the case of a solo report, and the first two reporting dates after 31 December 2006 in the case of a consolidated report, the figures reported should be the figures calculated at the 31 December 2006 reporting date, or latest reporting date prior to that if the reporting cycle is different. Thereafter, the figure of own funds should be the figure of capital resources, calculated in accordance with BIPRU 10.5.2, and reported to the FSA as data element 22A of FSA009 for the reporting date preceding the current reporting date. The figure of financial resources should then be blank.

...

SUP 16 Annex 16R

Financial returns - UCITS Management Companies

UQFS 5

3. LARGE EXPOSURES (*UCITS Investment Firms only*)

Provide details of all Large Exposures outstanding at the end of the period (72)

Counterparty	Value of Exposure	Percentage of Own Funds***	Nature of Item (e.g. Accrued fees, billed fees, settlement balance etc)
--------------	-------------------	----------------------------	----------------------------------------------------------------------------

...

**Delete whichever is not applicable*

***Consider by reference to Part IV Permission Statement*

***For the first reporting date after 31 December 2006, BIPRU investment firms should use the own funds figure that was used on their 31 December 2006 report, or the last report prior to that date if their reporting date is different. Thereafter, instead of the own funds figure, firms should use the figure of capital resources calculated in accordance with BIPRU 10.5.2R and reported to the FSA as data element 22A in FSA009 for the reporting date preceding the current reporting date.

SUP16 Ann 18BG

Notes for completion of the RMAR

...

Section D5: reportable *Large Exposures (ISD personal investment firms)*

...

A *large exposure* exists where a *firm* is owed a debt by, or is otherwise exposed to another person, or to two or more affiliated *persons*, and that exposure equals or exceeds 10% of its own funds. Under *IPRU(INV)*, a *firm* is required to ensure that its *large exposures* do not exceed 25% of its own funds (or the aggregated of exposure to its holding company, or a subsidiary company or a group of subsidiaries of its holding company does not exceed 20% of own funds).

Up to and including 31 December 2006, firms may use the own funds figure reported under item 19 in Section D3 in the same period. At a firm's first reporting date after 31 December 2006, it should use the figure reported on the previous reporting date in item 19 in Section D3. Thereafter, it should use the figure of capital resources, calculated in accordance with *BIPRU* 10.5.2, and reported to the FSA as data element 22A of FSA009 for the reporting date preceding the current reporting date. References to own funds, for large exposures purposes, should be regarded as referring to this capital resources figure once firms are reporting on this basis.

Part 4

Draft new rules in SUP 16 Annex 24 R

All of the text in this section is new and is not underlined. Insert the following new Annex after SUP 16 Annex 23

FSA009

Key data

The firm completing this is subject to the capital rules for (tick one only):

	A
1 A UK bank or a building society	
2 A full scope BIPRU investment firm	
3 A BIPRU limited activity firm	
4 A BIPRU limited licence firm, including a UCITS investment firm	
5 If you are a full scope BIPRU investment firm, do you meet the conditions in BIPRU TP 12.1R?	
6 If you are a BIPRU limited activity or BIPRU limited licence firm, have you a waiver under BIPRU 6.1.2G?	

If you are a BIPRU investment firm, are you a:

7 BIPRU 730K firm	
8 BIPRU 125K firm (excluding UCITS investment firms)	
9 UCITS investment firm	
10 BIPRU 50K firm	
11 Do you have a waiver from consolidated supervision?	
12 Have you notified the FSA, at least one month in advance of the date of this report, that you intend to deduct illiquid assets?	

13 Basis of reporting	Unconsolidated	
	Solo-consolidated	
	Consolidated	

If consolidated, please complete data elements 14 and 15, otherwise go straight to data element 16.

14 For consolidated reporting, provide

A	B
Group reference	Group name

15 For consolidated reporting, provide details of all other FSA authorised firms included in this consolidated report.

A	B
FRN	Name

	A
	Yes/No
16 If unconsolidated or solo-consolidated, are you a member of a non-EEA sub-group? <i>If you answer yes, you are also required to report FSA028</i>	

17 What is the currency of the report (all figures in 000s)?

--

	Yes/No
18 Have you adopted any of the new approaches to credit risk at the reporting date?	
19 Total tier one capital after deductions	
20 Total tier two capital after deductions	
21 Deductions from the totals of tier one and two	
22 Capital resources for large exposures	
23 Total tier three capital	
24 Deductions from total capital	
25 Total capital after deductions	
FSA009 continued	
26 Credit risk requirement under existing rules	
27 Market risk requirement under existing rules	
28 Other capital requirements under existing rules	
29 Total credit risk capital component	
30 Total operational risk capital requirement	
31 Reduction in operational risk capital requirement under BIPRU TP 12.8R	
32 Counterparty risk capital component	
33 Total market risk capital requirement	
34 Concentration risk capital component	
35 Fixed overheads requirement	
36 Capital resources requirement	
37 Base capital resources requirement	
38 Capital resources requirement arising from the operation of capital floors	
39 Surplus/Deficit of own funds	
40 Individual capital guidance - total capital resources	
41 Individual capital guidance - general purpose capital	
42 Surplus/(deficit) total capital over ICG	
43 Surplus/(deficit) general purpose capital over ICG	
Memorandum item (for UCITS investment firms only)	
44 Value of portfolio under management	

FSA028

Non-EEA sub-group

1 Is your non-EEA sub-group reporting requirement satisfied by your solo-consolidated FSA003/FSA009?

Yes/No

If the answer to 1A is 'Yes', you do not have to complete the rest of this data item.

2 Is your non-EEA sub-group reporting requirement satisfied by a UK consolidation group FSA003/FSA009?

Yes/No

3 If the answer to 2A is 'Yes', what is the reference number of the UK consolidation group?

If the answer to 2A was 'Yes' and you have completed 3A, you do not need to complete the rest of this data item.

4 What is the currency of this report?

Capital adequacy

5 Total tier one capital after deductions
6 Total tier two capital after deductions
7 Deductions from the totals of tier one and two
8 Capital resources for large exposures
9 Total tier three capital
10 Deductions from total capital
11 Total capital after deductions

A

12 Credit risk requirement under existing rules

13 Market risk requirement under existing rules

14	Other capital requirements under existing rules	
15	Total credit risk capital component	
16	Total operational risk capital requirement	
17	Reduction in operational risk capital requirement under BIPRU TP 12.8R	
18	Counterparty risk capital component	
19	Total market risk capital requirement	
20	Concentration risk capital component	
21	Fixed overheads requirement	
22	Capital requirement	
23	Capital resources requirement arising from the operation of capital floors	
24	Surplus/Deficit of own funds	

Large exposures

			A			
25	Capital resources					
	Exposure no	Counterparty name (or group name)	Exposures after risk mitigation techniques		CNCOM	
			Exempt exposures	Non-exempt exposures		
				of which non-trading book, non-exempt	of which trading book, non-exempt	non exempt % of capital resources
26	A	B	C	D	E	F
	1					
	...					
	<i>n</i>					

Part 5

Draft new guidance in SUP 16 Annex 25 G

All of the text in this section is new and is not underlined. Insert the following new Annex after SUP 16 Annex 24R

FSA009 – Key data

This data item should be completed by all *BIPRU firms*. It will only be used for reporting dates from 1 January 2007.

During 2007, we are making no change to existing reporting forms and, because some of the underlying rules on capital resources and capital requirements change, we will need to collect more accurate information on this data item to monitor the position. Those parts of the existing reports relating to balance sheet and profit and loss items should be largely unaffected by these changes, hence the reason we will continue to use them. The reporting dates for this data item will be the same as your existing report for capital adequacy.

Valuation

For the general policy on valuation, please see the rules and guidance set out in *GENPRU* 1.3.

Currency

You should report in the same currency as in your existing supervisory reports to the FSA, in thousands.

Data elements

These are referred to by row first, then by column, so data element 2B will be the element numbered 2 in column B.

General

To assist firms and ourselves, please identify your firm's characteristics so that the correct capital monitoring can be undertaken.

1A Is the firm a UK bank or a building society?

This box should be ticked if the report is being completed by a *UK bank* or a *building society*, or a *UK consolidation group* that is subject to the capital rules at Stage A of *BIPRU* 8 Annex 2R.

2A Is the firm a full scope BIPRU investment firm?

This box should be ticked if the report is being completed by either a *full scope BIPRU investment firm*, or a *UK consolidation group* that is subject to the capital rules at Stage 2 of *BIPRU* 8 Annex 2R.

3A Is the firm a BIPRU limited activity firm?

This box should be ticked if the report is being completed by either a *BIPRU limited activity firm*, or a *UK consolidation group* that is subject to the capital rules at Stage 3 of *BIPRU* 8 Annex 2R.

4A Is the firm a BIPRU limited licence firm?

This box should be ticked if the report is being completed by either a *BIPRU limited licence firm*, or a *UK consolidation group* that is subject to the capital rules at Stage 4 of *BIPRU* 8 Annex 2R.

5A If you are a full scope BIPRU investment firm, do you meet the conditions of BIPRU TP 12.1R?

This is only relevant for a *full scope BIPRU investment firm* and it allows a reduction in the operational risk capital requirement.

6A If you are a BIPRU limited activity firm or a BIPRU limited licence firm, do you have a waiver as set out in BIPRU 6.1.2R?

This is only relevant for a *BIPRU limited activity firm* or a *BIPRU limited licence firm*. Only tick this box if you have a waiver as set out in *BIPRU* 6.1.2G that allows you to calculate an *operational risk capital requirement* rather than a *fixed overheads requirement*.

7A Are you a BIPRU 730K firm?

This is only relevant if you are a *BIPRU investment firm*. Tick only if you meet the conditions in *BIPRU* 1.1.22R.

8A Are you a BIPRU 125K firm (excluding UCITS investment firms)?

This is only relevant if you are a *BIPRU investment firm*. Tick only if you meet the conditions in *BIPRU* 1.1.19R, and *BIPRU* 1.1.21R.

9A Are you a UCITS investment firm?

This is only relevant if you are a *UCITS investment firm*.

10A Are you a BIPRU 50K firm?

This is only relevant if you are a *BIPRU investment firm*. Tick here if you meet the conditions set out in *BIPRU 1.1.20R*.

11A Do you have a waiver from consolidated supervision?

This is only relevant if you are a *BIPRU investment firm*. Tick only if your firm has a waiver from consolidated supervision.

12A Have you notified the FSA, at least one month in advance of the date of this report, that you intend to deduct illiquid assets?

This is only relevant if you are a *BIPRU investment firm*. See *GENPRU 2.2.41R*.

13A The basis of reporting

Firms should identify whether the report being submitted is on an unconsolidated, solo-consolidated or consolidated basis.

14A/B For consolidated reporting, provide details of the group.

This is only completed by firms that checked the 'consolidated' box in data element 13A.

This will be provided in the form of a drop-down showing both the Group Reference and associated Group Name.

15A/B For consolidated reporting provide details of all other FSA authorised firms included in the consolidated report

This is only completed by firms that checked the 'consolidated' box in data element 13A.

Firms should list here all the FSA reference numbers and names of those firms, authorised by the FSA, that are included within the consolidated report.

16A If no, are you a member of a non-EEA sub-group at the reporting date?

This is a new reporting obligation from 1 January 2007. It should be completed on each reporting date, unless you are a monthly reporter in which case it should be completed on a quarterly cycle.

Members of a *non-EEA sub-group* (see *BIPRU 8.2.4R* to *BIPRU 8.2.8R*) are required to provide an additional data item (FSA028) on each date that they confirm they are members of such a group.

17A What is the currency of the report.

Firms should identify the currency of the data item from the selection provided. The currency must be the same as that used on your existing regulatory reports to the FSA. Acceptable currencies are Sterling, Euro, US Dollar, Canadian Dollar, Swedish Kroner, Swiss Franc and Japanese Yen. Figures should be reported in 000s.

18A Have you adopted of any of the new credit risk approaches at the reporting date?

If the answer is no, firms should not put any entries in data elements 29A to 34A. If the answer is yes, firms should not put any entries in data elements 26A to 28A.

19A Total tier one capital after deductions

This figure is equivalent to Stage F in:

- *GENPRU 2 Annex 2R*, for a *UK bank*;
- *GENPRU 2 Annex 3R*, for a *building society*;
- *GENPRU 2 Annex 4R*, for a *BIPRU investment firm* deducting *material holdings*;
- *GENPRU 2 Annex 5R*, for a *BIPRU investment firm* deducting *illiquid assets*; and
- *GENPRU 2 Annex 6R*, for a *BIPRU investment firm* with a waiver from consolidated supervision.

20A Total tier two capital after deductions

This figure is equivalent to stage K in:

- *GENPRU 2 Annex 2R*, for a *UK bank*;
- *GENPRU 2 Annex 3R*, for a *building society*;
- *GENPRU 2 Annex 4R*, for a *BIPRU investment firm* deducting *material holdings*;
- *GENPRU 2 Annex 5R*, for a *BIPRU investment firm* deducting *illiquid assets*; and
- *GENPRU 2 Annex 6R*, for a *BIPRU investment firm* with a waiver from consolidated supervision.

21A Deductions from the totals of tier one and two

This figure is equivalent to stage M in:

- *GENPRU 2 Annex 2R*, for a *UK bank*;
- *GENPRU 2 Annex 3R*, for a *building society*;
- *GENPRU 2 Annex 4R*, for a *BIPRU investment firm* deducting *material holdings*;
- *GENPRU 2 Annex 5R*, for a *BIPRU investment firm* deducting *illiquid assets*; and
- *GENPRU 2 Annex 6R*, for a *BIPRU investment firm* with a waiver from consolidated supervision.

22A Capital resources for large exposures

This is the total tier one plus tier two capital after deductions. It is equivalent to Stage N in:

- *GENPRU 2 Annex 2R*, for a *UK bank*;
- *GENPRU 2 Annex 3R*, for a *building society*;
- *GENPRU 2 Annex 4R*, for a *BIPRU investment firm* deducting *material holdings*;
- *GENPRU 2 Annex 5R*, for a *BIPRU investment firm* deducting *illiquid assets*; and
- *GENPRU 2 Annex 6R*, for a *BIPRU investment firm* with a waiver from consolidated supervision.

23A Total tier three capital

This figure is equivalent to Stage Q in:

- *GENPRU 2 Annex 2R*, for a *UK bank*;
- *GENPRU 2 Annex 3R*, for a *building society*;
- *GENPRU 2 Annex 4R*, for a *BIPRU investment firm* deducting *material holdings*;
- *GENPRU 2 Annex 5R*, for a *BIPRU investment firm* deducting *illiquid assets*; and
- *GENPRU 2 Annex 6R*, for a *BIPRU investment firm* with a waiver from consolidated supervision.

24A Deductions from total capital

This is equivalent to Stage S in:

- *GENPRU 2 Annex 2R*, for a *UK bank*;
- *GENPRU 2 Annex 3R*, for a *building society*;
- *GENPRU 2 Annex 4R*, for a *BIPRU investment firm* deducting *material holdings*;
- *GENPRU 2 Annex 5R*, for a *BIPRU investment firm* deducting *illiquid assets*; and
- *GENPRU 2 Annex 6R*, for a *BIPRU investment firm* with a waiver from consolidated supervision.

25A Total capital after deductions

This figure is equivalent to Stage T in:

- *GENPRU 2 Annex 2R*, for a *UK bank*;
- *GENPRU 2 Annex 2R*, for a *building society*;

- *GENPRU 2 Annex 4R*, for a *BIPRU investment firm* deducting *material holdings*;
- *GENPRU 2 Annex 5R*, for a *BIPRU investment firm* deducting *illiquid assets*; and
- *GENPRU 2 Annex 6R*, for a *BIPRU investment firm* with a waiver from consolidated supervision.

26A Credit risk requirement under existing rules

This should only be completed by firms to the extent that they have not yet adopted the approaches to credit risk set out in *BIPRU 3* and *BIPRU 4*.

27A Market risk capital requirement under existing rules

This should only be completed by firms to the extent that they have not yet adopted the approaches to credit risk set out in *BIPRU 3* and *BIPRU 4*.

28A Other capital requirements under existing rules

This should only be completed by firms that have not yet adopted one of the approaches to credit risk set out in *BIPRU 3* and *BIPRU 4*.

Enter here any other capital requirements, other than credit or market risk, under existing rules, including any secondary requirements arising under *BIPRU TP 8.11 R*.

29A Total credit risk capital component

This will be completed by firms that have adopted one of the new approaches to credit risk at the reporting date.

30A Total operational risk capital requirement

This will be completed by firms that have adopted one of the new approaches to credit risk at the reporting date.

31A Reduction in operational risk capital requirement under BIPRU TP 12.8R

This is only relevant for a *full scope BIPRU investment firm* that satisfies the conditions set out in *BIPRU TP 12.1R*.

Firms should report here the amount by which the *ORCR* reported in 29A is reduced as a result of the calculation in *BIPRU TP 12.8R* (thus 30A less this data element will give the reduced *ORCR*).

32A Counterparty risk capital component

This will be completed by firms that have adopted one of the new approaches to credit risk at the reporting date.

33A Total market risk capital requirement

This will only be completed by firms that have adopted one of the new approaches to credit risk at the reporting date.

34A Concentration risk capital component

This will only be completed by firms that have adopted one of the new approaches to credit risk at the reporting date.

35A Fixed overheads requirement

See *GENPRU 2.1.40R* to *GENPRU 2.1.46G*.

36A Capital requirement

Report here your calculation of your capital requirement.

For firms that have not adopted the new approaches to credit risk yet, the figure may well differ from that reported in your other (existing) regulatory returns. Although this may be expected, firms should be able to explain how the differences from that have arisen.

37A Base capital resources requirement

See *GENPRU 2.1.29R*.

38A Capital resources requirement arising from the operation of capital floors

This will only be completed by firms that have adopted the *IRB approach* to credit risk or *AMA* for operational

risk. See *BIPRU* TP 2.

When reporting, the scaling factors set out in *BIPRU* TP 2.8R should have been applied.

39A Surplus/Deficit of own funds

This is data element 25A less data element 36A.

Although not reported here, firms that have adopted the *IRB approach* should also be monitoring data element 38A in relation to 25A.

40A Individual capital guidance – total capital resources

Enter the amount of total capital resources that the FSA considers the firm should hold in order to meet *GENPRU* 1.2.26R (adequate financial resources). This amount can be calculated from information provided in the most recent letter the firm has received from the FSA setting out Individual Capital Guidance (as described in *BIPRU* 2.2.12G). The amount should be calculated as at the same reporting date as all other information included in this data item. Where this data item is being used to report for a *UK consolidation group*, you should enter the total group capital resources indicated in the ICG letter which will typically be based on the group capital resources requirement (data element 35A) – see *BIPRU* 2.2.19G.

For the purposes of giving individual capital guidance, the FSA distinguishes between capital resources which can be used to meet all risks (general purpose capital, ie stage N in *GENPRU* 2 Annexes 2R to 6R, as appropriate) and capital resources which can only be used to meet certain risks, for instance trading book risks, (limited purpose capital). Total capital resources after deductions are as defined in *GENPRU* 2.2.12R and is stage T in *GENPRU* 2 Annexes 2R to 6R as appropriate. The amount of total capital resources should be shown in data element 24A. See *BIPRU* 2.2.16G.

This data element should be used where an ICG letter provides guidance on the amount of total capital or is silent on the nature of the capital which can be used to meet the obligation in *GENPRU* 1.2.26R.

If no ICG has been set, firms should enter 0 here.

41A Individual capital guidance – general purpose capital

Enter the amount of general purpose capital that the FSA considers the firm should hold in order to meet *GENPRU* 1.2.26R (adequate financial resources). The amount should be calculated on the same basis set out for data element 25A, but refers only to general purpose capital rather than to total capital. If the firm's ICG letter does not provide guidance on the amount of general capital (or limited purpose capital) that the firm should hold or no ICG has been set for the firm, it should enter 0 here.

42A Surplus/(deficit) total capital over ICG

This is the amount in data element 25A (total capital after deductions) less data element 40A. However, if no ICG has been set and data element 40A is 0, this should also be 0.

43A Surplus/(deficit) general purpose capital over ICG

This is the amounts in data element 22A less data element 41A. However, if no ICG has been set and data element 41A is 0, this should also be 0.

Memorandum item

44A Value of portfolio under management

This is only relevant for a *UCITS investment firm*.

Enter the value of the portfolio under management at the reporting date.

FSA009 – Key data validations

Internal validations

Data elements are referenced by row then column.

Validation number	Data element		
1	1A		If (2A+3A+4A)=yes, then no, else yes
2	2A		If (1A+3A+4A)=yes, then no, else yes
3	3A		If (1A+2A+4A)=yes, then no, else yes
4	4A		If (1A+2A+3A)=yes, then no, else yes
5	5A		If 2A = no, then no
6	6A		If (3A+4A) = no, then no
7	7A		If (1A+8A+9A+10A) = yes, then no
8	8A		If (1A+7A+9A+10A) = yes, then no
9	9A		If (1A+7A+8A+10A) = yes, then no
10	10A		If (1A+7A+8A+9A) = yes, then no
11	11A		If 1A = yes, then no
12	22A	=	19A + 20A - 21A
13	25A	=	22A + 23A - 24A
14	29A		If 18A = yes, then ≥ 0 , else 0
15	30A		If 18A = yes, then ≥ 0 , else 0
16	31A	\leq	30A
17	32A		If 18A = yes, then ≥ 0 , else 0
18	33A		If 18A = yes, then ≥ 0 , else 0
19	34A		If 18A = yes, then ≥ 0 , else 0
20	35A		If 1A = yes, then 0, else ≥ 0
21	38A	=	25A – 36A
22	42A		If 40A = 0, then 0, else 25A - 40A
23	43A		If 41A = 0, then 0, else 22A – 41A
24	44A		If 9A = Yes, then ≥ 0 , else 0

FSA028 – Non-EEA sub-groups

This data item should be completed if a *BIPRU* firm is a member of a *non-EEA sub-group*, as set out in *BIPRU* 8.

Firms should use the diagrams in *BIPRU* 8 Annex 3G, in conjunction with *BIPRU* 8.3, to help them understand in the first instance whether a *non-EEA sub-group* exists. If a *non-EEA sub-group* exists, and has been identified as existing on FSA001 (or FSA009), then this data item should be completed. However, where a firm concludes that the reporting requirement is fully met by another regulatory submission of FSA003/FSA009 (which will either be a solo-consolidated submission, or a *UK consolidation group* submission), it should be noted on this data item, which can then be submitted with no further information required.

Valuation

For the general policy on valuation, please see the rules and guidance set out in *GENPRU* 1.3.

Data elements

These are referred to by row first, then by column, so data element 2B will be the element numbered 2 in column B.

1A Is your non-EEA sub-group reporting requirement satisfied by your solo-consolidated FSA003/FSA009?

The diagrams in *BIPRU* 8 Annex 3G, in conjunction with *BIPRU* 8.3, should assist firms in identifying those circumstances when a *non-EEA sub-group* exists and when a solo-consolidated FSA003 or FSA009 will satisfy the reporting requirement. Firms should answer Yes or No. Firms answering Yes do not need complete the rest of the data elements.

2A Is your non-EEA sub-group reporting requirement satisfied by your UK consolidation group FSA003/FSA009?

The diagrams in *BIPRU* 8 Annex 3G, in conjunction with *BIPRU* 8.3, should assist firms in identifying those circumstances when a *UK consolidation group* exists and when a *UK consolidation group* FSA003 or FSA009 will satisfy the reporting requirement. Firms should answer Yes or No. Firms answering Yes should complete 3A, and then do not need to complete the rest of the data elements.

3A If the answer to 2A is Yes, what is the reference number of the UK consolidation group?

Firms should enter the reference number used for the submission of the UK consolidation group FSA003/FSA009.

4A What is the currency of the report?

Firms should identify the currency of the data item from the selection provided. Acceptable currencies are Sterling, Euro, US Dollar, Canadian Dollar, Swedish Kroner, Swiss Franc and Japanese Yen. Figures should be reported in 000s.

5A Total tier one capital after deductions

This figure is equivalent to Stage F in:

- *GENPRU* 2 Annex 2R, for a *UK bank*;
- *GENPRU* 2 Annex 3R, for a *building society*;
- *GENPRU* 2 Annex 4R, for a *BIPRU investment firm* deducting *material holdings*;
- *GENPRU* 2 Annex 5R, for a *BIPRU investment firm* deducting *illiquid assets*; and
- *GENPRU* 2 Annex 6R, for a *BIPRU investment firm* with a waiver from consolidated supervision.

Firms should also see *BIPRU* 8.6 and *BIPRU* 8.7.1R.

6A Total tier two capital after deductions

This figure is equivalent to stage K in:

- *GENPRU* 2 Annex 2R, for a *UK bank*;
- *GENPRU* 2 Annex 3R, for a *building society*;

- *GENPRU 2 Annex 4R*, for a *BIPRU investment firm* deducting *material holdings*;
- *GENPRU 2 Annex 5R*, for a *BIPRU investment firm* deducting *illiquid assets*; and
- *GENPRU 2 Annex 6R*, for a *BIPRU investment firm* with a waiver from consolidated supervision.

Firms should also see *BIPRU 8.6* and *BIPRU 8.7.1R*.

7A Deductions from the totals of tier one and two

This figure is equivalent to stage M in:

- *GENPRU 2 Annex 2R*, for a *UK bank*;
- *GENPRU 2 Annex 3R*, for a *building society*;
- *GENPRU 2 Annex 4R*, for a *BIPRU investment firm* deducting *material holdings*;
- *GENPRU 2 Annex 5R*, for a *BIPRU investment firm* deducting *illiquid assets*; and
- *GENPRU 2 Annex 6R*, for a *BIPRU investment firm* with a waiver from consolidated supervision.

Firms should also see *BIPRU 8.6* and *BIPRU 8.7.1R*.

8A Capital resources for large exposures

This is equivalent to Stage N in:

- *GENPRU 2 Annex 2R*, for a *UK bank*;
- *GENPRU 2 Annex 3R*, for a *building society*;
- *GENPRU 2 Annex 4R*, for a *BIPRU investment firm* deducting *material holdings*;
- *GENPRU 2 Annex 5R*, for a *BIPRU investment firm* deducting *illiquid assets*; and
- *GENPRU 2 Annex 6R*, for a *BIPRU investment firm* with a waiver from consolidated supervision.

Firms should also see *BIPRU 8.6* and *BIPRU 8.7.1R*.

9A Total tier three capital

This figure is equivalent to Stage Q in:

- *GENPRU 2 Annex 2R*, for a *UK bank*;
- *GENPRU 2 Annex 3R*, for a *building society*;
- *GENPRU 2 Annex 4R*, for a *BIPRU investment firm* deducting *material holdings*;
- *GENPRU 2 Annex 5R*, for a *BIPRU investment firm* deducting *illiquid assets*; and
- *GENPRU 2 Annex 6R*, for a *BIPRU investment firm* with a waiver from consolidated supervision.

Firms should also see *BIPRU 8.6* and *BIPRU 8.7.1R*.

10A Deductions from total capital

This is equivalent to Stage S in:

- *GENPRU 2 Annex 2R*, for a *UK bank*;
- *GENPRU 2 Annex 3R*, for a *building society*;
- *GENPRU 2 Annex 4R*, for a *BIPRU investment firm* deducting *material holdings*;
- *GENPRU 2 Annex 5R*, for a *BIPRU investment firm* deducting *illiquid assets*; and
- *GENPRU 2 Annex 6R*, for a *BIPRU investment firm* with a waiver from consolidated supervision.

Firms should also see *BIPRU 8.6* and *BIPRU 8.7.1R*.

11A Total capital after deductions

This figure is equivalent to Stage T in:

- *GENPRU 2 Annex 2R*, for a *UK bank*;
- *GENPRU 2 Annex 3R*, for a *building society*;
- *GENPRU 2 Annex 4R*, for a *BIPRU investment firm* deducting *material holdings*;
- *GENPRU 2 Annex 5R*, for a *BIPRU investment firm* deducting *illiquid assets*; and
- *GENPRU 2 Annex 6R*, for a *BIPRU investment firm* with a waiver from consolidated supervision.

Firms should also see *BIPRU 8.6* and *BIPRU 8.7.1R*.

12A Credit risk requirement under existing rules

This data element is only relevant up to and including 31 December 2007. Thereafter, it must be zero.

This should only be completed by firms that have not yet adopted one of the approaches to credit risk set out in *BIPRU 3* and *BIPRU 4*.

13A Market risk capital requirement under existing rules

This data element is only relevant up to and including 31 December 2007. Thereafter, it must be zero.

This should only be completed by firms that have not yet adopted one of the approaches to credit risk set out in *BIPRU 3* and *BIPRU 4*.

14A Other capital requirements under existing rules

This data element is only relevant up to and including 31 December 2007. Thereafter, it must be zero.

Enter here any other capital requirements, other than credit or market risk, under existing rules including any secondary requirements arising under *BIPRU TP 8.11 R*.

15A Total credit risk capital component

During 2007, this will be completed by firms that have adopted one of the new approaches to credit risk at the reporting date.

See *GENPRU 2.1.39R* as modified if a firm has an IRB permission, as well as *BIPRU 8.7.6R* to *BIPRU 8.7.11R*.

16A Total operational risk capital requirement

During 2007, this will be completed by firms that have adopted one of the new approaches to credit risk at the reporting date.

See *BIPRU 6*, *BIPRU 8.7.14R* and *BIPRU 8.7.15R*.

17A Reduction in operational risk capital requirement under *BIPRU TP 12.8R*

This is only relevant for a *full scope BIPRU investment firm* that satisfies the conditions set out in *BIPRU TP 12.1R*.

Firms should report here the amount by which the *ORCR* reported in data element 16A is reduced as a result of the calculation in *BIPRU TP 12.8R* (thus data element 16A less this data element will give the reduced *ORCR*). So 17A will be less than 16A.

18A Counterparty risk capital component

During 2007, this will only be completed by firms that have adopted one of the new approaches to credit risk at the reporting date.

See *BIPRU 14.1.3R*, as well as *BIPRU 8.7.6R* to *BIPRU 8.7.11R*.

19A Total market risk capital requirement

During 2007, this will only be completed by firms that have adopted one of the new approaches to credit risk at the reporting date.

See *BIPRU 7*, *GENPRU 2.2.46R*, *BIPRU 8.7.12R* and *BIPRU 8.7.13R*.

20A Concentration risk capital component

During 2007, this will only be completed by firms that have adopted one of the new approaches to credit risk at the reporting date.

See *BIPRU* 10.5.14R to *BIPRU* 10.5.21G, as well as *BIPRU* 8.7.6R and *BIPRU* 8.9, for details of how this is calculated.

21A Fixed overheads requirement

During 2007, this will only be completed by firms that have adopted one of the new approaches to credit risk at the reporting date.

See *GENPRU* 2.1.40R to *GENPRU* 2.1.46G.

22A Capital requirements

Report here your calculation of your capital requirement.

For firms that have not adopted the new approaches to credit risk yet, the figure may well differ from that reported in your existing regulatory returns under *SUP* 16.7. Although this may be expected, firms should be able to explain how the differences from that have arisen.

23A Capital resources requirement arising from the operation of capital floors

This will only be completed by firms that have adopted the *IRB approach* to credit risk or *AMA* for operational risk. See *BIPRU* TP2.

When reporting, the scaling factors set out in *BIPRU* TP2.8R should have been applied.

24A Surplus/Deficit of own funds

This is data element 11A less data element 22A.

Although not reported here, firms that have adopted the *IRB approach* should also be monitoring data element 23A in relation to item 11A.

Large exposures

25A Capital resources

Enter here the figure previously reported for this *non-EEA sub-group* in data element 8A on the last submission. If it is the first occasion on which this sub-group has reported, use the figure in 8A above.

26 Counterparty details

Enter each counterparty name or group name for each large exposure at the reporting date, together with the appropriate details of the exposure.

26A Exposure number

Please number each *large exposure* consecutively.

26B Counterparty name

List here the names of the *counterparties*, *groups of connected clients*, and *connected counterparties* (as set out in *BIPRU* 10.3) that represent *large exposures*.

26C Amount of the exposure that is exempt

The amount of the exposure, after credit risk mitigation techniques, that is exempt under *BIPRU* 10.6

26D Amount of the exposure that is not exempt and is in the non-trading book

The amount of the exposure, after credit risk mitigation techniques, that is not exempt and is in the non-trading book.

26E Amount of the exposure that is not exempt and is in the trading book

The amount of the exposure, after credit risk mitigation techniques, that is not exempt and is in the trading book.

26F Non-exempt % of capital resources under *BIPRU* 10.5.2R

This is columns D plus E as a percentage of the capital resources under *BIPRU* 10.5.2R reported in data element 25A. It should be entered to two decimal places, omitting the % sign.

26G CNCOM

The amount of CNCOM calculated as set out in *BIPRU* 10.5.14R to 10.5.21G.

FSA028 – Non-EEA sub-groups validations

Internal validations

Data elements are referenced by row then column.

Validation number	Data element		
1	8A	=	5A + 6A – 7A
2	11A	=	8A + 9A – 10A
3	17A	≤	16A
4	24A	=	11A-22A

Part 6

Further amendments to SUP 16.7

16.7.17	R	Table Financial reports from a <i>building society</i> (see SUP 16.7.16R)			
		Content of report	Form (Note 1)	Frequency	Due date
		Adequate information on group balance sheet, analysed between society and subsidiary undertakings	MFS1— (Table A)	Monthly	9 <i>business days</i> after month end (largest societies) (Note 2)
		Adequate information on society's balance sheet and primary business transactions	MFS1— (Tables B to G)	Monthly	12 <i>business days</i> after month end (other societies) 7 <i>business days</i> after month end (largest societies) (Note 2)
		Sectoral information of the society's balance sheet	MFS1 Supp (Note 3)	Monthly	10 <i>business days</i> after month end (other societies) 7 <i>business days</i> after month end
		Adequate information on balance sheets and primary business transactions of society's subsidiary undertakings accepting deposits and/or lending	MFS2	Monthly	7 <i>business days</i> after month end (largest societies) (Note 2)
		...			10 <i>business days</i> after month end (other societies)
		Sectoral and other breakdown of assets and liabilities, gilt maturities, and derivative contracts	QFS2 (note 3)	Quarterly	11 <i>business days</i> after calendar quarter end
		...			
		Note 2 = Largest societies are defined as those societies who were the 40 largest <i>building societies</i> (in terms of total assets) as at 31 December 1991.			
		Note 3 = Only required from the largest tier (see Note 2).			
		...			

**NEW COLLECTIVE INVESTMENT SCHEMES SOURCEBOOK
(OTC DERIVATIVE REQUIREMENTS AND OTHER MISCELLANEOUS
AMENDMENTS) INSTRUMENT 2006**

Powers exercised

- A. The Financial Services Authority makes this instrument in the exercise of the following powers and related provisions:
- (1) the following sections of the Financial Services and Markets Act 2000 (“the Act”):
 - (a) section 138 (General rule-making power);
 - (b) section 140 (Restriction on managers of authorised unit trust schemes);
 - (c) section 156 (General supplementary powers);
 - (d) section 157 (Guidance);
 - (e) section 238(5) (Restrictions on promotion);
 - (f) section 242 (Applications for authorisation of unit trust schemes);
 - (g) section 247 (Trust scheme rules); and
 - (h) section 248 (Scheme particulars rules); and
 - (2) Regulation 6 (FSA rules) of the Open-Ended Investment Companies Regulations 2001 (SI 2001/1228).
- B. The rule-making powers and related provisions listed above are specified for the purpose of section 153(2) of the Act (Rule-making instruments).

Commencement

- C. This instrument comes into force on 6 November 2006, except that text in Annex A which is placed in bold square brackets is deleted with effect from 12 February 2007.

Amendments to the Handbook

- D. The modules of the FSA's Handbook of rules and guidance listed in column (1) below are amended in accordance with the Annexes to this instrument listed in column (2).

(1)	(2)
Glossary of definitions	Annex A
New Collective Investment Schemes sourcebook (COLL)	Annex B

Citation

- E. This instrument may be cited as the New Collective Investment Schemes Sourcebook (OTC Derivative Requirements and other Miscellaneous Amendments) Instrument 2006.

Annex A

Amendments to the Glossary of definitions

In this Annex, underlining indicates new text and striking through indicates deleted text. Handbook text in this Annex placed in bold square brackets is deleted with effect from 12 February 2007 but is not shown struck through.

Amend the following definition as shown:

...

marketing (in *COLL* [and *CIS*]) (in relation to marketing *units* in a *regulated collective investment scheme* in a particular country or territory):

- (a) *communicating* to a *person* in that country or territory an invitation or inducement to become, or offer to become, a *holder* in that ~~*authorised fund*~~ *regulated collective investment scheme*;
- (b) giving *advice on investments* to, or arranging (bringing about) a deal in an investment for a *person* in that country or territory to become a *holder* in that ~~*authorised fund*~~ *regulated collective investment scheme*.

...

Annex B

Amendments to the New Collective Investment Schemes sourcebook (COLL)

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

...

Table: contents of the prospectus

4.2.5 R This table belongs to *COLL* 4.2.2R (Publishing the prospectus).

...
Contracts and other relationships with parties
11 The following relevant details:
...
(h) in what capacity (if any), the <i>authorised fund manager</i> acts in relation to any other <u>regulated collective investment schemes</u> and ...
...

...

Investment in collective investment schemes

5.2.13 R ...

(4) where the second *scheme* is an *umbrella*, the provisions in (2) and (3) and *COLL* 5.2.11R (Spread: general) apply to each *sub-fund* as if it were a separate *scheme*.

...

OTC transactions in derivatives

5.2.23 R A transaction in an *OTC derivative* under *COLL* 5.2.20R (1)(b) must be:

...

(2) on approved terms: the terms of the transaction in *derivatives* are approved only if, before the transaction is entered into, the *depository* is satisfied that the counterparty has agreed with the *ICVC* or the *authorised fund manager*:

...

(b) that it or an alternative counterparty will, at the request of the *ICVC* or *authorised fund manager*, enter into a further transaction to sell, liquidate or close out that transaction at

any time, at a fair value ...

...

Risk management process

5.2.25 G ...

- (2) The *depository* should take reasonable care to review the appropriateness of the risk management process in line with its duties under COLL 6.6.4R (General duties of the depository) and COLL 6.6.14R (Duties of the depository and authorised fund manager: investment and borrowing powers), as appropriate.

...

Transferable securities and money-market instruments

5.6.5 R ...

- (1) be admitted to or *dealt* in on an *eligible* market within COLL 5.2.10R (Eligible markets: requirements); ~~and~~ or

...

Spread: general

5.6.7 R ...

- (7) For the purpose of calculating the limit in (5), the exposure in respect of an *OTC derivative* may be reduced to the extent that collateral is held in respect of it if the collateral meets each of the conditions specified in (8).
- (8) The conditions referred to in (7) are that the collateral:
- (a) is marked-to-market on a daily basis and exceeds the value of the amount at risk;
 - (b) is exposed only to negligible risks (e.g. government bonds of first credit rating or cash) and is liquid;
 - (c) is held by a third party custodian not related to the provider or is legally secured from the consequences of a failure of a related party; and
 - (d) can be fully enforced by the *non-UCITS retail scheme* at any time.
- (9) For the purpose of calculating the limit in (5), *OTC derivative* positions with the same counterparty may be netted provided that the netting procedures:
- (a) comply with the conditions set out in Section 3 (Contractual netting (Contracts for novation and other netting agreements))

of Annex III to the *Banking Consolidation Directive*; and

(b) are based on legally binding agreements.

(10) In applying this rule, all *derivatives* transactions are deemed to be free of counterparty risk if they are performed on an exchange where the *clearing house* meets each of the following conditions:

(a) it is backed by an appropriate performance guarantee; and

(b) it is characterised by a daily mark-to-market valuation of the *derivative* positions and an at least daily margining.

5.6.7A G Guidance on spread: general

(1) COLL 5.6.7R (7) to (10) replicate the provisions of Article 5 of the Commission Recommendation 2004/383/EC of 27 April 2004 on the use of financial derivative instruments for undertakings for collective investment in transferable securities, so as to enable *non-UCITS retail schemes* to benefit from the same flexibility. This Recommendation may be accessed via http://europa.eu.int/eur-lex/pri/en/oj/dat/2004/l_199/l_19920040607en00240029.pdf

(2) The attention of *authorised fund managers* is specifically drawn to condition (d) in COLL 5.6.7R (8) under which the collateral has to be legally enforceable at any time. It is the FSA's view that it is advisable for an *authorised fund manager* to undertake a legal due diligence exercise before entering into any financial collateral arrangement. This is particularly important where the collateral arrangements in question have a cross-border dimension. The *depository* will also need to exercise reasonable care to review the collateral arrangements in accordance with its duties under COLL 6.6.4 (General duties of the depository).

...

Investment in collective investment schemes

5.6.10 R ...

(5) where the second *scheme* is an *umbrella*, the provisions in (2) to (4) and COLL 5.6.7R (Spread: general) apply to each *sub-fund* as if it were a separate *scheme*.

...

Derivatives: general

5.6.12 R (1) ...

(a) of a kind specified in ~~COLL 5.2.20R~~ COLL 5.6.13R (Permitted transactions (derivatives and forwards)); and

...

Permitted transactions (derivatives and forwards)

- 5.6.13 R (1) ...
- (a) the underlying must be within ~~COLL 5.2.20R (2)~~ or COLL 5.6.4R (5) (Investment powers: general) or COLL 5.2.20R (2)(f) to (i) ; and

...

Risk management process

- 5.6.17 G ...
- (2) The *depository* should take reasonable care to review the appropriateness of the risk management process in line with its duties under ~~COLL 6.6 (Powers and duties of the scheme, the authorised fund manager and the depository)~~ COLL 6.6.4R (General duties of the depository) and COLL 6.6.14R (Duties of the depository and authorised fund manager: investment and borrowing powers), as appropriate.

...

Cash, borrowing, lending and other provisions

- 5.6.22 R ...
- (2) COLL 5.5.1R (Application) and COLL 5.5.2R (Table of application);
- ...
- (7) COLL 5.5.7R (1), and ~~COLL 5.5.7R (2) and (4)~~ (Restrictions on lending of property other than money);

...

Duties of the depository and the authorised fund manager: investment and borrowing powers

- 6.6.14 R (1) The *authorised fund manager* must avoid the *scheme property* being used or invested contrary to *COLL 5*, or any provision in the *instrument constituting the scheme* or the *prospectus* as referred to in COLL 5.2.4R (Investment powers: general) and COLL 5.6.4R (Investment powers: general), except to the extent permitted by (3)(b).

...

**PERIMETER GUIDANCE (HOME REVERSION AND HOME PURCHASE
ACTIVITIES) INSTRUMENT 2006**

Powers exercised

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

Commencement

- B. Annex A of this instrument comes into force on 6 November 2006.
- C. Annex B of this instrument comes into force on 6 April 2007.

Amendments to the Perimeter Guidance manual (PERG)

- D. PERG is amended in accordance with Annex A and Annex B. The general guidance in PERG does not form part of the Handbook.

Citation

- E. This instrument may be cited as the Perimeter Guidance (Home Reversion and Home Purchase Activities) Instrument 2006.

By order of the Board
25 October 2006

Annex A

Amendments to the Perimeter Guidance manual (PERG)

In this Annex, underlining indicates new text and striking through indicates deleted text. With the exception of Chapter 14 which represents new text.

1.4.2 G Table: list of general guidance to be found in *PERG*.

Chapter:	Applicable to:	About:
...		
<u><i>PERG 13: Guidance on the scope of the Markets in Financial Instruments Directive and the recast Capital Adequacy Directive</i></u> <u>[to be issued]</u>		
<u><i>PERG 14:</i></u> <u>Home reversion and home finance activities</u>	<u><i>Any person who needs to know whether his activities in relation to home reversion plans or home purchase plans will amount to regulated activities or whether the restriction in section 21 of the Act will apply to any financial promotions he may make.</i></u>	<ul style="list-style-type: none"> • <u><i>the regulated activities that arise in connection with home reversion plans and home purchase plans and any exclusions that may be relevant</i></u> • <u><i>the circumstances in which financial promotions about home reversion plans and home purchase plans may be made without breaching the restriction in section 21 of the Act</i></u>

New text to be added as Chapter 14

14 Guidance on home reversion and home purchase activities

14.1 Background

Q1. What is the purpose of these questions and answers (“Q&As”) and who should be reading them?

These Q&As are aimed at *persons* involved in the provision or promotion of financial arrangements involving the acquisition or disposal of land for the purpose of enabling an individual:

- to purchase a property; or
- to raise funds from the equity in a property that he already owns,

other than by means of a traditional mortgage.

They are intended to help such persons understand whether they will, as a result of the Regulation of Financial Services (Land Transactions) Act 2005 and secondary legislation made following that Act:

- be carrying on a *regulated activity* and need *authorisation* or exemption under section 19 of the Financial Services and Markets Act 2000; or
- be subject to the restriction on *financial promotions* in section 21 of the Financial Services and Markets Act 2000.

The Q&As complement the general *guidance* on regulated activities, which is in Chapter 2 of our Perimeter Guidance Manual (PERG 2), the general guidance on regulated mortgage activities in Chapter 4 (PERG 4), the general guidance on financial promotions in Chapter 8 (PERG 8) and the relevant legislation.

The Q&As that follow are set out in sections:

- general issues (PERG 14.2);
- activities relating to home reversion plans (PERG 14.3);
- activities relating to home purchase plans (PERG 14.4);
- the ‘by way of business’ test (PERG 14.5);
- carrying on a regulated activity in the United Kingdom (PERG 14.6);
- exemptions (PERG 14.7);
- financial promotions (PERG 14.8); and
- transitional provisions (PERG 14.9).

14.2 General issues

Q2. What is the purpose of the Regulation of Financial Services (Land Transactions) Act 2005?

This Act makes clear that the potential regulatory scope of the Financial Services and Markets Act 2000 enables the FSA to regulate activities that are similar to those that are already regulated when carried on in relation to traditional mortgages but which

involve the provider acquiring land rather than simply providing finance for its purchase by the homeowner. This typically includes:

- schemes (often termed 'equity release schemes') where a provider buys an interest in a homeowner's property and allows the homeowner to continue to reside in the property ('home reversion plans'); and
- certain types of Islamic financing arrangements designed to enable the purchase of a home in a way that is acceptable under Islamic law, such as Ijara or diminishing Musharaka ('home purchase plans').

Q3. I propose to carry on activities in relation to home finance arrangements of the kind mentioned in Q2. In what circumstances will I need to be authorised by the FSA or be an exempt person?

You will need to be an authorised or exempt person if you will:

- be carrying on *regulated activities*;
- be doing so by way of business;
- be doing so on or after 6 April 2007; and
- be doing so in the *United Kingdom*.

Q4. How will I know if my proposed home finance activities are regulated?

Regulated activities are specified in the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 ('the *Regulated Activities Order*'). This will be amended, following the enactment of the Regulation of Financial Services (Land Transactions) Act 2005, to extend its scope to cover certain home finance activities. These amendments are made in the Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) (No2) Order 2006 (SI 2006/2383) which comes into effect on 6 April 2007. The new regulated home finance activities are:

- *entering into a home reversion plan or entering into a home purchase plan as the provider of the plan or, in the case of home reversion plans only, as a person to whom rights or obligations acquired by the provider are transferred or who, during the currency of the plan, acquires all or part of the interest in land bought by the provider;*
- *administering a home reversion plan or administering a home purchase plan;*
- *arranging (bringing about) a home reversion plan or arranging (bringing about) a home purchase plan;*
- *making arrangements with a view to home reversion plans or making arrangements with a view to home purchase plans;*
- *advising on a home reversion plan or advising on a home purchase plan; and*
- agreeing to do any of the above.

But some activities are specifically excluded from regulatory scope.

14.3 Activities relating to home reversion plans

Q5. What is a home reversion plan?

Broadly speaking, this is an arrangement under which, at the time it is entered into, a *person* (the ‘reversion purchaser’) buys all or part of an interest in land (other than timeshare accommodation) in the UK from a homeowner (being an individual or a trustee whose beneficiary is an individual) (the ‘reversion occupier’) on the basis that the individual or a related person is entitled under the arrangement, and intends, to use at least 40% of the land as a dwelling until:

- the end of a fixed period of at least twenty years; or
- the individual dies; or
- the individual enters a care home.

It should be noted that an arrangement will be a *home reversion plan* if the intention is for the land to be used as a dwelling until any one of the above eventualities arises. It is not necessary for the arrangement to provide for all three eventualities, merely one or more of them.

This means that an arrangement is not a home reversion plan if:

- the occupier is not an individual; or
- the land is to be used for the purpose of letting as a dwelling to someone other than a related person of the individual (or beneficiary under the trust) who owns it; or
- the land is used primarily for business purposes; or
- the land is overseas.

A related person, in relation to an individual, means:

- that person’s spouse or civil partner; or
- a person (whether or not of the same sex) whose relationship with that person has the characteristics of a husband and wife relationship; or
- that person’s:
 - parent or grandparent;
 - child or grandchild; or
 - sibling.

Q6. Will a mortgage-to-rent scheme be a home reversion plan?

No. This is most unlikely as mortgage-to-rent schemes do not usually provide for the homeowner (having sold his property to the scheme provider), or a related person as the case may be, to occupy the property until he dies or enters a care home or for a fixed period of at least twenty years.

Q7. Can an arrangement that was established before 6 April 2007 be a home reversion plan?

Yes. An arrangement may still be a *home reversion plan* even though it was established before 6 April 2007. However, regulated activities carried on in relation to a home reversion plan established before 6 April 2007 will only be subject to regulation:

- when carried on on or after 6 April 2007; and
- in certain circumstances (see Q21 for a summary).

Q8. When will I be carrying on the activity of entering into a home reversion plan?

This will occur when you enter into the plan at the outset as the reversion purchaser. It can also occur at a later stage if all or part of the rights or obligations of the reversion purchaser are transferred to you or if you acquire all or part of the interest in land bought by the reversion purchaser (where you become a ‘reversion transferee’). This is so, whether you are acquiring the rights or obligations from the reversion purchaser or from an existing reversion transferee. This includes acquiring the rights or obligations or the interest in land purely as an investment. However, investors will only be regulated if they satisfy the ‘by way of business test’ (see Q38). We refer to reversion purchasers and reversion transferees collectively in this guidance as ‘reversion providers’.

So, if you are a reversion transferee under a plan that was established before 6 April 2007, you will only be subject to regulation for carrying on the regulated activity of entering into the plan if you do so on or after 6 April 2007.

Q9. What exclusions may be available to me if I am entering into home reversion plans?

The main exclusions are those:

- for trustees who enter into a plan where the reversion occupier is an individual who is a beneficiary under the trust, or a related person (article 66(6B) of the *Regulated Activities Order*); and
- for *overseas persons* who satisfy certain conditions (see Q39).

Q10. When will I be carrying on the activity of administering a home reversion plan?

This will arise if you carry out any one or more of the following functions for a reversion provider or a reversion occupier in relation to a plan that was originally established on or after 6 April 2007:

- taking necessary steps to make payments to the reversion occupier; or

- taking necessary steps to collect or recover payments due from the reversion occupier; or
- notifying the reversion occupier of changes in payments due under the plan, or of other matters of which the plan requires him to be notified.

One effect of this is that you will not become subject to regulation if you are administering a plan that was originally established before 6 April 2007 and a reversion transferee enters into the plan after that date. See Q21 for more detail about when activities are regulated if a plan was originally established before 6 April 2007.

It is irrelevant, for the purposes of determining if you are administering a home reversion plan, whether or not the plan was entered into by way of business. In this respect, the activity is different to the regulated activities of *administering a regulated mortgage contract* or *administering a home purchase plan*.

Q11. What exclusions may be available to me if I am administering home reversion plans?

Specific exclusions may apply if you are not an *authorised person* and:

- you arrange for an authorised person with the appropriate *Part IV permission* to administer the plan – this includes where you administer the plan for a period of up to one month following the termination of such an arrangement; or
- you administer the plan under an agreement with an authorised person who has Part IV permission to administer such a plan.

The other main exclusions are those:

- for trustees who administer a plan where the reversion occupier is an individual who is a beneficiary under the trust or a related person (article 66(6B) of the *Regulated Activities Order*); and
- for *overseas persons* who satisfy certain conditions (see Q39).

Q12. When will I be carrying on the activity of arranging home reversion plans?

There are three types of arranging activity that are regulated. These are making arrangements:

(1) for another *person* to enter into a plan as a reversion occupier or as a reversion provider;

(2) for another person, being a reversion occupier or a reversion provider, to vary the terms of a plan that was originally established on or after 6 April 2007, in such a way as to vary his obligations under that plan; and

(3) with a view to a person who participates in the arrangements entering into a plan as a reversion occupier or as a reversion provider.

But none of these arranging activities will apply to you if they relate to a plan to which, as a result of your arranging activities, you are or will become a party (article 28A of the *Regulated Activities Order*).

You will only be making arrangements under (1) or (2) if your actions are such as to bring about the entry into the plan or the variation as the case may be (article 26 of the *Regulated Activities Order*). This means that your involvement must be material to whether the transaction occurs. For example, assisting a person by completing the necessary application forms on their behalf or acting as their agent or attorney in negotiating entry will amount to bringing about the transaction.

Arranging activities under (3) will typically include making regular introductions of homeowners to reversion providers or of reversion transferees to reversion purchasers or vice versa or of any of these to a *reversion intermediary*.

Q13. I understand that any transaction that I have arranged before 6 April 2007 is not subject to regulation. But am I regulated if I arrange for a reversion transferee to enter into or vary a home reversion plan on or after 6 April 2007?

This depends on the type of arranging you are carrying on. If you are arranging variations, this will only be regulated if the plan was originally established on or after 6 April 2007. But, if you are arranging for a reversion transferee to enter into a plan and the arrangements are being made on or after 6 April 2007, you will be regulated for that arranging activity. See Q21 for more detail about when activities are regulated if a plan was originally established before 6 April 2007.

Q14. Will I be regulated for arranging for a reversion provider to dispose of his rights and obligations or his interest in land under a home reversion plan to a reversion transferee?

It is only arranging for a person to enter into or vary the terms of a plan that is subject to regulation. So, you will not be regulated for providing arranging services to the existing provider who wishes to dispose of his rights, obligations or interests but you are likely to be regulated if you are arranging for the transferee to enter into the plan by acquiring the rights, obligations or interests.

Q15. What exclusions may be available to me if I am arranging home reversion plans?

If you are an *unauthorised person* the following exclusions may be available to you:

- where you are arranging for a transaction to be entered into with or through an *authorised person* (article 29 of the *Regulated Activities Order*) (see Q16); and

- where you have arranged for an authorised person to administer the plan or are administering it yourself during the period of one month following the termination of your arrangement with the authorised person (article 29A(2) of the Regulated Activities Order).

Whether or not you are an unauthorised person, the other main exclusions that may apply include:

- introductions made with a view to the provision of regulated independent advice (article 33 of the Regulated Activities Order) (see Q17);
- introductions made to a regulated person who carries on home reversion plan activities (article 33A of the Regulated Activities Order) (see Q18);
- arrangements that are a necessary part of other services provided by a person in the course of carrying on a profession or business other than a *regulated activity* (article 67 of the Regulated Activities Order); and
- *overseas persons* (article 72 of the Regulated Activities Order) (see Q39).

Q16. When will the exclusion in article 29 of the Regulated Activities Order be available to me if I am arranging home reversion plans?

The exclusion will apply to you when, as an *unauthorised person*, you are arranging any of the following:

- for a homeowner (your client) to enter into a plan with an authorised reversion provider or through an authorised intermediary;
- for a reversion provider (your client) to enter into a plan with a homeowner or to transfer rights or obligations or an interest in land to a reversion transferee if either the reversion transferee is an authorised person or the transaction is to be effected through an authorised intermediary; or
- for a reversion transferee (your client) to acquire rights or obligations from an authorised reversion provider or through an authorised intermediary;
- for your client to vary the terms of a plan where the reversion provider is an authorised person or the variation is arranged through an authorised intermediary.

This is subject to your meeting certain conditions which are, broadly speaking, that:

- you must not advise your client on the merits of his entering into the transaction; and
- you must not be paid by anyone other than your client.

The requirement that you do not receive any payment other than from your client does not prevent you receiving payment from the *authorised person* but you must then treat the sums paid to you as belonging to your client. There is nothing to prevent you then using the sums to offset payments due to you from your client for services rendered to him. This is provided that you have your client's agreement to do so.

Q17. When will the exclusion in article 33 of the Regulated Activities Order be available to me if I am arranging home reversion plans?

Broadly speaking, the exclusion will apply where:

- your arranging activity is limited to *making arrangements with a view to home reversion plans*;
- you make introductions of homeowners, reversion purchasers or reversion transferees to an *authorised person*, an *exempt person* or an *overseas person*; and
- the introduction is made with a view to the provision of independent advice or the provision of independent discretionary services relating to home reversion plans.

Q18. When will the exclusion in article 33A of the Regulated Activities Order be available to me if I am arranging home reversion plans?

Broadly speaking, the exclusion will apply where:

- your arranging activity is limited to *making arrangements with a view to home reversion plans*;
- you make introductions of homeowners or of prospective reversion providers (your client) to an *authorised person*, an *appointed representative* or an *overseas person*;
- you do not receive any money paid by your client in relation to the transaction other than a sum that is due to you for your own account (for example, your fee for providing the introductory service); and
- you disclose to your client certain information about your relationship with the person to whom you are effecting introductions and about any reward you may receive for doing so.

Q19. When will I be carrying on the activity of advising on a home reversion plan?

This will arise if:

- you are giving advice to a *person* who is or who is contemplating becoming a reversion occupier, a reversion purchaser or a reversion transferee; and
- the advice relates to the merits of his entering into a home reversion plan in that capacity or varying the terms of a plan that he has already entered into.

Advice on the merits of varying the terms of a plan will only be regulated where the plan was originally established on or after 6 April 2007. However, advice given to a reversion transferee on the merits of his entering into a plan that was originally established before 6 April 2007 will be subject to regulation. See Q21 for more detail about when activities are regulated if a plan was originally established before 6 April 2007.

Advice given to a person on the merits of his transferring rights or obligations or interests in land under a plan to another person is not regulated.

Much of the detailed guidance on *advising on regulated mortgage contracts* in PERG 4.6 may be applied to the activity of *advising on a home reversion plan*.

Q20. What exclusions may be available to me if I am advising on home reversion plans?

The main exclusions that are available include:

- advice given in a periodical publication, broadcast or other form of regularly updated news or information service (article 54 of the *Regulated Activities Order*);
- advice that is a necessary part of other services provided by a person in the course of carrying on a profession or business other than a *regulated activity* (article 67 of the *Regulated Activities Order*); and
- *overseas persons* (article 72 of the *Regulated Activities Order*) (see Q39).

Detailed guidance on the exclusion in article 54 is in PERG 7.

Q21. I can see that the fact that the home reversion plan was originally established before 6 April 2007 can affect whether the services that I provide to parties to the plan after that date are regulated. Can you summarise the position in this respect please?

Yes. This all depends on the combination of the date of entry or variation and the capacity in which your customer enters or entered into the plan. The following table clarifies when your services will be regulated activities and when they will not.

Potential home reversion plan activity	Whether the activity is regulated if undertaken on or after 6 April 2007 when the plan was originally established before 6 April 2007
Entering into a plan as reversion purchaser (see Q8)	N/A – this activity will only take place when the plan is first established
Entering into a plan as reversion transferee (see Q8)	Yes
Administering a plan (see Q10)	No
Arranging (see Q12) for a person to enter into a plan as:	
(a) a reversion purchaser or a reversion occupier	N/A – this activity will only take place when the plan is first established
(b) a reversion transferee	Yes

Arranging variations (see Q12) of a plan	No
Advising (see Q19) a person on entering into a plan in his capacity as:	
(a) a reversion purchaser or a reversion occupier	N/A – this activity will only take place when the plan is first established
(b) a reversion transferee	Yes
Advising (see Q19) a person on varying the terms of a plan	No

Q22. Will changes involving the circumstances of the reversion occupier that may take place after the plan has been entered into (such as moving house, marriage or change of occupants) have any implications in terms of regulated activity?

This depends on the facts and is a question of degree that requires an assessment against the criteria that make up the definition of a home reversion plan. There are two main issues that would need to be considered. These are:

- is the change likely to cause a new plan to be entered into on or after 6 April 2007; and
- does the change involve a variation of the terms of the plan (if it was originally entered into on or after 6 April 2007) such as to vary the obligations of the provider or the occupier?

Broadly speaking, it would seem likely that, if the occupier were to move house, there would be a need for the existing plan to be terminated and a new plan to be entered into. Where this happens on or after 6 April 2007, the person who enters into the new plan as provider and anyone arranging or advising on the new plan will potentially need to be authorised or exempt. Changes such as may occur due to marriage or change of occupants, change of other relevant details or drawdown of funds under a staggered payment arrangement may necessitate a new plan or may involve a variation in the existing plan depending on the extent to which they alter the obligations of the provider or the occupier. Where such changes do involve a variation, anyone arranging or advising on the variation would potentially need to be authorised or exempt. But this applies only where the plan was originally entered into on or after 6 April 2007.

14.4 Activities relating to home purchase plans

Q23. What is a home purchase plan?

Broadly speaking, a *home purchase plan* is an arrangement under which, at the time it is entered into:

- a *person* (the ‘home purchase provider’) buys a qualifying interest, or an undivided share of a qualifying interest, in land (other than timeshare accommodation) in the *United Kingdom*;
- an individual or a trustee whose beneficiary is an individual (the ‘home purchaser’) is obliged to buy that interest over the course of or at the end of a specified period; and
- the individual or a related person is entitled to use at least 40% of the land as a dwelling during that fixed period and intends to do so.

Where an undivided share of a qualifying interest is bought, the interest must be held on trust for the home purchase provider and the individual or trustee as beneficial tenants in common.

This means that an arrangement is not a home purchase plan if:

- the home purchaser is not an individual or trustees;
- the land is used for the purpose of letting as a dwelling to someone other than a related person of the individual who is obliged to buy it;
- the land is used primarily for business purposes; or
- the land is overseas.

A related person, in relation to an individual, means:

- that person’s spouse or civil partner; or
- a person (whether or not of the same sex) whose relationship with that person has the characteristics of a husband and wife relationship; or
- that person’s:
 - parent or grandparent;
 - child or grandchild; or
 - sibling.

Q24. Are home purchase plans limited to arrangements designed to comply with Islamic principles?

There is nothing in the definition of a *home purchase plan* to suggest that this is the case. However, it is clear from the comments made by HM Treasury in relation to the introduction of the Regulation of Financial Services (Land Transactions) Act 2005 that the definition is primarily directed at arrangements of this kind.

Q25. Will all Islamic home financing arrangements be home purchase plans?

No. Murabaha arrangements involve the homeowner buying the property from the provider on deferred payment terms. These types of arrangement will be *regulated*

mortgage contracts assuming that they meet the necessary conditions including that there is a first legal charge over the property (see PERG 4).

Ijara arrangements (where the provider buys the land and allows the customer to occupy it whilst also making regular payments towards eventually buying the land) and diminishing Musharaka arrangements (where the provider and the customer share an interest in the land and the customer gradually acquires a greater interest in the land over a period of time) will be *home purchase plans* provided they meet the necessary conditions (see Q23).

A home purchase plan may also satisfy the requirements for a *regulated mortgage contract*. Where this arises, the plan is treated as a home purchase plan and not a regulated mortgage contract.

Q26. When will I be carrying on the activity of entering into a home purchase plan?

You will carry on this activity by entering into a *home purchase plan* as the home purchase provider. Unlike a reversion transferee under a *home reversion plan*, you will not be carrying on a regulated activity purely as a result of acquiring rights, obligations or interests in land from the provider.

Q27. What exclusions may be available to me if I am entering into home purchase plans as a provider?

The main exclusions are:

- for trustees who enter into a plan where the home purchaser is an individual who is a beneficiary under the trust or a related person (article 66(6C) of the *Regulated Activities Order*); and
- for *overseas persons* who satisfy certain conditions (see Q39).

Q28. When will I be carrying on the activity of administering a home purchase plan?

This will arise if you carry out either or both of the following functions in relation to a plan that was entered into by the home purchase provider by way of business on or after 6 April 2007:

- notifying the home purchaser of changes in payments due under the plan, or of other matters of which the plan requires him to be notified; and
- taking any necessary steps for the purposes of collecting or recovering payments due under the plan from the home purchaser.

But you will not be treated as *administering a home purchase plan* merely because you have, or you exercise, a right to take action for the purposes of enforcing the plan (or to require that such action is or is not taken).

Q29. I propose to administer home purchase plans. How will I know if the plan I propose to administer has been entered into by way of business?

In most cases, this will be obvious because the provider will be a body corporate whose business involves being a provider under such plans and, in the majority of cases, should be an *authorised person*. We understand that this is the usual situation with Islamic home financing arrangements. However, if the plan were to have been entered into by an investor, the factors set out in Q38 will need to be considered to determine whether it was entered into by way of business. A typical example of a plan not entered into by way of business would be where the provider is a friend or relative who does not seek to profit from acting as the provider. Another example might be a plan entered into by a charitable organisation that occasionally purchases interests in land with sums derived from charitable donations and that does so on non-commercial terms.

Q30. What exclusions may be available to me if I am administering home purchase plans?

Specific exclusions may apply if you are not an *authorised person* and:

- you arrange for an authorised person with the appropriate *Part IV permission* to administer the plan – this includes where you administer the plan for a period of up to one month following the termination of such an arrangement; or
- you administer the plan under an agreement with an authorised person who has Part IV permission to administer such a plan.

The other main exclusions are those:

- for trustees who administer a plan where the home purchaser is an individual who is a beneficiary under the trust or a related person (article 66(6C) of the *Regulated Activities Order*); and
- for *overseas persons* who satisfy certain conditions (see Q39).

Q31. When will I be carrying on the activity of arranging home purchase plans?

There are three types of arranging activity that are regulated. These are making arrangements:

- (1) for another person to enter into a plan as a home purchaser;
- (2) for another person being a home purchaser to vary the terms of a plan entered into by him on or after 6 April 2007, in such a way as to vary his obligations under that plan; and
- (3) with a view to a person who participates in the arrangements entering into a plan as a home purchaser.

But none of these arranging activities will apply to you if they relate to a plan to which you are or will, as a result of your arranging activities, become a party (article 28A of the *Regulated Activities Order*).

You will only be making arrangements under (1) or (2) if your actions are such as to bring about the entry into the plan or the variation as the case may be (article 26 of the *Regulated Activities Order*). This means that your involvement must be material to whether the transaction occurs. For example, assisting a home purchaser by completing the necessary application forms on their behalf or acting as their agent or attorney in negotiating entry will amount to bringing about the transaction.

Arranging activities under (3) will typically include making regular introductions of prospective home purchasers to a provider or intermediary.

Unlike home reversion plans, arranging for a person to enter into, or vary, a plan as a provider is not, itself, a regulated activity.

Q32. What exclusions may be available to me if I am arranging home purchase plans?

If you are an *unauthorised person* the following exclusions may be available to you:

- where you are arranging for a transaction to be entered into with or through an *authorised person* (article 29 of the *Regulated Activities Order*) (see Q33);
- where you have arranged for an authorised person to administer the plan or are administering it yourself during the period of one month following the termination of your arrangement with the authorised person (article 29A(3) of the *Regulated Activities Order*).

Whether or not you are an unauthorised person, the other main exclusions that may apply include:

- introductions made with a view to the provision of regulated independent advice (article 33 of the *Regulated Activities Order*) (see Q17 which applies equally to *home purchase plans*);
- introductions made to a regulated person who carries on home reversion plan activities (article 33A of the *Regulated Activities Order*) (see Q34);
- arrangements that are a necessary part of other services provided by a person in the course of carrying on a profession or business other than a *regulated activity* (article 67 of the *Regulated Activities Order*); and
- *overseas persons* (article 72 of the *Regulated Activities Order*) (see Q39).

33. When will the exclusion in article 29 of the Regulated Activities Order be available to me if I am arranging home purchase plans?

The exclusion will apply to you when, as an *unauthorised person*, you are arranging for a prospective home purchaser (your client) to enter into a plan with an authorised home purchase provider or through an authorised intermediary;

This is subject to your meeting certain conditions which are, broadly speaking, that:

- you must not advise your client on the merits of his entering into the transaction; and
- you must not be paid by anyone other than your client.

The requirement that you do not receive any payment other than from your client does not prevent you receiving payment from the *authorised person* but you must then treat the sums paid to you as belonging to your client. There is nothing to prevent you then using the sums to offset payments due to you from your client for services rendered to him. This is provided that you have your client's agreement to do so.

Q34. When will the exclusion in article 33A of the Regulated Activities Order be available to me if I am arranging home purchase plans?

Broadly speaking, the exclusion will apply where:

- the arranging activity you carry on is limited to *making arrangements with a view to home purchase plans*;
- you make introductions of prospective home purchasers (your client) to an *authorised person*, an *appointed representative* or an *overseas person*;
- you do not receive any money paid by your client in relation to the transaction other than a sum that is due to you for your own account (for example, your fee for providing the introductory service); and
- you disclose to your client certain information about your relationship with the person to whom you are effecting introductions and about any reward you may receive for doing so.

Q35. When will I be carrying on the activity of advising on home purchase plans?

This will arise if you are:

- giving advice to a person who is or who is contemplating becoming a home purchaser; and
- the advice relates to the merits of his entering into a *home purchase plan* in that capacity or varying the terms of a plan that he has already entered into.

Advice on the merits of varying the terms of a plan is only regulated when the plan was entered into on or after 6 April 2007.

This differs from the position in relation to *home reversion plans* where advice given to the provider is also regulated.

Much of the detailed guidance on *advising on regulated mortgage contracts* in PERG 4.6 may be applied to the activity of *advising on a home purchase plan*.

Q36. What exclusions may be available to me if I am advising on home purchase plans?

The main exclusions that are available include:

- advice given in a periodical publication, broadcast or other form of regularly updated news or information service (article 54 of the *Regulated Activities Order*);
- advice that is a necessary part of other services provided by a person in the course of carrying on a profession or business other than a *regulated activity* (article 67 of the Regulated Activities Order); and
- *overseas persons* (article 72 of the Regulated Activities Order) (see Q39).

Detailed guidance on the exclusion in article 54 is in PERG 7.

Q37. Will changes involving the circumstances of the home purchaser that may take place after the plan has been entered into (such as moving house, marriage or change of occupants) have any implications in terms of regulated activity?

This depends on the facts and is a question of degree that requires an assessment against the criteria that make up the definition of a home purchase plan. There are two main issues that would need to be considered. These are:

- is the change likely to cause a new plan to be entered into on or after 6 April 2007? and
- does the change involve a variation of the terms of the plan (if it was originally entered into on or after 6 April 2007) such as to vary the obligations of the home purchaser?

Broadly speaking, it would seem likely that, if the home purchaser were to move house, there would be a need for the existing plan to be terminated and a new plan to be entered into. Where this happens on or after 6 April 2007, the person who enters into the new plan as provider and anyone arranging, or advising the home purchaser on, the new plan will potentially need to be authorised or exempt. Changes such as may occur due to marriage or change of occupants or of other relevant details may necessitate a new plan. Alternatively, they may involve a variation in the existing plan, depending on the extent to which they alter the obligations of the home purchaser. Where such changes do involve a variation, anyone advising the home purchaser on, or arranging, the variation would potentially need to be authorised or exempt. But this applies only where the plan was originally entered into on or after 6 April 2007.

14.5 The ‘by-way-of-business’ test

Q38. How do I know if I am carrying on regulated activities by way of business?

Whether or not any particular *person* will meet the requirement that he carries on a *regulated activity* by way of business and so needs *authorisation* or exemption will invariably depend on that person’s individual circumstances. A number of factors need to be taken into account in determining whether the test is met. These include:

- the degree of continuity;
- the existence of a commercial element;
- the scale of the activity;
- the proportion which the activity bears to other activities carried on by the same person but which are not regulated; and
- the nature of the particular regulated activity that is carried on.

Corporate plan providers and those who provide professional services to them or to home occupiers are likely to be carrying on their activities by way of business. Unpaid individuals who act as trustees for home occupiers are not likely to be.

With *home reversion plans*, it is quite possible that the reversion provider may be an individual who is acting purely in the capacity of investor. Such a person may not be acting by way of business when the criteria listed above are applied to his particular circumstances.

14.6 Carrying on a regulated activity in the United Kingdom

Q39. Does a person who acts as provider, administrator, arranger or adviser in relation to home reversion plans or home purchase plans from overseas and without maintaining an office in the UK need to be an authorised or exempt person?

The position on territorial application is complex. Detailed guidance on this aspect is provided in relation to regulated mortgage activities in PERG 4.11 and that guidance may generally be applied to home finance activities.

But, briefly, there are two issues to be considered by such a person:

- am I carrying on a home finance activity in the *United Kingdom*? and
- if so, does the exclusion for *overseas persons* in article 72 of the *Regulated Activities Order* apply to me?

Whether you are carrying on the activity in the UK depends on a combination of factors. In very broad terms, however, as an overseas person, you are more likely than not to be carrying on a home finance activity in the UK if the home occupier or reversion provider is normally resident in the UK at the time that he enters into the plan. The table that follows applies this broad principle to the various permutations taking account of the conditions applying to the exclusions for home finance activities under article 72.

Table indicating whether authorisation or exemption is likely to be needed by a person who is carrying on home finance activities from overseas.

Activity carried on by overseas	Where the reversion occupier or home purchaser is or was normally resident in the UK at	Where the reversion occupier or home purchaser is or was not normally resident in the
---------------------------------	-----------------------------------------------------------------------------------------	---------------------------------------------------------------------------------------

person	the time he enters or entered into the plan		UK at the time he enters or entered into the plan	
	Home reversion plan	Home purchase plan	Home reversion plan	Home purchase plan
Entering into or administering.	Yes	Yes	No	No
Arranging for persons to enter into plans.	Yes	Yes	No, provided the reversion purchaser or the reversion transferee, as the case may be, is or was also not normally resident in the UK.	No
Arranging variations.	Yes	Yes	No	No
Advising.	Yes	Yes	No, unless the reversion occupier, reversion provider or reversion transferee is located in the UK at the time the advice is given to him.	No, unless the home purchaser is located in the UK at the time the advice is given.

14.7 Exemptions

Q40. Am I an exempt person in relation to home finance activities?

Yes, if you are:

- a *person* who is specifically exempt under the Financial Services and Markets Act 2000 (Exemption) Order 2001, such as a local authority or a registered social landlord; or
- an *appointed representative* whose agreement with his principal permits him to carry on the activities in question; or
- an *exempt professional firm*.

Q41. What home finance activities can I carry on as an appointed representative?

You will be able to carry on any of the following *regulated activities*:

- *arranging (bringing about) a home reversion plan* or *arranging (bringing about) a home purchase plan*; or
- *making arrangements with a view to home reversion plans* or *making arrangements with a view to home purchase plans*; or
- *advising on a home reversion plan* or *advising on a home purchase plan*; or
- agreeing to do any of the above.

You will not be able to carry on any of the following *regulated activities*:

- *entering into a home reversion plan* or *entering into a home purchase plan*; or
- *administering a home reversion plan* or *administering a home purchase plan*; or
- agreeing to do either of the above.

Q42. I am an exempt professional firm. Will I be able to carry on any of the regulated activities relating to home reversion plans and home purchase plans without needing FSA authorisation?

This depends on the activity in question. Subject to your being able to satisfy the general requirements of Part XX of the Financial Services and Markets Act 2000 you will be able:

- to carry on the regulated activities of:
 - *entering into a home reversion plan*; or
 - *entering into a home purchase plan*; or
 - *administering a home reversion plan*; or
 - *administering a home purchase plan*; or
 - agreeing to do any of these things,

but only where you are acting as a trustee or personal representative and the *reversion occupier* or *home purchaser* is a beneficiary under the trust, will or intestacy;

- to carry on the regulated activities of:

- *arranging (bringing about) a home reversion plan; or*
- *arranging (bringing about) a home purchase plan; or*
- *making arrangements with a view to home reversion plans; or*
- *making arrangements with a view to home purchase plans; or*
- agreeing to do any of these things,

without any further restriction; and

- to carry on the regulated activities of:
 - *advising on a home reversion plan; or*
 - *advising on a home purchase plan; or*
 - agreeing to do either of these things,

but only provided that:

- the advice is given to a trustee or a reversion provider who, in either case, is not an individual; or
- the advice is given to an individual but does not amount to a recommendation to enter into a plan as reversion provider, *reversion occupier* or *home purchaser*; or
- the advice is given to an individual and does amount to a recommendation to enter into a plan as reversion provider, *reversion occupier* or *home purchaser* with a reversion provider or a *home purchase provider* but only if the advice endorses a corresponding recommendation that has been given to the individual by a suitably authorised or exempt person.

14.8 Financial promotions

Q43. Are there any restrictions if I wish to promote my home finance activities?

Yes. The restriction in section 21 of the Financial Services and Markets Act 2000 will apply, broadly speaking, to any communication which:

- is made in the course of business; and
- invites or induces persons to:
 - become a *reversion occupier* or *home purchaser*; or
 - become a reversion provider; or
 - vary the terms of a *home reversion plan* or a *home purchase plan* that was originally established on or after 6 April 2007; or
 - be provided, as a reversion occupier or home purchaser or as a reversion provider, with arranging or advisory services.

Communications of this kind are termed *financial promotions*.

Promotions of home finance administration services or promotions intended to dissuade persons from entering into or varying the terms of regulated plans will not be financial promotions and so no restriction will apply to them.

The following table summarises when the restriction will apply.

Table indicating when the financial promotion restriction will apply to communications about home finance plans.

A communication inviting or inducing ...	To...	Will be a financial promotion?
...potential reversion occupiers or home purchasers	...enter into a home reversion plan or a home purchase plan	Yes
...potential home reversion purchasers or transferees	...enter into a home reversion plan	Yes (in the case of transferees, regardless of whether the plan was originally established before 6 April 2007)
...potential home purchase providers	...enter into a home purchase plan	No
...potential or existing: <ul style="list-style-type: none"> • reversion occupiers or home purchasers; or • reversion or home purchase providers 	...be provided with administration services	No
...potential or existing: <ul style="list-style-type: none"> • reversion occupiers or home purchasers; or • reversion purchasers or transferees 	...be provided with arranging or advisory services	Yes (but where the promotion relates to such a person varying the terms of a plan, this is only where the plan was originally established on or after 6 April 2007)
...potential or existing home purchase providers	...be provided with arranging or advisory services	No
...potential or existing: <ul style="list-style-type: none"> • reversion occupiers or home purchasers; or • reversion or home purchase providers 	...decline from entering into or varying the terms of a plan	No
...potential or existing: <ul style="list-style-type: none"> • reversion occupiers or home purchasers; or 	...dispose of rights, obligations or interests in land that they have under a	No

<ul style="list-style-type: none"> • reversion or home purchase providers 	plan	
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Q44. What are the restrictions that apply if I am making a financial promotion about home finance plans or activities?

The *financial promotion* will need either to be communicated or approved by an *authorised person* or to be exempt under the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (the *Financial Promotion Order*).

If you are an authorised person who is communicating or approving the financial promotion and it is not exempt you will need to comply with the provisions of the Mortgages and Home Finance: Conduct of Business Sourcebook (MCOB 3 for financial promotions of home reversion plans and MCOB 2.2.6R for financial promotions of home purchase plans).

Q45. What exemptions may be likely to be available to me when I communicate financial promotions about home finance plans or activities?

A number of exemptions may be available. Those most likely to apply are summarised below.

(1) Introductions (article 15 of the *Financial Promotion Order*). This applies, broadly speaking, where you introduce clients to an *authorised person* or an *exempt person* in the circumstances covered by the exclusion in article 29 of the *Regulated Activities Order* (see Q17). But this is provided the person to whom you make the introduction is not your close relative or a member of your *group*. In addition, there is an exemption for promotions concerning introductions relating specifically to home finance plans – see (5).

(2) Exempt persons (article 16 of the *Financial Promotion Order*). This applies, subject to certain conditions, if you are an exempt person such as a local authority, a registered social landlord or an *appointed representative*.

(3) Generic promotions (article 17 of the *Financial Promotion Order*). This applies to a general promotion that does not identify any particular persons as being either providers of, or as offering arranging or advisory services relating to, home finance plans.

(4) One-off promotions (articles 28 and 28A of the *Financial Promotion Order*). These apply to promotions that are intended for a particular recipient (or group of connected recipients).

(5) Introductions relating to home finance plans (article 28B of the *Financial Promotion Order*). This applies to real time financial promotions relating to home finance plans for the purpose of making introductions. This exemption is subject to the same conditions as apply to the exclusion in article 33A of the *Regulated Activities Order* (see Q18 and Q34); and

(6) Advice centres (article 73 of the Financial Promotion Order). This applies to bodies such as citizens' advice bureaux when they make promotions about home finance plans in the course of their business of providing free advice about debt matters.

Further guidance on these and other exemptions from the financial promotion restriction is in Chapter 8 of PERG (PERG 8).

14.9 Transitional provisions

Q46. I will need to obtain authorisation to carry on home finance activities. What will happen to me if I do not obtain authorisation by 6 April 2007?

Transitional arrangements have been put in place. The broad effect of these arrangements is that you will be able to benefit from interim authorisation as respects any of the new regulated activities that relate to home reversion plans or home purchase plans pending the final determination of your application. This is provided:

- you were carrying on the regulated activities, for which you are seeking authorisation, before 6 November 2006; and
- your application for authorisation was received by the FSA on or before 23 March 2007.

An interim authorisation granted under these transitional arrangements will lapse:

- in the case of the regulated activities involving providing or administering home reversion or home purchase plans, when the application has been finally determined; and
- in the case of the regulated activities involving arranging or advising on home reversion or home purchase plans, on the earlier of the date on which the application is finally determined or 6 April 2008.

Q47. I am already an authorised person. Will I need to extend the scope of my existing permission?

Yes, you will need to apply for a variation of permission in the normal way if you wish to carry on any of the new regulated activities. As with applications for authorisation (see Q46), you will benefit from interim permission if your application is not finally determined by 6 April 2007 provided:

- you were carrying on the regulated activities, for which you are seeking to vary your permission, on or before 6 November 2006; and
- your application to vary your permission was received by the FSA on or before 23 March 2007.

Your interim permission will lapse in the same circumstances as an application for authorisation (see Q46).

Q48. Can I avoid the need to be authorised by becoming an appointed representative of an authorised person?

You cannot be an *appointed representative* for the purpose of providing or administering home reversion or home purchase plans. But you can be an appointed representative for advising on or arranging such plans.

If you are an appointed representative prior to 6 April 2007 and you intend to carry on any of the new regulated activities, you will need to consider whether your existing agreement with your principal will cover those activities that an appointed representative is permitted to undertake or whether it will need to be amended to do so.

You may currently be an appointed representative of a life office for the purpose of advising on or arranging deals in its investment products and also undertake unregulated activities in relation to home reversion or home purchase plans offered by third parties. If those unregulated activities include activities that will become regulated from 6 April 2007, you will need either to become the appointed representative of another appropriately authorised firm or to seek authorisation yourself. This is because an appointed representative of a life office can only undertake regulated activities that arise directly from the life office's insurance business.

Remember also that a person cannot generally be authorised and exempt as an appointed representative at the same time. However, this rule is waived if you obtain interim authorisation to carry on the new regulated activities and wish, pending determination of your application for authorisation, to continue to conduct existing regulated activities as an appointed representative.

Annex B

Amendments to the Perimeter Guidance manual (PERG)

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

...

2.3.2 G There is power in the *Act* for the Treasury.....

- (2) Except as stated in *PERG* 2.3.2G (2A) and *PERG* 2.3.2G (3), the business element is not to be regarded as satisfied for any of the *regulated activities* carried on in relation to *securities* or *contractually based investments* (or for those *regulated activities* carried on in relation to 'any property') unless a *person* carries on the business of engaging in one or more of the activities. This also applies to the *regulated activities* of ~~arranging in relation to a regulated mortgage contract and advising on a home finance transaction~~ regulated mortgage contracts and arranging a home finance transaction. This is a narrower test than that of carrying on *regulated activities* by way of business (as required by section 22 of the *Act*), as it requires the *regulated activities* to represent the carrying on of a business in their own right.

...

- (4) The business element for all other *regulated activities* is that the activities are carried on by way of business. This applies to the activities of *effecting* or *carrying out contracts of insurance*, certain activities relating to the Lloyd's market, *entering as provider into a funeral plan contract* and *entering into a home finance transaction* or *administering a home finance plan* ~~regulated mortgage contracts~~ (see *PERG* 2.7.20 G).

...

Rights under a home reversion plan

2.6.27A G In accordance with article 63B(3)(a) of the *Regulated Activities Order*, a home reversion plan is an arrangement under which, at the time it is entered into:

- (1) a person (the "reversion purchaser") buys all or part of a qualifying interest in land (other than timeshare accommodation) in the *United Kingdom* from an individual or trustees (the "*reversion occupier*");
- (2) the reversion occupier (or, where trustees are concerned, an individual who is a beneficiary of the trust), or a related *person* of either, is entitled, and intends, to use at least 40% of that land as or in

connection with a dwelling; and

- (3) the entitlement to occupy ends on the occurrence of any one or more of the following events:
 - (a) the end of a specified period of at least twenty years; or
 - (b) the death of the individual; or
 - (c) the individual enters a care home.

Detailed guidance on this is set out in PERG 14.3(Guidance on home reversion and home purchase activities).

Rights under a home purchase plan

2.6.27B G In accordance with article 63F(3)(a) of the *Regulated Activities Order*, a *home purchase plan* is an arrangement under which, at the time it is entered into:

- (1) a person (the “*home purchase provider*”) buys a qualifying interest in land or an undivided share of a qualifying interest in land (other than timeshare accommodation) in the *United Kingdom*;
- (2) where an undivided share of a qualifying interest is bought, the interest is held on trust for the home purchase provider and the individual or trustee as beneficial tenants in common;
- (3) an individual or trustees (the “*home purchaser*”) is obliged to buy the interest bought by the *home purchase provider* over the course of or at the end of a specified period; and
- (4) the *home purchaser* (or, where trustees are concerned, by an individual who is a beneficiary of the trust), or a related person of either, is entitled, and intends, to use at least 40% of that land as or in connection with a dwelling.

Detailed guidance on this is set out in PERG 14.4 (Guidance on home reversion and home purchase activities).

2.6.28 G Rights to, or interests in, all the *specified investments* in PERG 2.6 (except rights to, or interests in, rights under a ~~*regulated mortgage contract*~~ *home finance transaction*) are themselves treated as *specified investments*.....

...

Arranging deals in investments and arranging a ~~regulated mortgage activities~~ home finance transaction

2.7.7 G ...

2.7.7A G There are eight ~~four~~ arranging activities that are *regulated activities* under

the *Regulated Activities Order*. These are:

...

- (3) *arranging (bringing about) regulated mortgage contracts*, which includes arranging for another *person* to vary the terms of a *regulated mortgage contract* entered into by him as borrower after 31 October 2004 (article 25A(1)); ~~and~~
- (4) *making arrangements with a view to regulated mortgage contracts* (article 25A(2));
- (5) *arranging (bringing about) a home reversion plan*, which includes arranging for another person to vary the terms of a home reversion plan entered into by him as the original reversion provider (and not merely as a person to whom the rights or obligations or the interest in land may be transferred) or as reversion occupier on or after 6 April 2007 (article 25B(1));
- (6) *making arrangements with a view to a home reversion plan* (article 25B(2));
- (7) *arranging (bringing about) a home purchase plan*, which includes arranging for another person to vary the terms of a home purchase plan entered into by him as home purchaser on or after 6 April 2007 (article 25C(1)); and
- (8) *making arrangements with a view to a home purchase plan* (article 25C(2)).

...

- 2.7.7C G Further *guidance* on the arranging activities as they relate to *regulated mortgage contracts* home finance transactions and *contracts of insurance* is in *PERG 4.5* (Arranging regulated mortgage contracts), *PERG 14.3* and *PERG 14.4* (Guidance on home reversion and home purchase activities) and *PERG 5.6* (The *regulated activities*: arranging deals in, and making arrangements with a view to transactions in, contracts of insurance) respectively.

...

Advising on home reversion plans

- 2.7.16C G Under article 53B of the *Regulated Activities Order*, giving advice to a person in his capacity as reversion occupier or reversion provider is a regulated activity if it is advice on the merits of the person:

- (1) entering into a particular home reversion plan; or

(2) varying the terms of a *home reversion plan*.

Advice on varying terms as referred to in (2) only comes within article 53B where the plan was entered into by the *person* on or after 6 April 2007 and the variation varies his obligations under the plan. Where a *person* is entering into the plan as reversion provider purely as a result of rights or obligations, or the interest in land, being transferred to him, advice given to him on the merits of the transaction is only regulated where the plan was originally entered into on or after 6 April 2007. Further *guidance* on the scope of the *regulated activity* under article 53B is in PERG 14.3 (Guidance on home reversion and home purchase activities).

Advising on a home purchase plan

2.7.16D G Under article 53C of the *Regulated Activities Order*, giving advice to a *person* in his capacity as *home purchaser* is a *regulated activity* if it is advice on the merits of the *person*:

(1) entering into a particular *home purchase plan*; or

(2) varying the terms of a *home purchase plan*.

Advice on varying terms as referred to in (2) only comes within article 53C where the plan is entered into by the *person* on or after 6 April 2007 and the variation varies the *person's* obligations under the plan. Further *guidance* on the scope of the *regulated activity* under article 53C is in PERG 14.4 (Guidance on home reversion and home purchase activities).

...

Entering into and administering a home reversion plan

2.7.20A G *Entering into a home reversion plan* and *administering a home reversion plan* are *regulated activities* under article 63B of the *Regulated Activities Order* (Regulated home reversion plans). *Guidance* on these *regulated activities* is in PERG 14.3 (Guidance on home reversion and home purchase activities).

Entering into and administering a home purchase plan

2.7.20B G *Entering into a home purchase plan* and *administering a home purchase plan* are *regulated activities* under article 63F of the *Regulated Activities Order* (Regulated home purchase plans). *Guidance* on these *regulated activities* is in PERG 14.4 (Guidance on home reversion and home purchase activities).

...

Arranging deals in investments and arranging a regulated mortgage

contracts home finance transaction

2.8.6 G The various activities that involve *arranging* fall into two general types. These are:

- (1) those relating to arranging a particular transaction or a contract or plan variation (articles 25(1), 25A(1), 25B(1) and 25C(1) of the *Regulated Activities Order*); and
- (2) those relating to making arrangements with a view to persons entering into certain transactions (articles 25(2), 25A(2), 25B(2) and 25C(2) of the *Regulated Activities Order*).

The exclusions in relation to the *regulated activities* of *arranging* under articles 25(1) and (2) are of particular relevance in the context of raising corporate finance. ~~Many~~ Some of the exclusions outlined ~~below in PERG 2.8.6A~~ relate to all of the arranging activities but most relate only to certain of those activities as indicated. ~~both the elements of the activity referred to in (1) and (2); that is, *arranging (bringing about) deals in investments* (under article 25(1) of the *Regulated Activities Order*) and *making arrangements with a view to transactions in investments* (under article 25(2) of the *Regulated Activities Order*).~~ But several exclusions relate only to one of those activities.

2.8.6A G The exclusions in the *Regulated Activities Order* that relate to the various *arranging* activities are as follows.

- (1) Under article 26, arrangements that do not or would not bring about the transaction to which they relate are excluded from the *arranging* activities that relate to a particular transaction (see *PERG 2.8.6G(1)*) only. A *person* will bring about a transaction or a contract or plan variation only if his involvement in the chain of events leading to a transaction or contract or plan variation is of sufficient importance that, without that involvement, it would not take place. This will require something more than the mere giving of advice (although giving such advice may be the *regulated activity* of *advising on investments* or *advising on home finance transactions*).
- (2) Under article 27, simply providing the means by which parties to a transaction (or possible transaction) are able to communicate with each other is excluded from arrangements made with a view to persons entering into certain transactions (see *PERG 2.8.6G(2)*) only. This will ensure that *persons* such as Internet service providers or telecommunications networks are excluded if all they do is provide communication facilities (and these would otherwise be considered to be arrangements made with a view to the participants entering into transactions). If a *person* makes arrangements that go beyond providing the means of communication, and add value to what is provided, he will lose the benefit of this exclusion.

(3) Under article 28, arranging investment transactions to which the arranger is to be a party is excluded from both article 25(1) and (2). The main purpose is to ensure that a person is not regarded as arranging deals for another when the transaction in question is one to which he intends to be a party. As a result, a person cannot both be engaging in a dealing activity (as principal or agent) and arranging deals for another as regards any particular transaction. But where the transaction involves a contract of insurance, article 28 will not apply if the person making the arrangements:

(a) is the only policyholder; or

(b) as a result of the transaction, would become the only policyholder.

Under article 28A, a person is excluded from any of the arranging activities that relate to home finance transactions (2) if he is to enter into the contract or plan to which the arrangements relate or if he is or is to become a party to a contract or plan that is varied or to be varied.

(4) Under article 29, an unauthorised person who, on behalf of a client, arranges transactions or contract or plan variations, with or through an authorised person, is excluded from each of the arranging activities if specified conditions as to advice and remuneration are satisfied. For example, the exclusion is dependent on the client not receiving any advice on the transactions or variations from the unauthorised person making the arrangements. The exclusion does not apply where the investment is a contract of insurance.

(5) Under article 29A, an unauthorised person is excluded from the regulated activity of arranging for another person to vary the terms of a regulated mortgage contract entered into on or after 31 October 2004 (article 25A(1)(b)) or a home reversion plan or home purchase plan entered into on or after 6 April 2007 (articles 25B(1)(b) and 25C(1)(b)). This is if the arranging is the result of:

(a) anything done in the course of the administration, by an authorised person:

(i) of a regulated mortgage contract in the way set out in article 62(a);

(ii) of a home reversion plan in the way set out in article 63C(a);

(iii) of a home purchase plan in the way set out in article 63G(a); or

(b) anything done by the unauthorised person in connection with the administration:

- (i) of a regulated mortgage contract in the way set out in article 62(b);
 - (ii) of a home reversion plan in the way set out in article 63C(b);
 - (iii) of a home purchase plan in the way set out in article 63G(b).
- (6) Under article 30, arranging investment transactions in connection with lending on the security of contracts of insurance is excluded, from article 25(1) and (2) but only where a person is not carrying on insurance mediation or reinsurance mediation.
- (7) Under article 31, making arrangements for finance (in whatever form) to be supplied to a person by a third party is excluded from article 25(1) and (2) if the finance is given in exchange for an instrument acknowledging the debt. This mirrors the exclusion from dealing in investments as principal in similar circumstances (see PERG 2.8.4G (3)).
- (8) Under article 32, arrangements the only purpose of which is to provide finance to enable persons to enter into investment transactions are excluded from article 25(2) only. There is no equivalent exemption from article 25(1). But arrangements for the provision of finance will only be caught by that provision if the arrangements actually bring about the transaction.
- (9) Under article 33, making arrangements under which persons will be introduced to third parties who will provide independent services (consisting of advice or the exercise of discretion in relation to certain investments) is excluded from articles 25(2), 25A(2), 25B(2) and 25C(2) only. The party to whom the introduction is made must be of a specified standing (including that of an authorised person). The exclusion does not apply where the arrangements relate to a contract of insurance.
- (10) Under article 33A, making arrangements for introducing persons to:
 - (a) an authorised person who has permission to carry on certain regulated activities concerned with home finance transactions;
or
 - (b) an appointed representative who is able to carry on any of those activities without breaching the general prohibition; or
 - (c) an overseas person who carries on any of those activities;is excluded from articles 25A(2), 25B(2) and 25C(2) subject to certain conditions related to the receipt of client money and the

disclosure of certain information.

- (11) Under article 34, a company is not carrying on a regulated activity under article 25(1) or (2) of the Regulated Activities Order (Arranging deals in investments) by arranging for the issue of its own shares or share warrants and a person is not doing so by arranging for the issue of his own debentures or debenture warrants.
- (12) Under article 35, a body carrying out international securities business of a specified type can apply to the Treasury for approval as an international securities self-regulating organisation (ISSRO). Arrangements made in order to carry out the functions of an ISSRO are excluded from article 25(1) and (2). The exclusion applies whether the arrangements are made by the ISSRO or by a person acting on its behalf.
- (13) The following exclusions from both article 25(1) and (2) (outlined in PERG 2.9) apply in specified circumstances where a *person* makes arrangements:
- (a) while acting as trustee or personal representative (see PERG 2.9.3 G);
 - (b) in connection with the carrying on of a profession or of a business not otherwise consisting of regulated activities (see PERG 2.9.5 G);
 - (c) in connection with the sale of goods or supply of services (see PERG 2.9.7 G);
 - (d) in connection with certain transactions by a group member or by a participator in a joint enterprise (see PERG 2.9.9 G);
 - (e) in connection with the sale of a body corporate (see PERG 2.9.11 G);
 - (f) in connection with an employee share scheme (see PERG 2.9.13 G);
 - (g) as an overseas person (see PERG 2.9.15 G);
 - (h) as an incoming ECA provider (see PERG 2.9.18 G);
 - (i) as a provider of non-motor goods or services related to travel (see PERG 2.9.19 G);
 - (j) involving the provision, on an incidental basis, of information to policyholders or potential policyholders about contracts of insurance (see PERG 2.9.19 G);
 - (k) that involve a contract of insurance covering large risks situated

outside the EEA (see PERG 2.9.19 G) ;1

- (l) for or with a view to transactions to be entered into by or on behalf of the participants of a business angel-led enterprise capital fund and that person is a body corporate as specified in article 72E(7) of the Regulated Activities Order.

More detailed guidance on the exclusions that relate to contracts of insurance is in PERG 5 (Insurance mediation activities).

The exclusions referred to in (a), (b), (g) and (h) also apply to arranging activities related to home finance transactions. More detailed guidance on the exclusions that relate to contracts of insurance is in PERG 5 (Insurance mediation activities).

- 2.8.6AB G The exclusions referred to in PERG 2.8.6G (4) and PERG 2.8.6G (13)(c), (d), (e) and (l) will not be available to *persons* who, in carrying on an *arranging* activity, are *investment firms* (see PERG 2.5.4 G (Investment services and activities)).

...

- 2.8.12 G In certain circumstances, advice that takes the form of a regularly updated news or information service and advice which is given in one of a range of different media (for example, newspaper or television) is excluded from the *regulated activities* of:

- (1) advising on investments; and
- (2) advising on regulated mortgage contracts;
- (3) advising on a home reversion plan; and
- (4) advising on a home purchase plan.

See (see PERG 7 (Periodical publications: news services and broadcasts: applications for certification)) for further guidance on this exclusion.

- 2.8.12A G Advice given by an *unauthorised person* in ~~the course of the administration of relation to a regulated mortgage contract~~ home finance transaction in the circumstances referred to in PERG 2.8.6AG(5)(a) or (b) (Arranging deals in investments and arranging a home finance transaction) by an ~~authorised person~~ is also excluded ~~subject to certain conditions~~. In addition:

- (1) the following exclusions apply in specified circumstances where a *person* is *advising on investments* or advising on regulated mortgage contracts a home finance transaction:

- (a)

(2) the following exclusions apply in specified circumstances where a *person* is ~~advising on~~ advising on investments:

(a)

More detailed *guidance* on certain of these exclusions is in *PERG* 4 (~~*Regulated activities*~~ Regulated activities connected with mortgages), and *PERG* 5 (Insurance mediation activities) and *PERG* 14.3 and *PERG* 14.4 (Guidance on home reversion and home purchase activities).

...

2.8.14A G Exclusions from the ~~*regulated activities*~~ activity of that involve administering a regulated mortgage contract home finance transaction are provided where an unauthorised persons; arrange for administration by an authorised person and where ~~unauthorised persons administer under an agreement with an authorised person.~~

(1) arranges for administration by an authorised person who has permission for carrying on that regulated activity;

(2) carries out the administration for up to one month after an arrangement of the kind mentioned in (1) comes to an end; or

(3) carries out the administration under an agreement with an authorised person who has permission for carrying on that regulated activity.

These exclusions are subject to certain conditions and are explained in greater detail in ~~*PERG* 4.8~~ Auth 4.8 (Administering a regulated mortgage contract); and *PERG* 14.3 and *PERG* 14.4 (Guidance on home reversion and home purchase activities).

2.8.14B G The following exclusions apply in specified circumstances where a *person* is administering a home finance plan:

(1) while acting as trustee or personal representative (see *PERG* 2.9.3 G);

(2) in connection with the carrying on of a profession or of a business not otherwise consisting of *regulated activities* (see *PERG* 2.9.5 G); and

(3) as an *incoming ECA provider* (see *PERG* 2.9.18 G).

...

2.9.1 G The various exclusions outlined below deal with a range of different circumstances.

(1) Each set of circumstances described in *PERG* 2.9.3 G to *PERG* 2.9.17 G has some application to several *regulated activities* relating to *securities, relevant investments* or ~~*regulated mortgage contracts*~~ *home finance transactions*. They have no effect.....

...

2.9.3 G This group of exclusions applies, in specified circumstances, to the *regulated activities* of:

- (1) *dealing in investments as principal;*
- (2) *arranging (bringing about) deals in investments; ~~arranging (bringing about) regulated mortgage contracts; and making arrangements with a view to transactions in investments and making arrangements with a view to regulated mortgage contracts;~~*

(2A) arranging a home finance transaction;

...

- (7) *advising on investments or advising on a home finance transaction; ~~regulated mortgage contracts~~*
- (8) *entering into ~~regulated mortgage contracts~~ a home finance transaction; and*
- (9) *administering ~~a regulated mortgage contracts~~ home finance transaction.*

...

2.9.4 G A person carrying on certain *regulated activities* does not require *authorisation* in specified circumstances if he by reference to time spent). The exclusions for *entering into a home finance transaction* and for *administering a home finance transaction* ~~*regulated mortgage contracts*~~, however, work on a different basis. They apply where the activity relates to a *home finance transaction* ~~*regulated mortgage contract*~~ under which the borrower, reversion occupier or home purchaser as the case may be is a beneficiary.

2.9.5 G This group of exclusions applies, in specified circumstances, to the *regulated activities* of:

- (1) *dealing in investments as agent;*
- (2) *arranging (bringing about) deals in investments; ~~arranging (bringing about) regulated mortgage contracts; and making arrangements with a view to transactions in investments and making arrangements with a view to regulated mortgage contracts;~~*

(2A) arranging a home finance transaction;

...

- (5) *advising on investments or advising on a home finance transaction; ~~regulated mortgage~~*

~~contracts~~ a home finance transaction.

...

- 2.9.15 G This group of exclusions applies, in specified circumstances, to the *regulated activities* of:
- (1) *dealing in investments as principal;*
 - (2) *dealing in investments as agent;*
 - (3) *arranging (bringing about) deals in investments; ~~arranging (bringing about) regulated mortgage contracts; and making arrangements with a view to transactions in investments and making arrangements with a view to regulated mortgage contracts;~~*
 - (3A) *arranging a home finance transaction;*
 - (4) *advising on investments;*
 - (5) *entering into ~~regulated mortgage contracts~~ a home finance transaction;*
 - (6) *administering ~~a regulated mortgage contracts~~ home finance transaction; and*
 - (7) ...

...

- 2.9.17 G The exclusions are available, for *regulated activities* other than those that relate to ~~regulated mortgage contracts~~ home finance transactions in the two broad cases set out below. For some of these *regulated activities*, the exclusions apply in each case. In others, they apply in only one.

- (1) ...

...

- 2.9.17A G The exclusions for *overseas persons* who carry on certain *regulated activities* related to ~~regulated mortgage contracts~~ home finance transactions work in a different way. They depend on the residency of the borrower or borrowers, the reversion occupier or reversion occupiers or the home purchaser or home purchasers as the case may be. In addition, some of the exclusions also depend on the residency of the reversion provider. Guidance on these exclusions is in PERG 4.11 (Link between activities and the United Kingdom) and PERG 14.6 (Guidance on home reversion and home purchase activities).

...

- 2.10.15 G In addition, there are restrictions on carrying on (or agreeing to carry on)

certain other *regulated activities*. These relate to *managing investments, advising on investments, ~~or advising on regulated~~ a home finance transaction mortgage contracts, advising on syndicate participation at Lloyd's, and entering into a regulated mortgage contract home finance transaction or administering a home finance transaction regulated mortgage contract.*

...

PERG 2 Annex 2 Regulated activities and the permission regime

2 Table

Table 1: Regulated Activities [See note 1 to Table 1]	
Regulated activity	Specified investment in relation to which the regulated activity (in the corresponding section of column one) may be carried on
Accepting deposits	
(a) <i>accepting deposits ...</i>	...
...	
Regulated mortgage home finance activity	
(v) <i>arranging (bringing about) regulated mortgage contracts</i> (article 25(A)(1))	<i>regulated mortgage contract</i> (article 88)
(w) <i>making arrangements with a view to regulated mortgage contracts</i> (article 25(A)(2))	
(x) ...	
(y) ...	
(z) ...	

<p><u>(za) arranging (bringing about) a home reversion plan (article 25B(1))</u></p> <p><u>(zb) making arrangements with a view to a home reversion plan (article 25B(2))</u></p> <p><u>(zc) advising on a home reversion plan (article 53B)</u></p> <p><u>(zd) entering into a home reversion plan (article 63B(1))</u></p> <p><u>(ze) administering a home reversion plan (article 63B(2))</u></p>	<p><u>rights under a home reversion plan (article 88A)</u></p>
<p><u>(zf) arranging (bringing about) a home purchase plan (article 25C(1))</u></p> <p><u>(zg) making arrangements with a view to a home purchase plan (article 25C(2))</u></p> <p><u>(zh) advising on a home purchase plan (article 53C)</u></p> <p><u>(zi) entering into a home purchase plan (article 63F(1))</u></p> <p><u>(zj) administering a home purchase plan (article 63F(2))</u></p>	<p><u>rights under a home purchase plan (article 88B)</u></p>

...

- 4.1.6 G A person may be intending to carry on activities related to other forms of investment in connection with mortgages, such as advising on and arranging an endowment policy or ISA to repay an interest-only mortgage. Such a person should also consult the *guidance* in *PERG 2* (Authorisation and ~~regulated activities~~ regulated activities) and ~~PERG 8~~ (Financial promotion and related activities), and *PERG 5* (~~Mediation of general and pure protection~~ Guidance on insurance mediation activities) and *PERG 8* (Financial promotion and related activities). In addition, *PERG 14* (Guidance on home reversion and home purchase activities) has *guidance on regulated activities relating to home reversion plans and home purchase plans*.

...

- 4.4.1 G Article 61(3)(a) of the ...
- (1) ...

...

PERG 4.4.2 G to PERG 4.4.9 G set out the FSA's understanding of some key concepts contained in article 61(3)(a). It should be noted that, where a contract meets the necessary requirements for both a regulated mortgage contract and a home purchase plan, it will be treated as a home purchase plan only and will not be a regulated mortgage contract. Guidance on the meaning of a home purchase plan is in PERG 14.4 (Guidance on home reversion and home purchase activities).

...

7.1.1 G This chapter applies to anyone involved in publishing periodicals, or in providing news services or broadcasts, who gives (or proposes to give) advice about *securities, relevant investments* or ~~*regulated mortgage contracts*~~ *home finance transactions* and who wishes to determine whether he will be carrying on the *regulated activities* of *advising on investments* or *advising on* ~~*regulated mortgage contracts*~~ *a home finance transaction*.

7.1.2 G The purpose of this chapter is to provide *guidance* as to:

(1) when a *person* involved in publishing periodicals, or in providing news services or broadcasts, requires *authorisation* to carry on the *regulated activities* of *advising on investments* or *advising on* ~~*regulated mortgage contracts*~~ *a home finance transaction* (see *PERG 7.3* (Does the activity require authorisation));

(2) ...

...

7.2.1 G Advice is excluded by article 54 of the *Regulated Activities Order* from the *regulated activities* of *advising on investments* and *advising on* ~~*regulated mortgage contracts*~~ *a home finance transaction* if:

...

7.2.2 G If a *person* would, but for the exclusion, be carrying on the *regulated activities* of *advising on investments* or *advising on* ~~*regulated mortgage contracts*~~ *a home finance transaction*, or any or each of them both, and will be doing so.....

...

Advising on investments and advising on ~~regulated mortgage contracts~~ home finance transactions

7.3.1 G ...

7.3.1B G Under article 53B of the *Regulated Activities Order* (Advising on regulated home reversion plans), advising a *person* is a specified kind of activity if:

- (1) the advice is given to the *person* in his capacity as a *reversion occupier* or reversion provider or as a potential *reversion occupier* or reversion provider; and
 - (2) it is advice on the merits of his doing any of the following:
 - (a) entering into a particular *home reversion plan*; or
 - (b) varying the terms of a *home reversion plan* entered into by him as *reversion occupier* or as reversion provider (but only where the plan was originally entered into on or after 6 April 2007) in such a way as to vary his obligations under that plan.
- 7.3.1C G Under article 53C of the *Regulated Activities Order* (Advising on regulated home purchase plans), advising a *person* is a specified kind of activity if:
- (1) the advice is given to the *person* in his capacity as a *home purchaser* or potential *home purchaser*; and
 - (2) it is advice on the merits of his doing any of the following:
 - (a) entering into a particular *home purchase plan*; or
 - (b) varying the terms of a *home purchase plan* entered into by him on or after 6 April 2007 in such a way as to vary his obligations under that plan.
- 7.3.2 G Articles 53, ~~and 53A, 53B and 53C~~ of the *Regulated Activities Order* contain a number of elements, all of which must be present before a *person* will require *authorisation*. For *guidance* on whether a *person* is carrying on these *regulated activities*, see *PERG* 8 (Financial promotion and related activities), ~~and~~ *PERG* 4 (Guidance on ~~*regulated activities*~~ regulated activities connected with mortgages) and *PERG* 14.3 and *PERG* 14.4 (Guidance on home reversion and home purchase activities).
- 7.3.3 G Under section 22 of the *Act* (~~*Regulated activities*~~ Regulated activities), for an activity has been amended by article 18 of the Financial Services and Markets Act 2000 (Regulated A activities) (Amendment) (No 2) Order 2003 (SI 2003/1476) and by article 28 of the Financial Services and Markets Act 2000 (Regulated activities) (Amendment) (No 2) Order 2006 (SI 2006/2383) as explained in *PERG* 7.3.3A G.
- 7.3.3A G The result of the amendments made to the meaning of the business test in section 22 of the *Act* is that the test differs depending on the activity in question. Where the *regulated activities* of *advising on investments* and *advising on* ~~*regulated mortgage contracts*~~ a home finance transaction are concerned, the business test is not to be regarded as satisfied unless
- 7.3.4 G In the *FSA's* view, for a *person* to be carrying on the business of *advising on investments* or *advising on* ~~*regulated mortgage contracts*~~ a home finance transaction he will usually need to be doing so if advice on *securities*,

relevant investments or ~~regulated home finance transactions mortgage contracts~~ is given, then, in the FSA's view, the business of advising on investments or advising on ~~regulated mortgage contracts a home finance transaction~~ is being carried on. In addition the journal or journalist would not be regarded as carrying on the business of advising on investments or advising on ~~regulated mortgage contracts a home finance transaction~~ as he would be acting to prevent crime rather than in the carrying on of a business.

...

7.3.7 G But even if advice is given in the *United Kingdom*, the *general prohibition* will not be contravened if the giving of advice does not amount to the carrying on, in the *United Kingdom*, of the business of *advising on investments or advising on ~~regulated mortgage contracts a home finance transaction~~*. Also, the *general prohibition* will not be contravened if the exclusions in article 72 ~~only do not~~ apply to the *regulated activities of that involve advising on a home finance transaction mortgage contracts where both the lender and the borrower are outside the United Kingdom*. The effect of this is that, where the ~~principal~~ *principal* purpose of an overseas periodical publication is to offer advice on *securities or relevant investments and home finance transactions mortgage contracts*, the exclusion for an *overseas person* who provides advice to *persons* in the *United Kingdom* as a result of a legitimate approach will not apply to the advice concerning *home finance transactions mortgage contracts*.

7.3.8 G If a *person* is carrying on the business of *advising on investments or advising on a home finance transaction* in the *United Kingdom*, he will not require *authorisation* if:

(1) ...

(2) he is an *exempt person* (see *PERG 2.11 (What to do n Now?)*); since *persons* are exempt only in relation to specified *regulated activities*, his exemption must apply to the *regulated activity of advising on investments or advising on a home finance transaction as the case may be*.

7.3.9 G Many people may be involved in the production of a periodical publication, news service or broadcast. But if the *regulated activity of advising on investments or advising on a home finance transaction* is being carried on

.....

...

7.4.2 G But the exclusion applies only if the principal purpose of the publication or service is not:

(1) to advise on *securities or relevant investments or home finance transactions mortgage contracts*: or

- (2) to lead or enable *persons*:
 - (a) to *buy, sell*, subscribe for or underwrite *securities* or *relevant investments*; or ~~(as the case may be)~~;
 - (b) to enter as borrower into *regulated mortgage contracts*, or vary the terms of *regulated mortgage contracts* entered into by ~~the persons to whom the advice is given~~ them as borrower on or after 31 October 2004 ; or
 - (c) to enter as *reversion occupier* or reversion provider into *home reversion plans* or to vary the terms of *home reversion plans* entered into by them as *reversion occupier* or as *reversion provider* where the plan was originally established on or after 6 April 2007; or
 - (d) to enter as *home purchaser* into *home purchase plans* or to vary the terms of *home purchase plans* entered into by them as *home purchaser* on or after 6 April 2007.

7.4.3 G (1) ...

- (3) since this would not generally constitute the *regulated activity* of *advising on investments* (see *PERG* 8.28 (Advice or information)), ~~or *advising on regulated mortgage contracts* (see *PERG* 4.6.13 G to *PERG* 4.6.16 G (Advice or information))~~, *advising on a home reversion plan* or *advising on a home purchase plan*. So the exclusion applies to services providing material in addition to news or information, such as comment or advice.

...

7.4.5 G The exclusion applies only if the principal purpose of the publication or service is not:

- (1) to give advice on *securities, relevant investments* or ~~*regulated home finance transactions*~~ ~~*mortgage contracts*~~ (see *PERG* 7.3.1 G); or
- (2) to lead or enable *persons* to:
 - (a) *buy, sell*, subscribe for or underwrite *securities* or *relevant investments*; or
 - (b) to enter as borrower into *regulated mortgage contracts*, or vary the terms of *regulated mortgage contracts* entered into by ~~persons to whom the advice is given~~ them as borrower on or after 31 October 2004 ; or
 - (c) to enter as *reversion occupier* or reversion provider into *home reversion plans* or to vary the terms of *home reversion plans* entered into by them as *reversion occupier* or as *reversion provider* where the plan was originally established

on or after 6 April 2007; or

- (d) to enter as home purchaser into home purchase plans or to vary the terms of home purchase plans entered into by them as home purchaser on or after 6 April 2007.

...

7.4.8 G Looking at the first disqualifying purpose set out in the exclusion, all the matters relevant to whether the *regulated activities* of *advising on investments* or *advising on a home finance transaction* ~~*mortgage contracts*~~ are being carried on must be taken into account (see *PERG* 8.24 (Advising on investments)). If the principal purpose of a publication or service is to give to *persons*, in their capacity as investors (or potential investors), ~~or as borrowers, as reversion occupiers or reversion providers or as home purchasers~~ (as the case may be), advice as referred to in *PERG* 7.4.5G (1), then the publication or service will not be able to benefit from this exclusion.

7.4.9 G ...

- (1) material in a publication or service that invites or seeks to procure *persons* to engage in a relevant transaction can be said to "lead" to those transactions even if it would not constitute the *regulated activities* of *advising on investments* or *advising on regulated a home finance transaction* ~~*mortgage contracts*~~; this includes, for example, material

- (2) ...

In the *FSA's* view, material will not lead or enable a *person* to engage in a relevant transaction where the material is intended merely to raise people's awareness of matters relating to *securities*, *relevant investments* or ~~*regulated home finance transactions mortgage contracts*~~.

...

8.4.22 G (7) Article 15 (Introductions) may apply provided certain conditions are met (see *PERG* 8.12.11 G). In addition, article 28B (Real time communications: introductions ~~in connection with qualifying credit~~) may apply where an introduction is a *real time financial qualifying credit promotion about home finance transactions and home finance activities* (see *PERG* 8.17.12 G).

...

8.14.40B G Article 73 exempts any *financial promotion* made by a *person* in the course of carrying out his duties as an adviser for, or employee of, an advice centre. This is provided the *financial promotion* relates to:

- (1) ~~*qualifying credit*~~ *a home finance transaction*; or

(2) ...

...

8.17.1 G ~~[not used]~~ Section 21 applies to financial promotions concerning agreements for qualifying credit. PERG 8.17.1AG to PERG 8.17.18G has guidance about the treatment of such financial promotions. Section 21 applies not only to financial promotions about regulated mortgage contracts but also to financial promotions about certain other types of credit agreement. This is explained in more detail in PERG 8.17.2 G. to PERG 8.17.3 G.

8.17.1A G ~~Section 21 applies to financial promotions concerning agreements for qualifying credit (qualifying credit promotions). In this respect, it not only covers financial promotions about regulated mortgage contracts but also financial promotions about certain other types of credit agreement. This is explained in more detail in PERG 8.17.2 G. to PERG 8.17.3 G. Section 21 also applies to financial promotions concerning home reversion plans and home purchase plans. Guidance on these activities and related financial promotions is given in PERG 14 (Guidance on home reversion and home purchase activities).~~

...

8.17.9 G The exemptions in Part IV of the *Financial Promotion Order* (Exempt communications: all controlled activities) will apply to *financial promotions* about *qualifying credit* (~~*qualifying credit promotions*~~). Some of the exemptions ...

...

8.17.12 G Article 28B (Real time communications: introductions ~~in connection with qualifying credit~~) exempts a *real time financial promotion* that relates to one or more of the *controlled activities* about *regulated mortgage contracts*, as well as *home reversion plans* and *home purchase plans*. The exemption is subject to the following conditions being satisfied:

(1) ...

(a) ...

(c) an overseas person who carries on the *controlled activity* to which the communication relates; for this purpose, an 'overseas person' is a *person* who carries on any of the *controlled activities* about ~~*qualifying credit*~~ *home finance transactions* but does not do so, or offer to do so, from a permanent place of business maintained by him in the *United Kingdom*; and

...

8.23.3 G The *regulated activities* which are likely to be conducted in the

circumstances referred to in *PERG* 8.23.2 G are:

- (1) giving advice on certain investments (articles 53 (Advising on investments), 53A (Advising on regulated mortgage contracts), 53B (Advising on regulated home reversion plans), 53C (Advising on regulated home purchase plans) and 56 (Advice on syndicate participation at Lloyd's) of the *Regulated Activities Order*) - for example, where the *financial promotion* is the advice;
- (2) *making arrangements with a view to transactions in investments* (article 25(1 2) of the *Regulated Activities Order* (Arranging deals in investments)); ~~or~~
- (2A) *making arrangements with a view to regulated mortgage contracts* (article 25A(2) of the *Regulated Activities Order* (Arranging regulated mortgage contracts));
- (2B) *making arrangements with a view to a home reversion plan* (article 25B(2) of the *Regulated Activities Order* (Arranging regulated home reversion plans));
- (2C) *making arrangements with a view to a home purchase plan* (article 25C(2) of the *Regulated Activities Order* (Arranging regulated home purchase plans) for example, where the *person* concerned makes arrangements that are intended to lead to a transaction by a third party; and
- (3) ...

8.23.4 G The *guidance* that follows is concerned with the *regulated activities* of *making arrangements with a view to transactions in investments* ~~and~~ and *advising on investments*. *Guidance* on the *regulated activities* of *making arrangements with a view to regulated mortgage contracts* ~~and~~ and *advising on regulated mortgage contracts* is in *PERG* 4 (Guidance on regulated activities ~~regulated activities~~ connected with mortgages). Guidance on the regulated activities of making arrangements with a view to a home reversion plan and advising on a home reversion plan and making arrangements with a view to a home purchase plan and advising on a home purchase plan is in *PERG* 14 (Guidance on home reversion and home purchase activities).

...

8.36.3 G Table Controlled activities

1.	...
...	
10.	Providing qualifying credit

10A. <u>11.</u>	Arranging qualifying credit etc
10B. <u>12.</u>	Advising on qualifying credit etc
<u>13</u>	<u>Providing a home reversion plan</u>
<u>14</u>	<u>Arranging a home reversion plan</u>
<u>15</u>	<u>Advising on a home reversion plan</u>
<u>16</u>	<u>Providing a home purchase plan</u>
<u>17</u>	<u>Arranging a home purchase plan</u>
<u>18</u>	<u>Advising on a home purchase plan</u>
11. <u>19.</u>	Agreeing to do anything in 3 to 10B <u>18</u> above

8.36.4 G Table Controlled investments

1.	...
...	
15.	Agreements for qualifying credit.
<u>16.</u>	<u>Rights under a home reversion plan.</u>
<u>17.</u>	<u>Rights under a home purchase plan.</u>
16. <u>18.</u>	Rights to or interests in anything falling under 1 to 15-14 above.

14 Guidance on home reversion and home purchase activities

14.1 Background

Q1. What is the purpose of these questions and answers (“Q&As”) and who should be reading them?

These Q&As are aimed at *persons* involved in the provision or promotion of financial arrangements involving the acquisition or disposal of land for the purpose of enabling an individual ...

- exemptions (PERG 14.7); and
- financial promotions (PERG 14.8); ~~and~~
- ~~transitional provisions (PERG 14.9).~~

...

Q4. How will I know if my proposed home finance activities are regulated?

Regulated activities are specified in the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 ('the *Regulated Activities Order*'). This ~~will be~~ was amended, following the enactment of the Regulation of Financial Services (Land Transactions) Act 2005, to extend its scope to cover certain home finance activities. These amendments ~~were~~ are made in the Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) (No2) Order 2006 (SI 2006/2383) which came ~~comes~~ into effect on 6 April 2007. ~~The new~~ Regulated home finance activities are:

...

Q22. Will changes involving the circumstances of the reversion occupier that may take place after the plan has been entered into (such as moving house, marriage or change of occupants) have any implications in terms of regulated activity?

This depends on the facts and is a question of degree that requires an assessment against the criteria that make up the definition of a home reversion plan. There are two main issues that would need to be considered. These are:

- is the change likely to cause a new plan to be entered into ~~on or after 6 April 2007~~; and
- does the change involve a variation of the terms of the plan (if it was originally entered into on or after 6 April 2007) such as to vary the obligations of the provider or the occupier?

Broadly speaking, it would seem likely that, if the occupier were to move house, there would be a need for the existing plan to be terminated and a new plan to be entered into. Where this happens ~~on or after 6 April 2007~~, the person who enters into the plan

...

...

Q37. Will changes involving the circumstances of the home purchaser that may take place after the plan has been entered into (such as moving house, marriage or change of occupants) have any implications in terms of regulated activity?

This depends on the facts and is a question of degree that requires an assessment against the criteria that make up the definition of a home purchase plan. There are two main issues that would need to be considered. These are:

- is the change likely to cause a new plan to be entered into ~~on or after 6 April 2007?~~ and
- does the change involve a variation of the terms of the plan (if it was originally entered into on or after 6 April 2007) such as to vary the obligations of the provider or the purchaser?

Broadly speaking, it would seem likely that, if the home purchaser were to move house, there would be a need for the existing plan to be terminated and a new plan to be entered. Where this happens ~~on or after 6 April 2007~~, the person who enters the plan as provider...

...

14.9 Transitional provisions

~~Q46. I will need to obtain authorisation to carry on home finance activities. What will happen to me if I do not obtain authorisation by 6 April 2007?~~

~~Transitional arrangements have been put in place. The broad effect of these arrangements is that you will be able to benefit from interim authorisation as respects any of the new regulated activities that relate to home reversion plans or home purchase plans pending the final determination of your application. This is provided:~~

- ~~you were carrying on the regulated activities, for which you are seeking permission, before 6 November 2006; and~~
- ~~your application for authorisation was received by the FSA on or before 23 March 2007.~~

~~An interim authorisation granted under these transitional arrangements will lapse:~~

- ~~in the case of the regulated activities involving providing or administering home reversion or home purchase plans, when the application has been finally determined; and~~
- ~~in the case of the regulated activities involving arranging or advising on home reversion or home purchase plans, on the earlier of the date on which the application is finally determined or 6 April 2008.~~

~~Q47. I am already an authorised person. Will I need to extend the scope of my existing permission?~~

~~Yes, you will need to apply for a variation of permission in the normal way if you wish to carry on any of the new regulated activities. As with applications for authorisation (see Q46), you will benefit from interim permission if your application is not finally determined by 6 April 2007 provided:~~

- ~~• you were carrying on the regulated activities, for which you are seeking to vary your permission, on or before 6 November 2006; and~~
- ~~• your application to vary your permission was received by the FSA on or before 23 March 2007.~~

~~Your interim permission will lapse in the same circumstances as an application for authorisation (see Q46).~~

Q48. ~~Can I avoid the need to be authorised by becoming an appointed representative of an authorised person?~~

~~You cannot be an *appointed representative* for the purpose of providing or administering home reversion or home purchase plans. But you can be an appointed representative for advising on or arranging such plans.~~

~~If you are an appointed representative prior to 6 April 2007 and you intend to carry on any of the new regulated activities, you will need to consider whether your existing agreement with your principal will cover those activities that an appointed representative is permitted to undertake or whether it will need to be amended to do so.~~

~~You may currently be an appointed representative of a life office for the purpose of advising on or arranging deals in its investment products and also undertake unregulated activities in relation to home reversion or home purchase plans offered by third parties. If those unregulated activities include activities that will become regulated from 6 April 2007, you will need either to become the appointed representative of another appropriately authorised firm or to seek authorisation yourself. This is because an appointed representative of a life office can only undertake regulated activities that arise directly from the life office's insurance business.~~

~~Remember also that a person cannot generally be authorised and exempt as an appointed representative at the same time. However, this rule is waived if you obtain interim authorisation to carry on the new regulated activities and wish, pending determination of your application for authorisation, to continue to conduct existing regulated activities as an appointed representative.~~

**INTERIM PERMITTED PERSONS
(HOME REVERSION AND HOME PURCHASE ACTIVITIES)
INSTRUMENT 2006**

Powers exercised

- A. The Financial Services Authority makes this instrument in the exercise of the powers and related provisions in:
- (1) the following sections of the Financial Services and Markets Act 2000 (“the Act”):
 - (a) section 138 (General rule-making power);
 - (b) section 156 (General supplementary powers);
 - (c) section 213 (The compensation scheme); and
 - (d) section 214 (General); and
 - (2) article 39 of The Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) (No.2) Order 2006 (SI No 2006/2383) (“the Order”).
- B. The powers listed above are specified for the purposes of section 153(2) (Rule-making instruments) of the Act.

Commencement

- C. Subject to the Order being in force on 6 November 2006, this instrument comes into force on 6 April 2007.

Citation

- D. This instrument may be cited as the Interim Permitted Persons (Home Reversion and Home Purchase Activities) Instrument 2006.

By order of the Board
25 October 2006

Annex

Directions and rules for Interim Permitted Persons in respect of Home Finance Business

In this Annex, new provisions are being introduced and they are not underlined.

1. Application
 - 1.1 R These *rules* and directions apply to:
 - (1) an *authorised person* with an *interim permission*; and
 - (2) an *authorised person* with an *interim variation of permission*.
 2. The application of the Handbook and the disapplication of COMP
 - 2.1 D The *FSA* directs that the *Handbook* applies to an *authorised person* with an *interim permission* or an *interim variation of permission* as if that *person's application* had been granted in the terms applied for.
 - 2.2 D The *FSA* directs that the *Glossary* definition of '*relevant person*' does not include an *authorised person* with an *interim permission*.
3. Disclosure of status
 - 3.1 R Whenever an *authorised person* with an *interim permission* or an *interim variation of permission* is required, and whenever that *person* is permitted and chooses, to disclose that:
 - (1) it is an *authorised person* or it is regulated by the *FSA*, and that disclosure is made in respect of; or
 - (2) it has *permission* to carry on,
one or more of the *regulated activities* described in article 37 (Interim permission) of the *Order*, that *person* must instead disclose that:
 - (3) (if the *authorised person* has an *interim permission*):
 - (a) it is an authorised person with an interim permission, pending the determination of its application for a permission; and
 - (b) compensation will not be available from the Financial Services Compensation Scheme if the authorised person cannot meet its obligations.
 - (4) (if the *authorised person* has an *interim variation of permission*) it is an authorised person with an interim permission that allows it to carry on home reversion business or home purchase business (as applicable) pending the determination of its application for a variation of permission.
 - 3.2 R Whenever:
 - (1) an *authorised person* with an *interim permission* or an *interim variation of permission* is required, and whenever that *person* is

permitted and chooses, to disclose that the *FSA* has approved one or more of its *approved persons* for the purposes of section 59 of the *Act* (Approval for particular arrangements); and

- (2) the disclosure in (1) is related to one or more of the *regulated activities* described in article 37 (Interim permission) of the *Order*,

the *authorised person* must instead disclose (if it is the case) that one or more of its approved persons has been approved on an interim basis pending the determination of an application for approved person status.

4. Defined terms

- 4.1 R In these *rules* and directions, the terms in (1) have the meanings ascribed to them by (2). Further, terms in italics that do not appear below have the meaning given to them in the *Glossary of definitions* in the *FSA's Handbook*.

(1)	(2)
<i>application</i>	an application for: (1) a <i>Part IV permission</i> which includes; or (2) a variation of a <i>Part IV permission</i> so that it will include, one or more of the <i>regulated activities</i> described in article 37 (Interim permission) of the <i>Order</i> .
<i>interim permission</i>	a <i>Part IV permission</i> deemed to have been granted by article 37 (Interim permission) of the <i>Order</i> to a <i>person</i> because he has submitted an application for a <i>Part IV permission</i> .
<i>interim variation of permission</i>	a variation of a <i>Part IV permission</i> deemed to have been granted by article 37 (Interim permission) of the <i>Order</i> .
<i>Order</i>	the Financial Services and Markets Act 2000 (Regulated Activities) (Amendment) (No.2) Order 2006 (SI No 2006/2383).

**SENIOR MANAGEMENT ARRANGEMENTS, SYSTEMS AND CONTROLS
(MARKETS IN FINANCIAL INSTRUMENTS AND CAPITAL REQUIREMENTS
DIRECTIVES) INSTRUMENT 2006**

Powers exercised

- A. The Financial Services Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):
- (1) section 138 (General rule-making power);
 - (2) section 141 (Insurance business rules);
 - (3) section 145 (Financial promotion rules);
 - (4) section 146 (Money laundering rules);
 - (5) section 147 (Control of information rules);
 - (6) section 149 (Evidential provisions);
 - (7) section 150(2) (Actions for damages);
 - (8) section 156 (General supplementary powers); and
 - (9) section 157(1) (Guidance).
- B. The rule-making powers listed above are specified for the purpose of section 153(2) (Rule-making instruments) of the Act.

Commencement

- C. This instrument comes into force as follows:
- (1) Annex C and E on 31 December 2006;
 - (2) Annex F, L and M on 1 November 2007;
 - (3) The remainder of this instrument comes into force on 1 January 2007.

Amendments to the Integrated Prudential Sourcebook and the Senior Management Arrangement, Systems and Controls Sourcebook

- D.
- (1) In relation to the “Amended text” in column (3) of the table in D(5), SYSC is amended in accordance with Annex A of this instrument.
 - (2) In relation to the “New text” indicated in column (3), SYSC is amended by inserting the provisions in Annex B to this instrument.
 - (3) In relation to the “Transferred, Amended and New text” in column (3), SYSC is amended by inserting the provisions in Annex C in this instrument (which has the effect of transferring the provisions in PRU identified in column (2), with amendments, to the location indicated in column (1) and inserting new text in Annex C).

- (4) In relation to the “Transferred and Amended text” in column (3), SYSC is amended by inserting the provisions in Annex D in this instrument (which has the effect of transferring the provisions in PRU identified in column (2), with amendments, to the location indicated in column (1)).
- (4) In relation to the “Transferred text” in column (3), SYSC is amended by inserting the provisions of Annex E in this instrument (which has the effect of transferring the provisions in SYSC and PRU identified in column (2), with necessary consequential changes, to the location indicated in column (1)).
- (5) The table referred to is:

(1) SYSC	(2) Current designation in PRU or SYSC (where applicable)	(3) Type of text	(4) Annex in this Instrument
SYSC TP		New text	Annex B
SYSC 1	SYSC 1	Amended text	Annex A
SYSC 3	SYSC 3	Amended text	Annex A
SYSC 4		New text	Annex B
SYSC 5		New text	Annex B
SYSC 6		New text	Annex B
SYSC 7		New text	Annex B
SYSC 8		New text	Annex B
SYSC 10		New text	Annex B
SYSC 11	PRU 5.1	Transferred and Amended and New text	Annex C
SYSC 12	PRU 8.1	Transferred and Amended text	Annex D
SYSC 13	SYSC 3A	Transferred text	Annex E
SYSC 14 (except 14.1.65G)	PRU 1.4	Transferred text	Annex E
SYSC 14.1.65G	PRU 6.1.9G	Transferred text	Annex E
SYSC 15	PRU 3.1	Transferred text	Annex E
SYSC 16	PRU 4.1	Transferred text	Annex E
SYSC 17	PRU 7.1	Transferred text	Annex E
SYSC 18	SYSC 4	Transferred text	Annex E
SYSC Schedule 1	SYSC Schedule 1	Amended text	Annex A
SYSC Schedule 5	SYSC Schedule 5	Amended text	Annex A
SYSC Schedule 6	SYSC Schedule 6	Amended text	Annex A

Further amendments to SYSC

- E. SYSC is further amended by the provisions in Annex F to this instrument.

Amendments to the Glossary

- F. The Glossary is amended by the provisions in Annex T to this instrument.

Amendments to the Handbook

- G. The modules of the FSA's Handbook of rules and guidance listed in column (1) below are amended in accordance with the Annexes to this instrument listed in column (2).

(1)	(2)
Principles for Businesses sourcebook (PRIN)	Annex G
Threshold Conditions (COND)	Annex H
Conduct of Business sourcebook (COB)	Annex I
Insurance: Conduct of Business sourcebook (ICOB)	Annex J
Mortgages: Conduct of Business sourcebook (MCOB)	Annex K
Client Assets sourcebook (CASS)	Annex L
Market Conduct sourcebook (MAR)	Annex M
Training and Competence sourcebook (TC)	Annex N
Supervision manual (SUP)	Annex O
Enforcement manual (ENF)	Annex P
Credit Unions sourcebook (CRED)	Annex Q
Professional Firms sourcebook (PROF)	Annex R
Recognised Investment Exchanges and Recognised Clearing Houses sourcebook (REC)	Annex S

Citation

- H. This instrument may be cited as the Senior Management Arrangements, Systems and Controls (Markets in Financial Instruments and Capital Requirements Directives) Instrument 2006.

By order of the Board
23 November 2006

Annex A

Senior Management Arrangements, Systems and Controls Handbook (SYSC)

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

1 Application and purpose

1.1 Application of SYSC 2 and SYSC 3

Purpose of this section

1.1.-2 G ~~[deleted]~~

1.1.-1 G ~~[deleted]~~

1.1.1 R Who?

SYSC 2 and SYSC 3 apply to every firm except that:

...

(c) *SYSC 3 applies, but only with respect to the activities in SYSC 1.1.4 R; ~~and~~*

(5) *for an authorised professional firm when carrying on non-mainstream regulated activities, SYSC 3.2.6A R to SYSC 3.2.6J G do not apply; ~~and~~*

(6) *SYSC 3.2.23R to SYSC 3.2.36R apply only to a BIPRU firm.*

...

1.2 Purpose of SYSC

1.2.1 G The purposes of SYSC are:

(1) to encourage *firms' directors and senior managers* to take appropriate practical responsibility for their *firms'* arrangements on matters likely to be of interest to the *FSA* because they impinge on the *FSA's* functions under the *Act*;

(2) to increase certainty by amplifying *Principle 3*, under which a *firm* must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems; ~~and~~

(3) to encourage *firms* to vest responsibility for effective and responsible organisation in specific *directors and senior managers*; ~~;~~

- (4) to create a common platform of organisational and systems and controls requirements for firms subject to the CRD and/or MiFID; and
- (5) to set out high-level organisational and systems and controls requirements for insurers.

1.2.2 G ~~The main matters, referred to in SYSC1.2.1G (1), which are likely to be of interest to the FSA are those which relate to confidence in the financial system; to the fair treatment of firms' customers; to the protection of consumers; and to the use of the financial system in connection with financial crime. The FSA is not primarily concerned with risks which threaten only the owners of a financial business except in so far as these risks may have an impact on those matters.~~

To be inserted after SYSC 1.2

1.3 Application of the common platform requirements

Who?

1.3.1 R The *common platform requirements* apply to a *common platform firm* unless provided otherwise in a specific *rule*.

1.3.1A G From 1 January 2007 until 1 November 2007, the application of the *common platform requirements* is limited by SYSC TP 1.

What?

1.3.2 R The *common platform organisational requirements* apply with respect to the carrying on of the following (unless provided otherwise within a specific *rule*):

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

1.3.3 G The application of the provisions on the conflicts of interest in SYSC 10 is set out in SYSC 10.1.1R and SYSC 10.2.1R.

1.3.4 R [To follow.]

1.3.5 R The *common platform requirements on financial crime* apply as set out in SYSC 1.3.2R, except that they do not apply:

- (1) with respect to:
 - (a) activities that constitute *dealing in investments as principal*, disregarding the exclusion in article 15 of the *Regulated Activities Order* (Absence of holding out etc); and
 - (b) *ancillary activities*; or
- (2) in relation to the following *regulated activities*:
 - (a) *general insurance business*;
 - (b) *insurance mediation activity* in relation to a *general insurance contract* or *pure protection contract*;
 - (c) *long-term insurance business* which is outside the *Consolidated Life Directive* (unless it is otherwise one of the *regulated activities* specified in this *rule*);
 - (d) business relating to contracts which are within the *Regulated Activities Order* only because they fall within paragraph (e) of the definition of "contract of insurance" in article 3 of that Order;
 - (e)
 - (i) arranging by the *Society of Lloyd's* of deals in *general insurance contracts* written at Lloyd's; and
 - (ii) *managing the underwriting capacity of a Lloyd's syndicate as a managing agent at Lloyd's*; and
 - (f) *home finance mediation activity* and *administering a home finance transaction*.

- 1.3.6 R The *common platform organisational requirements*, except the *common platform requirements on financial crime*, also apply with respect to the *communication* and *approval* of *financial promotions* which:
- (1) if *communicated* by an *unauthorised person* without *approval* would contravene section 21(1) of the *Act* (Restrictions on financial promotion); and
 - (2) may be *communicated* by a *firm* without contravening section 238(1) of the *Act* (Restrictions on promotion of collective investment schemes).

- 1.3.7 R The *common platform organisational requirements*, except the *common platform requirements on financial crime*, also:
- (1) apply with respect to the carrying on of *unregulated activities* in a *prudential context*; and

(2) take into account any activity of other members of a *group* of which the *firm* is a member.

1.3.8 G *SYSC 1.3.7R(2)* does not mean that inadequacy of a *group* member's systems and controls will automatically lead to a *firm* contravening any of the *common platform organisational requirements*. Rather, the potential impact of a *group* member's activities, including its systems and controls, and any systems and controls that operate on a *group* basis, will be relevant in determining the appropriateness of the *firm's* own systems and controls.

Where?

1.3.9 R The *common platform requirements* apply to a *common platform firm* in relation to activities carried on by it from an establishment in the *United Kingdom*.

1.3.10 R The *common platform requirements*, except the *common platform requirements on financial crime*, apply to a *common platform firm* in relation to *passported activities* carried on by it from a *branch* in another *EEA State*.

1.3.11 R The *common platform organisational requirements*, except the *common platform requirements on financial crime*, also apply in a *prudential context* to a *UK domestic firm* with respect to activities wherever they are carried on.

Actions for damages

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

1.4 Application of SYSC 11 to SYSC 18

What?

1.4.1 G The application of each of chapters *SYSC 11* to *SYSC 18* is set out in those chapters.

Actions for damages

1.4.2 R A contravention of a *rule* in *SYSC 11* to *SYSC 18* does not give rise to a right of action by a *private person* under section 150 of the *Act* (and each of those *rules* is specified under section 150(2) of the *Act* as a provision giving rise to no such right of action).

To be inserted after SYSC 3.1.1R

- 3.1.1A R SYSC 3.1 and SYSC 3.2.1G to SYSC 3.2.22G apply to a *BIPRU firm* only to the extent that they do not conflict with SYSC 3.2.23R to SYSC 3.2.36R.

...

To be inserted after SYSC 3.2.5G

Organisation

...

- 3.2.5A R An *overseas bank* must ensure that at least two individuals effectively direct its business.
- 3.2.5B G In the case of an *overseas bank*, the *FSA* assesses whether at least two individuals effectively direct the business of the *bank* (and not just the business of its branch in the *United Kingdom*). The *FSA* also takes into account the manner in which management decisions are taken in the *United Kingdom* branch in assessing the adequacy of the *overseas bank's* systems and controls.

...

To be inserted after SYSC 3.2.22G

CRD requirements

(1) General organisation requirements

- 3.2.23 R A *BIPRU firm* must have robust governance arrangements, which include a clear organisational structure with well defined, transparent and consistent lines of responsibility, effective processes to identify, manage, monitor and report the risks it is or might be exposed to, and adequate internal control mechanisms, including sound administrative and accounting procedures.

[Note: article 22(1) of the *Banking Consolidation Directive*]

- 3.2.24 R The arrangements, processes and mechanisms referred to in SYSC 3.2.23R must be comprehensive and proportionate to the nature, scale and complexity of the *BIPRU firm's* activities. The technical criteria laid down in *BIPRU* 2.3.7R(1), *BIPRU* 9.1.6R, *BIPRU* 9.13.21R (Liquidity plans), *BIPRU* 10.12.3R (Concentration risk policies), SYSC 3.2.26R and SYSC 3.2.28R to SYSC 3.2.36R must be taken into account.

[Note: article 22(2) of the *Banking Consolidation Directive*]

- 3.2.25 R A *BIPRU firm* must ensure that its internal control mechanisms and administrative and accounting procedures permit the verification of its compliance with *rules* adopted in accordance with the Capital Adequacy Directive at all times.
- [Note: article 35(1) second sentence of the *Capital Adequacy Directive*]
- 3.2.26 R A *BIPRU firm* must have contingency and business continuity plans in place aimed at ensuring its ability to operate on an ongoing basis and limit losses in the event of severe business disruption.
- [Note: annex V paragraph 13 of the *Banking Consolidation Directive*]
- 3.2.27 R A *credit institution* must have at least two persons who effectively direct the business of the *firm*. These persons must be of sufficiently good repute and have sufficient experience to perform their duties.
- [Note: article 11(1) of the *Banking Consolidation Directive*]
- (2) Employees, agents and other relevant persons
- 3.2.28 R The *governing body* of a *BIPRU firm* must define arrangements concerning the segregation of duties in the organisation and the prevention of conflicts of interest.
- [Note: annex V paragraph 1 of the *Banking Consolidation Directive*]
- (3) Risk control
- 3.2.29 R The *governing body* of a *BIPRU firm* must approve and periodically review the strategies and policies for taking up, managing, monitoring and mitigating the risks the *firm* is or might be exposed to, including those posed by the macroeconomic environment in which it operates in relation to the status of the business cycle.
- [Note: annex V paragraph 2 of the *Banking Consolidation Directive*]
- 3.2.30 R A *BIPRU firm* must base credit-granting on sound and well-defined criteria and clearly establish the process for approving, amending, renewing, and re-financing credits.
- [Note: annex V paragraph 3 of the *Banking Consolidation Directive*]
- 3.2.31 R A *BIPRU firm* must operate through effective systems the ongoing administration and monitoring of its various credit risk-bearing portfolios and exposures, including for identifying and managing problem credits and for making adequate value adjustments and provisions.
- [Note: annex V paragraph 4 of the *Banking Consolidation Directive*]

- 3.2.32 R A *BIPRU firm* must adequately diversify credit portfolios given its target markets and overall credit strategy.
[Note: annex V paragraph 5 of the *Banking Consolidation Directive*]
- 3.2.33 R A *BIPRU firm* must address and control by means of written policies and procedures the risk that recognised credit risk mitigation techniques used by it prove less effective than expected.
[Note: annex V paragraph 6 of the *Banking Consolidation Directive*]
- 3.2.34 R A *BIPRU firm* must implement policies and processes for the measurement and management of all material sources and effects of market risks.
[Note: annex V paragraph 10 of the *Banking Consolidation Directive*]
- 3.2.35 R A *BIPRU firm* must implement systems to evaluate and manage the risk arising from potential changes in interest rates as they affect a *BIPRU firm's* non-trading activities.
[Note: annex V paragraph 11 of the *Banking Consolidation Directive*]
- 3.2.36 R A *BIPRU firm* must implement policies and processes to evaluate and manage the exposure to operational risk, including to low-frequency high severity events. Without prejudice to the definition of *operational risk*, *BIPRU firms* must articulate what constitutes operational risk for the purposes of those policies and procedures.
[Note: annex V paragraph 12 of the *Banking Consolidation Directive*]

Schedule 1 to be amended as follows:

...

Handbook reference	Subject of record	Contents of record	When record must be made	Retention period
.....				
SYSC 10.1.6R	Conflict of interest	Kinds of service or activity carried out by or on behalf of the <i>firm</i> in which a conflict of interest entailing a material risk of damage to the interests of one or more <i>clients</i> has arisen or, in the case of an ongoing service or activity, may arise.	Not specified	5 years
SYSC 14.1.53R	Prudential risk management and systems and controls	Accounting and other records that are sufficient to enable the <i>firm</i> to demonstrate to the <i>FSA</i> : (1) that the <i>firm</i> is financially sound and has appropriate systems and controls; (2) the <i>firm's</i> financial position and exposure to risk (to a reasonable degree of accuracy); (3) the <i>firm's</i> compliance with the <i>rules</i> in <i>GENPRU</i> , <i>INSPRU</i> and	Not specified	3 years, or longer as appropriate

		SYSC.		
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Schedule 5 to be amended as follows

...

Chapter/ Appendix	Section/ Annex	Paragraph	Right of action under section 150		
			For private person?	Removed?	For other person?
			No	Yes <i>SYSC</i> 1.1.12R	No
		All rules in <u><i>SYSC</i> 2 and <i>SYSC</i> 3</u>			
		<u><i>SYSC</i> 4 to <i>SYSC</i> 10</u>	<u>No</u>	<u>Yes <i>SYSC</i> 1.3.12R</u>	<u>No</u>
		<u><i>SYSC</i> 11 to <i>SYSC</i> 18</u>	<u>No</u>	<u>Yes <i>SYSC</i> 1.4.2R</u>	<u>No</u>

Schedule 6 to be amended as follows

Schedule 6 Rules that can be waived

- G The *rules* in SYSC can be *waived* by the FSA under section 148 of the Act (Modification or waiver of rules) in so far as this is compatible with the United Kingdom's responsibilities to implement the requirements of any European Directive .

Annex B

Senior Management Arrangements, Systems and Controls Handbook (SYSC)

In this Annex, all text in new and is not underlined.

To be inserted in SYSC Transchedule

TP Transitional provisions

TP 1 Common platform firms

Application

1.1 R SYSC TP 1 applies to a *common platform firm*.

Commencement and expiry of SYSC TP 1

1.2 R SYSC TP 1 comes into force on 1 January 2007 and applies until 1 November 2007.

Purpose

1.3 G From 1 November 2007, a *firm* must comply with the *common platform requirements* and SYSC 3 will cease to apply to it. However, until 1 November 2007, a *firm* may choose to comply with the specific parts of the *common platform requirements* instead of SYSC 3. The purpose of SYSC TP 1 is to give a *firm* the option of complying with the *common platform requirements* sooner than 1 November 2007.

1.4 G The ability to comply with the *common platform requirements* before 1 November 2007 does not apply to SYSC 9 (Record-keeping), SYSC 8.2 (Outsourcing of portfolio management for retail clients to a non-EEA State) or SYSC 8.3 (Guidance on outsourcing portfolio management for retail clients to a non-EEA State). All *firms* must continue to comply with the record-keeping requirements in SYSC 3.2.20R until 1 November 2007, when SYSC 9 will enter into force.

The decision to comply with the common platform requirements

1.5 R SYSC 4 to 7, SYSC 8.1 and SYSC 10 do not apply to a *firm* unless it decides to comply with them sooner than 1 November 2007.

1.6 R If a *firm* decides to comply with the *common platform requirements* in accordance with SYSC TP 1.5R:

(1) it must make a record of the date of the decision and the date from which it is to be effective; and

- (2) subject to SYSC TP 1.7R below, from the effective date, it must comply with SYSC 4 to 7, SYSC 8.1 and SYSC 10, and SYSC 3 will not apply to it.
- 1.7 R The following provisions in SYSC 3 will continue to apply to a *firm* that decides to comply with the *common platform requirements* before the 1 November 2007:
- (1) SYSC 3.2.23R, SYSC 3.2.24R, SYSC 3.2.26R and SYSC 3.2.28R to SYSC 3.2.35R in so far as SYSC 12.1.13R applies to it; and
- (2) SYSC 3.2.20R to SYSC 3.2.22G.
- 1.8 G The purpose of SYSC TP 1.7R is to ensure the effective operation of the provisions on consolidated risk management processes and internal control mechanisms in relation to a *firm* that decides to comply with the *common platform requirements* before 1 November 2007.
- 1.9 G A decision by a *firm* to comply with the *common platform requirements* must be made in relation to all of the *common platform requirements*. The firm may not 'cherry-pick'.
- Definitions in SYSC TP1 and the common platform requirements
- 1.10 R The terms *common platform firm* and *MiFID investment firm* have effect in SYSC TP1 and the *common platform requirements* as if *MiFID* applied generally from 1 January 2007.

To be inserted after SYSC 3

4 General organisational requirements

4.1 General requirements

- 4.1.1 R A *common platform firm* must have robust governance arrangements, which include a clear organisational structure with well defined, transparent and consistent lines of responsibility, effective processes to identify, manage, monitor and report the risks it is or might be exposed to, and internal control mechanisms, including sound administrative and accounting procedures and effective control and safeguard arrangements for information processing systems.

[Note: article 22(1) of the *Banking Consolidation Directive*, article 13(5) second paragraph of *MiFID*]

- 4.1.2 R The arrangements, processes and mechanisms referred to in SYSC 4.1.1R must be comprehensive and proportionate to the nature, scale and complexity of the *common platform firm's* activities and must take into account the specific technical criteria described in SYSC 4.1.7R, SYSC 5.1.7R and SYSC 7.

[Note: article 22(2) of the *Banking Consolidation Directive*]

- 4.1.3 R A *BIPRU firm* must ensure that its internal control mechanisms and administrative and accounting procedures permit the verification of its compliance with *rules* adopted in accordance with the *Capital Adequacy Directive* at all times.

[Note: article 35(1) final sentence of the *Capital Adequacy Directive*]

- 4.1.4 R A *common platform firm* must, taking into account the nature, scale and complexity of the business of the *firm*, and the nature and range of the *investment services and activities* undertaken in the course of that business:

- (1) establish, implement and maintain decision-making procedures and an organisational structure which clearly and in a documented manner specifies reporting lines and allocates functions and responsibilities;
- (2) establish, implement and maintain adequate internal control mechanisms designed to secure compliance with decisions and procedures at all levels of the *firm*; and
- (3) establish, implement and maintain effective internal reporting and communication of information at all relevant levels of the *firm*.

[Note: articles 5(1) final paragraph, 5(1)(a), 5(1)(c) and 5(1)(e) of the *MiFID implementing Directive*]

- 4.1.5 R A *MiFID investment firm* must establish, implement and maintain systems

and procedures that are adequate to safeguard the security, integrity and confidentiality of information, taking into account the nature of the information in question.

[Note: article 5(2) of the *MiFID implementing Directive*]

Business continuity

- 4.1.6 R A *common platform firm* must take reasonable steps to ensure continuity and regularity in the performance of its *regulated activities*. To this end the *firm* must employ appropriate and proportionate systems, resources and procedures.

[Note: article 13(4) of *MiFID*]

- 4.1.7 R A *common platform firm* must establish, implement and maintain an adequate business continuity policy aimed at ensuring, in the case of an interruption to its systems and procedures, that any losses are limited, the preservation of essential data and functions, and the maintenance of its *regulated activities*, or, where that is not possible, the timely recovery of such data and functions and the timely resumption of its *regulated activities*.

[Note: article 5(3) of the *MiFID implementing Directive* and annex V paragraph 13 of the *Banking Consolidation Directive*]

- 4.1.8 G The matters dealt with in a business continuity policy should include:
- (1) resource requirements such as people, systems and other assets, and arrangements for obtaining these resources;
 - (2) the recovery priorities for the *firm's* operations;
 - (3) communication arrangements for internal and external concerned parties (including the *FSA*, *clients* and the press);
 - (4) escalation and invocation plans that outline the processes for implementing the business continuity plans, together with relevant contact information;
 - (5) processes to validate the integrity of information affected by the disruption; and
 - (6) regular testing of the business continuity policy in an appropriate and proportionate manner in accordance with SYSC 4.1.10R.

Accounting policies

- 4.1.9 R A *common platform firm* must establish, implement and maintain accounting policies and procedures that enable it, at the request of the *FSA*, to deliver in a timely manner to the *FSA* financial reports which reflect a true and fair view of its financial position and which comply with all applicable accounting standards and rules.

[Note: article 5(4) of the *MiFID implementing Directive*]

Regular monitoring

- 4.1.10 R A *common platform firm* must monitor and, on a regular basis, evaluate the adequacy and effectiveness of its systems, internal control mechanisms and arrangements established in accordance with SYSC 4.1.4R to SYSC 4.1.9R and take appropriate measures to address any deficiencies.

[Note: article 5(5) of the *MiFID implementing Directive*]

Audit committee

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

4.2 Persons who effectively direct the business

- 4.2.1 R The *senior personnel* of a *common platform firm* must be of sufficiently good repute and sufficiently experienced as to ensure the sound and prudent management of the *firm*.

[Note: article 9(1) of *MiFID* and article 11(1) second paragraph of the *Banking Consolidation Directive*]

- 4.2.2 R A *common platform firm* must ensure that its management is undertaken by at least two persons meeting the requirements laid down in SYSC 4.2.1R.

[Note: article 9(4) first paragraph of *MiFID* and article 11(1) first paragraph of the *Banking Consolidation Directive*]

- 4.2.3 G In the case of a *body corporate*, the persons referred to in SYSC 4.2.2R should either be executive *directors* or persons granted executive powers by, and reporting immediately to, the *governing body*. In the case of a *partnership*, they should be active *partners*.

- 4.2.4 G At least two independent minds should be applied to both the formulation

and implementation of the policies of a *common platform firm*. Where a *common platform firm* nominates just two individuals to direct its business, the *FSA* will not regard them as both effectively directing the business where one of them makes some, albeit significant, decisions relating to only a few aspects of the business. Each should play a part in the decision-making process on all significant decisions. Both should demonstrate the qualities and application to influence strategy, day-to-day policy and its implementation. This does not require their day-to-day involvement in the execution and implementation of policy. It does, however, require involvement in strategy and general direction, as well as knowledge of, and influence on, the way in which strategy is being implemented through day-to-day policy.

4.2.5 G Where there are more than two individuals directing the business, the *FSA* does not regard it as necessary for all of these individuals to be involved in all decisions relating to the determination of strategy and general direction. However, at least two individuals should be involved in all such decisions. Both individuals' judgement should be engaged so that major errors leading to difficulties for the *firm* are less likely to occur. Similarly, each individual should have sufficient experience and knowledge of the business and the necessary personal qualities and skills to detect and resist any imprudence, dishonesty or other irregularities by the other individual. Where a single individual, whether a chief executive, managing *director* or otherwise, is particularly dominant in a *firm* this will raise doubts about whether SYSC 4.2.2R is met.

4.2.6 R If a *common platform firm*, other than a *credit institution*, is:

- (1) a natural person; or
- (2) a legal person managed by a single natural person;

it must have alternative arrangements in place which ensure sound and prudent management of the *firm*.

[Note: article 9(4) second paragraph of *MiFID*]

4.3 Responsibility of senior personnel

4.3.1 R A *MiFID investment firm*, when allocating functions internally, must ensure that *senior personnel* and, where appropriate, the *supervisory function*, are responsible for ensuring that the *firm* complies with its obligations under *MiFID*. In particular, *senior personnel* and, where appropriate, the *supervisory function* must assess and periodically review the effectiveness of the policies, arrangements and procedures put in place to comply with the *firm's* obligations under *MiFID* and take appropriate measures to address any deficiencies.

[Note: article 9(1) of the *MiFID implementing Directive*]

4.3.2 R A *MiFID investment firm*, must ensure:

- (1) that its *senior personnel* receive on a frequent basis, and at least annually, written reports on the matters covered by SYSC 6.1.2R to 6.1.5R, SYSC 6.2.1R and SYSC 7.1.2R, SYSC 7.1.3R and SYSC 7.1.5R to SYSC 7.1.7R, indicating in particular whether the appropriate remedial measures have been taken in the event of any deficiencies; and
- (2) the *supervisory function*, if any, must receive on a regular basis written reports on the same matters.

[Note: article 9(2) and article 9(3) of the *MiFID implementing Directive*]

- 4.3.3 G The *supervisory function* does not include a general meeting of the shareholders of a *common platform firm*, or equivalent bodies, but could involve, for example, a separate supervisory board within a two-tier board structure or the establishment of a non-executive committee of a single-tier board structure.
- 4.3.4 G SYSC 2, which sets out how certain functions in a firm should be allocated, does not affect the collective responsibility of the *senior personnel* of a *MiFID investment firm* under this section.

- 5 Employees, agents and other relevant persons
- 5.1 Skills, knowledge and expertise
- 5.1.1 R A *common platform firm* must employ personnel with the skills, knowledge and expertise necessary for the discharge of the responsibilities allocated to them.
- [Note: article 5(1)(d) of the *MiFID implementing Directive*]
- 5.1.2 G A *firm's* systems and controls should enable it to satisfy itself of the suitability of anyone who acts for it. This includes assessing an individual's honesty and competence. This assessment should normally be made at the point of recruitment. An individual's honesty need not normally be revisited unless something happens to make a fresh look appropriate.
- 5.1.3 G Any assessment of an individual's suitability should take into account the level of responsibility that the individual will assume within the *firm*. The nature of this assessment will generally differ depending upon whether it takes place at the start of the individual's recruitment, at the end of the probationary period (if there is one) or subsequently.
- 5.1.4 G The *FSA's* requirements on *firms* with respect to the competence of individuals are in the Training and Competence sourcebook (*TC*).
- 5.1.5 G The requirements on *firms* with respect to *approved persons* are in Part V of the *Act* (Performance of regulated activities) and *SUP 10*.
- Segregation of functions
- 5.1.6 R A *common platform firm* must ensure that the performance of multiple functions by its *relevant persons* does not and is not likely to prevent those persons from discharging any particular functions soundly, honestly and professionally.
- [Note: article 5(1)(g) of the *MiFID implementing Directive*]
- 5.1.7 R The *senior personnel* of a *common platform firm* must define arrangements concerning the segregation of duties within the *firm* and the prevention of conflicts of interest.
- [Note: annex V paragraph 1 of the *Banking Consolidation Directive*]
- 5.1.8 G The effective segregation of duties is an important element in the *internal controls* of a *firm* in the *prudential context*. In particular, it helps to ensure that no one individual is completely free to commit a *firm's* assets or incur liabilities on its behalf. Segregation can also help to ensure that a *firm's governing body* receives objective and accurate information on financial performance, the risks faced by the *firm* and the adequacy of its systems.

- 5.1.9 G A *common platform firm* should normally ensure that no single individual has unrestricted authority to do all of the following:
- (1) initiate a transaction;
 - (2) bind the *firm*;
 - (3) make payments; and
 - (4) account for it.
- 5.1.10 G Where a *common platform firm* is unable to ensure the complete segregation of duties (for example, because it has a limited number of staff), it should ensure that there are adequate compensating controls in place (for example, frequent review of an area by relevant *senior managers*).
- 5.1.11 G Where a *common platform firm* outsources its internal audit function, it should take reasonable steps to ensure that every individual involved in the performance of this service is independent from the individuals who perform its external audit. This should not prevent services from being undertaken by a *firm's* external auditors provided that:
- (1) the work is carried out under the supervision and management of the *firm's* own internal staff; and
 - (2) potential conflicts of interest between the provision of external audit services and the provision of internal audit are properly managed.

Awareness of procedures

- 5.1.12 R A *common platform firm* must ensure that its *relevant persons* are aware of the procedures which must be followed for the proper discharge of their responsibilities.

[Note: article 5(1)(b) of the *MiFID implementing Directive*]

General

- 5.1.13 R The systems, internal control mechanisms and arrangements established by a *firm* in accordance with this chapter must take into account the nature, scale and complexity of its business and the nature and range of *investment services and activities* undertaken in the course of that business.

[Note: article 5(1) final paragraph of the *MiFID implementing Directive*]

- 5.1.14 R A *common platform firm* must monitor and, on a regular basis, evaluate the adequacy and effectiveness of its systems, internal control mechanisms and arrangements established in accordance with this chapter, and take appropriate measures to address any deficiencies.

[Note: article 5(5) of the *MiFID implementing Directive*]

- 6 Compliance, internal audit and financial crime
- 6.1 Compliance
- 6.1.1 R A *common platform firm* must establish, implement and maintain adequate policies and procedures sufficient to ensure compliance of the *firm* including its managers, employees and *appointed representatives* with its obligations under the *regulatory system*.
- [Note: article 13(2) of *MiFID*]
- 6.1.2 R A *common platform firm* must, taking in to account the nature, scale and complexity of its business, and the nature and range of *investment services and activities* undertaken in the course of that business, establish, implement and maintain adequate policies and procedures designed to detect any risk of failure by the *firm* to comply with its obligations under the *regulatory system*, as well as associated risks, and put in place adequate measures and procedures designed to minimise such risks and to enable the *FSA* to exercise its powers effectively under the *regulatory system* and to enable any other *competent authority* to exercise its powers effectively under *MiFID*.
- [Note: article 6(1) of the *MiFID implementing Directive*]
- 6.1.3 R A *common platform firm* must maintain a permanent and effective compliance function which operates independently and which has the following responsibilities:
- (1) to monitor and, on a regular basis, to assess the adequacy and effectiveness of the measures and procedures put in place in accordance with *SYSC 6.1.2R*, and the actions taken to address any deficiencies in the *firm's* compliance with its obligations;
 - (2) to advise and assist the *relevant persons* responsible for carrying out *regulated activities* to comply with the *firm's* obligations under the *regulatory system*.
- [Note: article 6(2) of the *MiFID implementing Directive*]
- 6.1.4 R In order to enable the compliance function to discharge its responsibilities properly and independently, a *common platform firm* must ensure that the following conditions are satisfied:
- (1) the compliance function must have the necessary authority, resources, expertise and access to all relevant information;
 - (2) a compliance officer must be appointed and must be responsible for the compliance function and for any reporting as to compliance required by *SYSC 4.3.2R*;
 - (3) the *relevant persons* involved in the compliance functions must not be

involved in the performance of services or activities they monitor;

- (4) the method of determining the remuneration of the *relevant persons* involved in the compliance function must not compromise their objectivity and must not be likely to do so.

[Note: article 6(3) first paragraph of the *MiFID implementing Directive*]

- 6.1.5 R A *common platform firm* need not comply with SYSC 6.1.4R(3) or SYSC 6.1.4R(4) if it is able to demonstrate that in view of the nature, scale and complexity of its business, and the nature and range of *investment services and activities*, the requirements under those *rules* are not proportionate and that its compliance function continues to be effective.

[Note: article 6(3) second paragraph of the *MiFID implementing Directive*]

6.2 Internal audit

- 6.2.1 R A *common platform firm* must, where appropriate and proportionate in view of the nature, scale and complexity of its business and the nature and range of *investment services and activities* undertaken in the course of that business, establish and maintain an internal audit function which is separate and independent from the other functions and activities of the *firm* and which has the following responsibilities:

- (1) to establish, implement and maintain an audit plan to examine and evaluate the adequacy and effectiveness of the *firm's* systems, internal control mechanisms and arrangements;
- (2) to issue recommendations based on the result of work carried out in accordance with (1);
- (3) to verify compliance with those recommendations;
- (4) to report in relation to internal audit matters in accordance with SYSC 4.3.2R.

[Note: article 8 of the *MiFID implementing Directive*]

6.3 Financial crime

- 6.3.1 R A *common platform firm* must ensure the policies and procedures established under SYSC 6.1.1R include systems and controls that:
- (1) enable it to identify, assess, monitor and manage *money laundering* risk; and
 - (2) are comprehensive and proportionate to the nature, scale and complexity of its activities.
- 6.3.2 G "*Money laundering* risk" is the risk that a *firm* may be used to further *money laundering*. Failure by a *firm* to manage this risk effectively will increase the

risk to society of crime and terrorism.

- 6.3.3 R A *common platform firm* must carry out regular assessment of the adequacy of these systems and controls to ensure that it continues to comply with SYSC 6.3.1R.
- 6.3.4 G A *common platform firm* may also have separate obligations to comply with relevant legal requirements, including the Terrorism Act 2000, the Proceeds of Crime Act 2002 and the *Money Laundering Regulations*. SYSC 6.1.1R and SYSC 6.3.1R to SYSC 6.3.10G are not relevant for the purposes of regulation 3(3) of the *Money Laundering Regulations*, section 330(8) of the Proceeds of Crime Act 2002 or section 21A(6) of the Terrorism Act 2000.
- 6.3.5 G The FSA, when considering whether a breach of its *rules* on systems and controls against *money laundering* has occurred, will have regard to whether a *common platform firm* has followed relevant provisions in the guidance for the *United Kingdom* financial sector issued by the Joint Money Laundering Steering Group.
- 6.3.6 G In identifying its *money laundering* risk and in establishing the nature of these systems and controls, a *common platform firm* should consider a range of factors, including:
- (1) its customer, product and activity profiles;
 - (2) its distribution channels;
 - (3) the complexity and volume of its transactions;
 - (4) its processes and systems; and
 - (5) its operating environment.
- 6.3.7 G A *common platform firm* should ensure that the systems and controls include:
- (1) appropriate training for its employees in relation to *money laundering*;
 - (2) appropriate provision of information to its *governing body* and senior management, including a report at least annually by that *firm's money laundering reporting officer (MLRO)* on the operation and effectiveness of those systems and controls;
 - (3) appropriate documentation of its risk management policies and risk profile in relation to *money laundering*, including documentation of its application of those policies (see SYSC 9);
 - (4) appropriate measures to ensure that *money laundering* risk is taken into account in its day-to-day operation, including in relation to:

- (a) the development of new products;
 - (b) the taking-on of new customers; and
 - (c) changes in its business profile; and
- (5) appropriate measures to ensure that procedures for identification of new customers do not unreasonably deny access to its services to potential customers who cannot reasonably be expected to produce detailed evidence of identity.

6.3.8 R A *common platform firm* must allocate to a *director* or *senior manager* (who may also be the *money laundering reporting officer*) overall responsibility within the *firm* for the establishment and maintenance of effective anti-*money laundering* systems and controls.

The money laundering reporting officer

- 6.3.9 R A *common platform firm* must:
- (1) appoint an individual as *MLRO*, with responsibility for oversight of its compliance with the *FSA's rules* on systems and controls against *money laundering*; and
 - (2) ensure that its *MLRO* has a level of authority and independence within the *firm* and access to resources and information sufficient to enable him to carry out that responsibility.
- 6.3.10 G The job of the *MLRO* within a *firm* is to act as the focal point for all activity within the *firm* relating to anti-*money laundering*. The *FSA* expects that a *firm's MLRO* will be based in the *United Kingdom*.

- 7 Risk control
- 7.1 Risk control
- 7.1.1 G SYSC 4.1.1R requires a *common platform firm* to have effective processes to identify, manage, monitor and report the risks it is or might be exposed to.
- 7.1.2 R A *common platform firm* must establish, implement and maintain adequate risk management policies and procedures, including effective procedures for risk assessment, which identify the risks relating to the *firm's* activities, processes and systems, and where appropriate, set the level of risk tolerated by the *firm*.
- [Note: article 7(1)(a) of the *MiFID implementing Directive*, article 13(5) second paragraph of *MiFID*]
- 7.1.3 R A *common platform firm* must adopt effective arrangements, processes and mechanisms to manage the risk relating to the *firm's* activities, processes and systems, in light of that level of risk tolerance.
- [Note: article 7(1)(b) of the *MiFID implementing Directive*]
- 7.1.4 R The *senior personnel* of a *common platform firm* must approve and periodically review the strategies and policies for taking up, managing, monitoring and mitigating the risks the *firm* is or might be exposed to, including those posed by the macroeconomic environment in which it operates in relation to the status of the business cycle.
- [Note: annex V paragraph 2 of the *Banking Consolidation Directive*]
- 7.1.5 R A *common platform firm* must monitor the following:
- (1) the adequacy and effectiveness of the *firm's* risk management policies and procedures;
 - (2) the level of compliance by the *firm* and its *relevant persons* with the arrangements, processes and mechanisms adopted in accordance with SYSC 7.1.3R;
 - (3) the adequacy and effectiveness of measures taken to address any deficiencies in those policies, procedures, arrangements, processes and mechanisms, including failures by the *relevant persons* to comply with such arrangements or processes and mechanisms or follow such policies and procedures.
- [Note: article 7(1)(c) of the *MiFID implementing Directive*]
- 7.1.6 R A *common platform firm* must, where appropriate and proportionate in view of the nature, scale and complexity of its business and the nature and range of the *investment services and activities* undertaken in the course of that business, establish and maintain a risk management function that operates

independently and carries out the following tasks:

- (1) implementation of the policies and procedures referred to in *SYSC 7.1.2R* to *SYSC 7.1.5R*; and
- (2) provision of reports and advice to *senior personnel* in accordance with *SYSC 4.3.2R*.

[Note: *MiFID implementing Directive* article 7(2) first paragraph]

- 7.1.7 R Where a *common platform firm* is not required under *SYSC 7.1.6R* to maintain a risk management function that functions independently, it must nevertheless be able to demonstrate that the policies and procedures which it has adopted in accordance with *SYSC 7.1.2R* to *SYSC 7.1.5R* satisfy the requirements of those *rules* and are consistently effective.

[Note: article 7(2) second paragraph of the *MiFID implementing Directive*]

- 7.1.8 G *SYSC 4.1.3R* requires a *BIPRU firm* to ensure that its internal control mechanisms and administrative and accounting procedures permit the verification of its compliance with *rules* adopted in accordance with the *Capital Adequacy Directive* at all times. In complying with this obligation, a *BIPRU firm* should document the organisation and responsibilities of its risk management function and it should document its risk management framework setting out how the risks in the business are identified, measured, monitored and controlled.

Credit and counterparty risk

- 7.1.9 R A *BIPRU firm* must base credit-granting on sound and well-defined criteria and clearly establish the process for approving, amending, renewing, and re-financing credits.

[Note: annex V paragraph 3 of the *Banking Consolidation Directive*]

- 7.1.10 R A *BIPRU firm* must operate through effective systems the ongoing administration and monitoring of its various credit risk-bearing portfolios and exposures, including for identifying and managing problem credits and for making adequate value adjustments and provisions.

[Note: annex V paragraph 4 of the *Banking Consolidation Directive*]

- 7.1.11 R A *BIPRU firm* must adequately diversify credit portfolios given its target market and overall credit strategy.

[Note: annex V paragraph 5 of the *Banking Consolidation Directive*]

- 7.1.12 G The documentation maintained by a *BIPRU firm* under *SYSC 4.1.3R* should include its policy for credit risk, including its risk appetite and provisioning policy and should describe how it measures, monitors and controls that risk. This should include descriptions of the systems used to ensure that the

policy is correctly implemented.

Residual risk

- 7.1.13 R A *BIPRU firm* must address and control by means of written policies and procedures the risk that recognised credit risk mitigation techniques used by it prove less effective than expected.

[Note: annex V paragraph 6 of the *Banking Consolidation Directive*]

Market risk

- 7.1.14 R A *BIPRU firm* must implement policies and processes for the measurement and management of all material sources and effects of market risks.

[Note: annex V paragraph 10 of the *Banking Consolidation Directive*]

Interest rate risk

- 7.1.15 R A *BIPRU firm* must implement systems to evaluate and manage the risk arising from potential changes in interest rates as they affect a *BIPRU firm's* non-trading activities.

[Note: annex V paragraph 11 of the *Banking Consolidation Directive*]

Operational risk

- 7.1.16 R A *BIPRU firm* must implement policies and processes to evaluate and manage the exposure to operational risk, including to low-frequency high severity events. Without prejudice to the definition of *operational risk*, *BIPRU firms* must articulate what constitutes operational risk for the purposes of those policies and procedures.

[Note: annex V paragraph 12 of the *Banking Consolidation Directive*]

- 8 Outsourcing
- 8.1 General outsourcing requirements
- 8.1.1 R A *common platform firm* must:
- (1) when relying on a third party for the performance of operational functions which are critical for the performance of *regulated activities, listed activities* or *ancillary services* (in this chapter "relevant services and activities") on a continuous and satisfactory basis, ensure that it takes reasonable steps to avoid undue additional operational risk;
 - (2) not undertake the *outsourcing* of important operational functions in such a way as to impair materially:
 - (a) the quality of its internal control; and
 - (b) the ability of the *FSA* to monitor the *firm's* compliance with all obligations under the *regulatory system* and, if different, of a *competent authority* to monitor the *firm's* compliance with all obligations under *MiFID*.
- [Note: article 13(5) first paragraph of *MiFID*]
- 8.1.2 G The application of *SYSC* 8.1 to relevant services and activities (see *SYSC* 8.1.1R(1)) is limited by *SYSC* 1.3 (Application of the common platform requirements).
- 8.1.3 G *SYSC* 4.1.1R requires a *common platform firm* to have effective processes to identify, manage, monitor and report risks and internal control mechanisms. Except in relation to those functions described in *SYSC* 8.1.5R, where a *firm* relies on a third party for the performance of operational functions which are not critical or important for the performance of relevant services and activities (see *SYSC* 8.1.1R(1)) on a continuous and satisfactory basis, it should take into account, in a manner that is proportionate given the nature, scale and complexity of the *outsourcing*, the *rules* in this section in complying with that requirement.
- 8.1.4 R For the purposes of this chapter an operational function is regarded as critical or important if a defect or failure in its performance would materially impair the continuing compliance of a *common platform firm* with the conditions and obligations of its *authorisation* or its other obligations under the *regulatory system*, or its financial performance, or the soundness or the continuity of its relevant services and activities.
- [Note: article 13(1) of the *MiFID implementing Directive*]
- 8.1.5 R Without prejudice to the status of any other function, the following functions will not be considered as critical or important for the purposes of

this chapter:

- (1) the provision to the *firm* of advisory services, and other services which do not form part of the relevant services and activities of the *firm*, including the provision of legal advice to the *firm*, the training of personnel of the *firm*, billing services and the security of the *firm's* premises and personnel;
- (2) the purchase of standardised services, including market information services and the provision of price feeds.

[Note: article 13(2) of the *MiFID implementing Directive*]

8.1.6 R If a *common platform firm outsources* critical or important operational functions or any relevant services and activities, it remains fully responsible for discharging all of its obligations under the *regulatory system* and must comply, in particular, with the following conditions:

- (1) the *outsourcing* must not result in the delegation by *senior personnel* of their responsibility;
- (2) the relationship and obligations of the *firm* towards its *clients* under the *regulatory system* must not be altered;
- (3) the conditions with which the *firm* must comply in order to be *authorised*, and to remain so, must not be undermined;
- (4) none of the other conditions subject to which the *firm's authorisation* was granted must be removed or modified.

[Note: article 14(1) of the *MiFID implementing Directive*]

8.1.7 R A *common platform firm* must exercise due skill and care and diligence when entering into, managing or terminating any arrangement for the *outsourcing* to a service provider of critical or important operational functions or of any relevant services and activities.

[Note: article 14(2) first paragraph of the *MiFID implementing Directive*]

8.1.8 R A *common platform firm* must in particular take the necessary steps to ensure that the following conditions are satisfied:

- (1) the service provider must have the ability, capacity, and any *authorisation* required by law to perform the *outsourced* functions, services or activities reliably and professionally;
- (2) the service provider must carry out the *outsourced* services effectively, and to this end the *firm* must establish methods for assessing the standard of performance of the service provider;
- (3) the service provider must properly supervise the carrying out of the *outsourced* functions, and adequately manage the risks associated

with the *outsourcing*;

- (4) appropriate action must be taken if it appears that the service provider may not be carrying out the functions effectively and in compliance with applicable laws and regulatory requirements;
- (5) the *firm* must retain the necessary expertise to supervise the *outsourced* functions effectively and manage the risks associated with the *outsourcing* and must manage those risks and must supervise those functions and manage those risks;
- (6) the service provider must disclose to the *firm* any development that may have a material impact on its ability to carry out the *outsourced* functions effectively and in compliance with applicable laws and regulatory requirements;
- (7) the *firm* must be able to terminate the arrangement for the *outsourcing* where necessary without detriment to the continuity and quality of its provision of services to *clients*;
- (8) the service provider must co-operate with the *FSA* and any other relevant *competent authority* in connection with the *outsourced* activities;
- (9) the *firm*, its auditors, the *FSA* and any other relevant *competent authority* must have effective access to data related to the *outsourced* activities, as well as to the business premises of the service provider; and the *FSA* and any other relevant *competent authority* must be able to exercise those rights of access;
- (10) the service provider must protect any confidential information relating to the *firm* and its *clients*;
- (11) the *firm* and the service provider must establish, implement and maintain a contingency plan for disaster recovery and periodic testing of backup facilities where that is necessary having regard to the function, service or activity that has been *outsourced*.

[Note: article 14(2) second paragraph of the *MiFID implementing Directive*]

- 8.1.9 R A *common platform firm* must ensure that the respective rights and obligations of the *firm* and of the service provider are clearly allocated and set out in a written agreement.

[Note: article 14(3) of the *MiFID implementing Directive*]

- 8.1.10 R If a *common platform firm* and the service provider are members of the same *group*, the *firm* may, for the purpose of complying with SYSC 8.1.7R to SYSC 8.1.11R and SYSC 8.2 and SYSC 8.3, take into account the extent to which the *common platform firm controls* the service provider or has the

ability to influence its actions.

[Note: article 14(4) of the *MiFID implementing Directive*]

- 8.1.11 R A *common platform firm* must make available on request to the *FSA* and any other relevant *competent authority* all information necessary to enable the *FSA* and any other relevant *competent authority* to supervise the compliance of the performance of the *outsourced* activities with the requirements of the *regulatory system*.

[Note: article 14(5) of the *MiFID implementing Directive*]

- 8.1.12 G As *SUP 15.3.8G* explains, a *common platform firm* should notify the *FSA* when it intends to rely on a third party for the performance of operational functions which are critical or important for the performance of relevant services and activities on a continuous and satisfactory basis.

[Note: recital 20 of the *MiFID implementing Directive*]

To be inserted after SYSC 9

10.1 Conflicts of interest

Application

- 10.1.1 R This section applies to a *common platform firm* which provides services to its *clients* in the course of carrying on *regulated activities* or *ancillary activities*.

Requirements only apply if a service is provided

- 10.1.2 G The requirements in this section only apply where a service is provided by a *common platform firm*. The status of the *client* to whom the service is provided (as a *retail client*, *professional client* or *eligible counterparty*) is irrelevant for this purpose.

[Note: recital 25 of *MiFID implementing Directive*]

Identifying conflicts

- 10.1.3 R A *common platform firm* must take all reasonable steps to identify conflicts of interest between:

- (1) the *firm*, including its managers, employees, *appointed representatives* or *tied agents*, or any *person* directly or indirectly linked to them by *control*, and a *client* of the *firm*; or
- (2) one *client* of the *firm* and another *client*;

that arise, or may arise, in the course of the *firm* providing any service referred to in SYSC 10.1.1R.

[Note: article 18(1) of *MiFID*]

Types of conflicts

- 10.1.4 R For the purposes of identifying the types of conflict of interest that arise, or may arise, in the course of providing a service and whose existence may entail a material risk of damage to the interests of a *client*, a *common platform firm* must take into account, as a minimum, whether the *firm* or a *relevant person*, or a *person* directly or indirectly linked by *control* to the *firm*:

- (1) is likely to make a financial gain, or avoid a financial loss, at the expense of the *client*;
- (2) has an interest in the outcome of a service provided to the *client* or of a transaction carried out on behalf of the *client*, which is distinct from the *client's* interest in that outcome;

- (3) has a financial or other incentive to favour the interest of another *client* or group of *clients* over the interests of the *client*;
- (4) carries on the same business as the *client*; or
- (5) receives or will receive from a *person* other than the *client* an inducement in relation to a service provided to the *client*, in the form of monies, goods or services, other than the standard commission or fee for that service.

The conflict of interest may result from the *firm* or *person* providing a service referred to in SYSC 10.1.1R or engaging in any other activity.

[Note: article 21 of *MiFID implementing Directive*]

- 10.1.5 G The circumstances which should be treated as giving rise to a conflict of interest should cover cases where there is a conflict between the interests of the *firm* or certain *persons* connected to the *firm* or the *firm's group* and the duty the *firm* owes to a *client*; or between the differing interests of two or more of its *clients*, to whom the *firm* owes in each case a duty. It is not enough that the *firm* may gain a benefit if there is not also a possible disadvantage to a *client*, or that one *client* to whom the *firm* owes a duty may make a gain or avoid a loss without there being a concomitant possible loss to another such *client*.

[Note: Recital 24 of *MiFID implementing Directive*]

Record of conflicts

- 10.1.6 R A *common platform firm* must keep and regularly update a record of the kinds of service or activity carried out by or on behalf of the *firm* in which a conflict of interest entailing a material risk of damage to the interests of one or more *clients* has arisen or, in the case of an ongoing service or activity, may arise.

[Note: article 23 of *MiFID implementing Directive*]

Managing conflicts

- 10.1.7 R A *common platform firm* must maintain and operate effective organisational and administrative arrangements with a view to taking all reasonable steps to prevent conflicts of interest as defined in SYSC 10.1.3R from constituting or giving rise to a material risk of damage to the interests of its *clients*.

[Note: article 13(3) of *MiFID*]

Disclosure of conflicts

- 10.1.8 R (1) If arrangements made by a *common platform firm* under SYSC 10.1.7R to manage conflicts of interest are not sufficient to ensure, with reasonable confidence, that risks of damage to the interests of a *client* will be prevented, the *firm* must clearly disclose the general

nature and/or sources of conflicts of interest to the *client* before undertaking business for the *client*.

- (2) The disclosure must:
- (a) be made in a *durable medium*; and
 - (b) include sufficient detail, taking into account the nature of the *client*, to enable that *client* to take an informed decision with respect to the service in the context of which the conflict of interest arises.

[Note: article 18(2) of *MiFID* and article 22(4) of *MiFID implementing Directive*]

- 10.1.9 G *Common platform firms* should aim to identify and manage the conflicts of interest arising in relation to their various business lines and their *group's* activities under a comprehensive *conflicts of interest policy*. In particular, the disclosure of conflicts of interest by a *firm* should not exempt it from the obligation to maintain and operate the effective organisational and administrative arrangements under SYSC 10.1.7R. While disclosure of specific conflicts of interest is required by SYSC 10.1.8R, an over-reliance on disclosure without adequate consideration as to how conflicts may appropriately be managed is not permitted.

[Note: Recital 27 of *MiFID implementing Directive*]

Conflicts policy

- 10.1.10 R (1) A *common platform firm* must establish, implement and maintain an effective conflicts of interest policy that is set out in writing and is appropriate to the size and organisation of the *firm* and the nature, scale and complexity of its business.
- (2) Where the *common platform firm* is a member of a *group*, the policy must also take into account any circumstances, of which the *firm* is or should be aware, which may give rise to a conflict of interest arising as a result of the structure and business activities of other members of the *group*.

[Note: article 22(1) of *MiFID implementing Directive*]

Contents of policy

- 10.1.11 R (1) The *conflicts of interest policy* must include the following content:
- (a) it must identify in accordance with SYSC 10.1.3R and SYSC 10.1.4R, by reference to the specific services and activities carried out by or on behalf of the *common platform firm*, the circumstances which constitute or may give rise to a conflict of interest entailing a material risk of damage to the interests

of one or more *clients*; and

- (b) it must specify procedures to be followed and measures to be adopted in order to manage such conflicts.

(2) The procedures and measures provided for in paragraph (1)(b) must:

- (a) be designed to ensure that *relevant persons* engaged in different business activities involving a conflict of interest of the kind specified in paragraph (1)(a) carry on those activities at a level of independence appropriate to the size and activities of the *common platform firm* and of the *group* to which it belongs, and to the materiality of the risk of damage to the interests of *clients*; and

- (b) include such of the following as are necessary and appropriate for the *common platform firm* to ensure the requisite degree of independence:

- (i) effective procedures to prevent or control the exchange of information between *relevant persons* engaged in activities involving a risk of a conflict of interest where the exchange of that information may harm the interests of one or more *clients*;
- (ii) the separate supervision of *relevant persons* whose principal functions involve carrying out activities on behalf of, or providing services to, *clients* whose interests may conflict, or who otherwise represent different interests that may conflict, including those of the *firm*;
- (iii) the removal of any direct link between the remuneration of *relevant persons* principally engaged in one activity and the remuneration of, or revenues generated by, different *relevant persons* principally engaged in another activity, where a conflict of interest may arise in relation to those activities;
- (iv) measures to prevent or limit any *person* from exercising inappropriate influence over the way in which a *relevant person* carries out services or activities; and
- (v) measures to prevent or control the simultaneous or sequential involvement of a *relevant person* in separate services or activities where such involvement may impair the proper management of conflicts of interest.

(3) If the adoption or the practice of one or more of those measures and

procedures does not ensure the requisite level of independence, a *common platform firm* must adopt such alternative or additional measures and procedures as are necessary and appropriate for those purposes.

[Note: article 22(2) and (3) of *MiFID implementing Directive*]

- 10.1.12 G In drawing up a *conflicts of interest policy* which identifies circumstances which constitute or may give rise to a conflict of interest, a *common platform firm* should pay special attention to the activities of investment research and advice, proprietary trading, portfolio management and corporate finance business, including underwriting or selling in an offering of securities and advising on mergers and acquisitions. In particular, such special attention is appropriate where the *firm* or a *person* directly or indirectly linked by *control* to the *firm* performs a combination of two or more of those activities.

[Note: Recital 26 of *MiFID implementing Directive*]

Corporate finance

- 10.1.13 G This section is relevant to the management of a *securities* offering by a *common platform firm*.
- 10.1.14 G A *common platform firm* will wish to note that when carrying on a mandate to manage an offering of *securities*, the *firm's* duty for that business is to its corporate finance *client* (in many cases, the corporate issuer or seller of the relevant *securities*), but that its responsibilities to provide services to its investment *clients* are unchanged.
- 10.1.15 G Measures that a *common platform firm* might wish to consider in drawing up its *conflicts of interest policy* in relation to the management of an offering of *securities* include:
- (1) at an early stage agreeing with its corporate finance *client* relevant aspects of the offering process such as the process the *firm* proposes to follow in order to determine what recommendations it will make about allocations for the offering; how the target investor group will be identified; how recommendations on allocation and pricing will be prepared; and whether the *firm* might place *securities* with its investment *clients* or with its own proprietary book, or with an associate, and how conflicts arising might be managed; and
 - (2) agreeing allocation and pricing objectives with the corporate finance *client*; inviting the corporate finance *client* to participate actively in the allocation process; making the initial recommendation for allocation to *retail clients* of the *firm* as a single block and not on a named basis; having internal arrangements under which senior personnel responsible for providing services to *retail clients* make the initial allocation recommendations for allocation to *retail clients* of the *firm*; and disclosing to the *issuer* details of the allocations

actually made.

[Note: The provisions in *SYSC* 10.1 also implement *BCD* article 22 and *BCD* Annex V paragraph 1]

10.2 Chinese walls

Application

10.2.1 R This section applies to a *common platform firm*.

Control of information

10.2.2 R (1) When a *common platform firm* establishes and maintains a *Chinese wall* (that is, an arrangement that requires information held by a *person* in the course of carrying on one part of the business to be withheld from, or not to be used for, *persons* with or for whom it acts in the course of carrying on another part of its business) it may:

- (a) withhold or not use the information held; and
- (b) for that purpose, permit *persons* employed in the first part of its business to withhold the information held from those employed in that other part of the business;

but only to the extent that the business of one of those parts involves the carrying on of *regulated activities* or *ancillary activities*.

- (2) Information may also be withheld or not used by a *common platform firm* when this is required by an established arrangement maintained between different parts of the business (of any kind) in the same *group*. This provision does not affect any requirement to transmit or use information that may arise apart from the *rules* in *COB* or *COBS*.
- (3) For the purpose of this *rule*, "maintains" includes taking reasonable steps to ensure that the arrangements remain effective and are adequately monitored, and must be interpreted accordingly.
- (4) For the purposes of section 118A(5)(a) of the *Act*, behaviour conforming with paragraph (1) does not amount to market abuse.

Effect of rules

10.2.3 G *SYSC* 10.2.2R is made under section 147 of the *Act* (Control of information rules). It has the following effect:

- (1) acting in conformity with *SYSC* 10.2.2R(1) provides a defence against proceedings brought under section 397(2) or (3) of the *Act* (Misleading statements and practices) – see sections 397(4) and (5)(c);
- (2) behaviour in conformity with *SYSC* 10.2.2R(1) does not amount to *market abuse* (see *SYSC* 10.2.2R(4)); and
- (3) acting in conformity with *SYSC* 10.2.2R(1) provides a defence for a firm against *FSA* enforcement action, or an action for damages under

section 150 of the *Act*, based on a breach of a relevant requirement to disclose or use this information.

Attribution of knowledge

- 10.2.4 R When any of the *rules* of *COB*, *COBS* or *CASS* apply to a *common platform firm* that acts with knowledge, the *firm* will not be taken to act with knowledge for the purposes of that *rule* if none of the relevant individuals involved on behalf of the *firm* acts with that knowledge as a result of arrangements established under *SYSC 10.2.2R*.
- 10.2.5 G When a *common platform firm* manages a conflict of interest using the arrangements in *SYSC 10.2.2R* which take the form of a *Chinese wall*, individuals on the other side of the wall will not be regarded as being in possession of knowledge denied to them as a result of the *Chinese wall*.

Annex C
Senior Management Arrangements, Systems and Controls Handbook (SYSC)

In this Annex, the place where the text is being inserted is indicated and the text is not underlined.

- 11 Liquidity risk systems and controls
- 11.1 Application
- 11.1.1 R SYSC 11 applies to:
- (1) an *insurer*, unless it is an *EEA deposit insurer* or a *Swiss general insurer*;
 - (2) a *BIPRU firm*;
 - (3) an *incoming EEA firm* which:
 - (a) is a *full BCD credit institution*; and
 - (b) has a *branch* in the *United Kingdom*;
 - (4) a *third country BIPRU firm* which:
 - (a) is a *bank*; and
 - (b) has a *branch* in the *United Kingdom*.
- [Note: first paragraph of article 41 of the *Banking Consolidation Directive*]
- 11.1.2 R If this chapter applies because the *firm* has a *branch* in the *United Kingdom* (see SYSC 11.1.1R(3) or SYSC 11.1.1R(4)), SYSC 11 applies only with respect to the *branch*.
- 11.1.3 R SYSC 11 applies to an *incoming EEA firm* only to the extent that the relevant matter is not reserved by the relevant *Single Market Directive* to the *firm's Home State regulator*.
- 11.1.4 R SYSC 11 does not apply to:
- (1) a *non-directive friendly society*; or
 - (2) a *UCITS qualifier*; or
 - (3) an *ICVC*; or
 - (4) an *incoming EEA firm* (unless it has a *branch* in the *United Kingdom* - see SYSC 11.1.1R(3)); or
 - (5) an *incoming Treaty firm*.

- 11.1.5 R (1) SYSC 11.1.11R and SYSC 11.1.12R apply only to a *BIPRU firm*
(2) SYSC 11.1.26G to SYSC 11.1.32G do not apply to *insurers*.

- 11.1.6 R If a *firm* carries on:
(1) *long-term insurance business*; and
(2) *general insurance business*;
SYSC 11 applies separately to each type of business.

Purpose

- 11.1.7 G The purpose of SYSC 11 is to amplify *GENPRU* and SYSC in their specific application to *liquidity risk* and, in so doing, to indicate minimum standards for systems and controls in respect of that risk.
- 11.1.8 G Appropriate systems and controls for the management of *liquidity risk* will vary with the scale, nature and complexity of the *firm's* activities. Most of the material in SYSC 11 is, therefore, *guidance*. SYSC 11 lays out some of the main issues that the *FSA* expects a *firm* to consider in relation to *liquidity risk*. A *firm* should assess the appropriateness of any particular item of *guidance* in the light of the scale, nature and complexity of its activities as well as its obligations as set out in *Principle 3* to organise and control its affairs responsibly and effectively.
- 11.1.9 G SYSC 11 addresses the need to have appropriate systems and controls to deal both with liquidity management issues under normal market conditions, and with stressed or extreme situations resulting from either general market turbulence or *firm-specific* difficulties.
- 11.1.10 G SYSC 11.1.11R and SYSC 11.1.12R implement the specific *liquidity risk* requirements of the *BCD*.

Requirements

- 11.1.11 R A *BIPRU firm* must have policies and processes for the measurement and management of its net funding position and requirements on an ongoing and forward looking basis. Alternative scenarios must be considered and the assumptions underpinning decisions concerning the net funding position must be reviewed regularly.
[Note: annex V paragraph 14 of the *Banking Consolidation Directive*]
- 11.1.12 R A *BIPRU firm* must have contingency plans in place to deal with liquidity crises.
[Note: annex V paragraph 15 of the *Banking Consolidation Directive*]
- 11.1.13 G An *insurer* is also required to comply with the requirements in relation to

liquidity risk set out in *INSPRU* 4.1.

- 11.1.14 G *SYSC* 4.1.1R requires a *BIPRU firm* to have effective processes to identify, manage, monitor and report the risks it is or might be exposed to. A *BIPRU firm* is required by *SYSC* 7.1.2R to establish, implement and maintain adequate risk management policies and procedures, including effective procedures for risk assessment. *Liquidity risk* is one of the risks covered by both of those requirements.
- 11.1.15 G A *UK bank*, a *branch* of an *EEA bank* and a *branch* of an *overseas bank* is required in *IPRU(BANK)* GN 3.4.3R to set out its policy on the management of its liquidity. *Guidance* on a bank's liquidity policy statement is given in *IPRU(BANK)* LM Section 10. *Guidance* on a bank's management of *liquidity risk* is given in *IPRU(BANK)* LM Sections 2 and 9.
- 11.1.16 G A *building society* is required by *IPRU(BSOC)* 5.2.7R to maintain a board-approved policy statement on liquidity. *Guidance* on a *building society's* liquidity policy statement is given in *IPRU(BSOC)* 5.2.8G and *IPRU(BSOC)* Annex 5B. *Guidance* on a *building society's* management of *liquidity risk* is given in *IPRU(BSOC)* Sections 5.3 to 5.8.
- 11.1.17 G High level requirements in relation to carrying out stress testing and scenario analysis are set out in *GENPRU* 1.2. In particular, *GENPRU* 1.2.42R requires a *firm* to carry out appropriate stress testing and scenario analysis. *SYSC* 11 gives *guidance* in relation to these tests in the case of *liquidity risk*.

Stress testing and scenario analysis

- 11.1.18 G The effect of *GENPRU* 1.2.30R, *GENPRU* 1.2.34R, *GENPRU* 1.2.37R(1) and *GENPRU* 1.2.42R is that, for the purposes of determining the adequacy of its overall financial resources, a *firm* must carry out appropriate stress testing and scenario analysis, including taking reasonable steps to identify an appropriate range of realistic adverse circumstances and events in which *liquidity risk* might occur or crystallise.
- 11.1.19 G *GENPRU* 1.2.40G and *GENPRU* 1.2.62G to *GENPRU* 1.2.78G give *guidance* on stress testing and scenario analysis, including on how to choose appropriate scenarios, but the precise scenarios that a *firm* chooses to use will depend on the nature of its activities. For the purposes of testing *liquidity risk*, however, a *firm* should normally consider scenarios based on varying degrees of stress and both *firm-specific* and market-wide difficulties. In developing any scenario of extreme market-wide stress that may pose systemic risk, it may be appropriate for a *firm* to make assumptions about the likelihood and nature of central bank intervention.
- 11.1.20 G A *firm* should review frequently the assumptions used in stress testing scenarios to gain assurance that they continue to be appropriate.
- 11.1.21 E (1) A scenario analysis in relation to *liquidity risk* required under *GENPRU* 1.2.42R should include a cash-flow projection for each

scenario tested, based on reasonable estimates of the impact (both on and off balance sheet) of that scenario on the *firm's* funding needs and sources.

- (2) Contravention of (1) may be relied on as tending to establish contravention of *GENPRU* 1.2.42R.

11.1.22 G In identifying the possible on and off balance sheet impact referred to in *SYSC* 11.1.21E(1), a *firm* may take into account:

- (1) possible changes in the market's perception of the *firm* and the effects that this might have on the *firm's* access to the markets, including:
 - (a) (where the *firm* funds its holdings of assets in one currency with liabilities in another) access to foreign exchange markets, particularly in less frequently traded currencies;
 - (b) access to secured funding, including by way of repo transactions; and
 - (c) the extent to which the *firm* may rely on committed facilities made available to it;
- (2) (if applicable) the possible effect of each scenario analysed on currencies whose exchange rates are currently pegged or fixed; and
- (3) that:
 - (a) general market turbulence may trigger a substantial increase in the extent to which *persons* exercise rights against the *firm* under off balance sheet instruments to which the *firm* is party;
 - (b) access to *OTC derivative* and foreign exchange markets are sensitive to credit-ratings;
 - (c) the scenario may involve the triggering of early amortisation in asset securitisation transactions with which the *firm* has a connection; and
 - (d) its ability to securitise assets may be reduced.

Contingency funding plans

11.1.23 G *GENPRU* 1.2.26R states that a *firm* must at all times maintain overall financial resources adequate to ensure that there is no significant risk that its liabilities cannot be met as they fall due. *GENPRU* 1.2.42R(1)(b) provides that for the purposes of determining the adequacy of its overall financial resources, a *firm* must estimate the financial resources it would need in each of the circumstances and events considered in carrying out its stress testing and scenario analysis in order to, inter alia, meet its liabilities as they fall due.

- 11.1.24 E (1) A *firm* should have an adequately documented *contingency funding plan* for taking action to ensure, so far as it can, that, in each of the scenarios analysed under *GENPRU* 1.2.42R(1)(b), it would still have sufficient liquid financial resources to meet liabilities as they fall due.
- (2) The *contingency funding plan* should cover what events or circumstances will lead the *firm* to put into action any part of the plan.
- (3) The *contingency funding plan* of a *firm* described in *SYSC* 11.1.1R(2) to *SYSC* 11.1.1R(4) should cover the extent to which the actions in (1) include:
- (a) selling, using as *collateral* in secured funding (including repo), or securitising, its assets;
 - (b) otherwise reducing its assets;
 - (c) modifying the structure of its liabilities or increasing its liabilities; and
 - (d) the use of committed facilities.
- (4) A *firm's contingency funding plan* should, where relevant, take account of the impact of stressed market conditions on:
- (a) the behaviour of any credit-sensitive liabilities it has; and
 - (b) its ability to securitise assets.
- (5) A *firm's contingency funding plan* should contain administrative policies and procedures that will enable the *firm* to manage the plan's implementation effectively, including:
- (a) the responsibilities of senior management;
 - (b) names and contact details of members of the team responsible for implementing the *contingency funding plan*;
 - (c) where, geographically, team members will be assigned;
 - (d) who within the team is responsible for contact with head office (if appropriate), analysts, investors, external auditors, press, significant *client's*, regulators, lawyers and others; and
 - (e) mechanisms that enable senior management and the *governing body* to receive management information that is both relevant and timely.
- (6) Contravention of any of (1) to (5) may be relied upon as tending to

establish contravention of *GENPRU* 1.2.30R(2)(c).

Documentation

- 11.1.25 G *GENPRU* 1.2.60R requires a *firm* to document its assessment of the adequacy of its liquidity financial resources, how it intends to deal with those risks, and details of the stress tests and scenario analyses carried out and the resulting financial resources estimated to be required. Accordingly, a *firm* should document both its stress testing and scenario analysis (see *SYSC* 11.1.18G) and its *contingency funding plan* (see *SYSC* 11.1.23G).

Management information systems

- 11.1.26 G A *firm* should have adequate information systems for controlling and reporting *liquidity risk*. The management information system should be used to check for compliance with the *firm's* established policies, procedures and limits.
- 11.1.27 G Reports on *liquidity risk* should be provided on a timely basis to the *firm's governing body*, senior management and other appropriate personnel. The appropriate content and format of reports depends on a *firm's* liquidity management practices and the nature, scale and complexity of the *firm's* business. Reports to the *firm's governing body* may be less detailed and less frequent than reports to senior management with responsibility for managing *liquidity risk*.
- 11.1.28 G The *FSA* would expect management information to normally contain the following:
- (1) a cash-flow or funding gap report;
 - (2) a funding maturity schedule;
 - (3) a list of large providers of funding; and
 - (4) a limit monitoring and exception report.
- 11.1.29 G When considering what else might be included in *liquidity risk* management information, a *firm* should consider other types of information that may be important for understanding its *liquidity risk* profile. This may include:
- (1) asset quality and trends;
 - (2) any changes in the *firm's* funding strategy;
 - (3) earnings projections; and
 - (4) the *firm's* reputation in the market and the condition of the market itself.

Limit setting

- 11.1.30 G A *firm's* senior management should decide what limits need to be set, in accordance with the nature, scale and complexity of its activities. The structure of limits should reflect the need for a *firm* to have systems and controls in place to guard against a spectrum of possible risks, from those arising in day-to-day *liquidity risk* management to those arising in stressed conditions.
- 11.1.31 G A *firm* should periodically review and, where appropriate, adjust its limits when conditions or risk tolerances change.
- 11.1.32 G Policy or limit exceptions should receive the prompt attention of the appropriate management and should be resolved according to processes described in approved policies.

Annex D

Senior Management Arrangements, Systems and Controls Handbook (SYSC)

In this Annex, the place where the text is being inserted is indicated and the text is not underlined.

- 12 Group risk systems and controls requirement
- 12.1 Application
- 12.1.1 R Subject to SYSC 12.1.2R to SYSC 12.1.4R, this section applies to each of the following which is a member of a *group*:
- (1) a *firm* that falls into any one or more of the following categories:
 - (a) a *regulated entity*;
 - (b) an *ELMI*;
 - (c) an *insurer*;
 - (d) a *BIPRU firm*;
 - (e) a non-*BIPRU firm* that is a *parent financial holding company* in a *Member State* and is a member of a *UK consolidation group*; and
 - (f) a *firm* subject to the *rules* in *IPRU(INV)* Chapter 14.
 - (2) a *UCITS firm*, but only if its *group* contains a *firm* falling into (1); and
 - (3) the *Society*.
- 12.1.2 R Except as set out in SYSC 12.1.4R, this section applies with respect to different types of *group* as follows:
- (1) SYSC 12.1.8R and SYSC 12.1.10R apply with respect to all *groups*, including *FSA regulated EEA financial conglomerates*, other *financial conglomerates* and *groups* dealt with in SYSC 12.1.13R to SYSC 12.1.16R;
 - (2) the additional requirements set out in SYSC 12.1.11R and SYSC 12.1.12R only apply with respect to *FSA regulated EEA financial conglomerates*; and
 - (3) the additional requirements set out in SYSC 12.1.13R to SYSC 12.1.16R only apply with respect to *groups* of the kind dealt with by whichever of those *rules* apply.
- 12.1.3 R This section does not apply to:

- (1) an *incoming EEA firm*; or
- (2) an *incoming Treaty firm*; or
- (3) a *UCITS qualifier*; or
- (4) an *ICVC*.

12.1.4 R (1) This *rule* applies in respect of the following *rules*:

- (a) *SYSC 12.1.8R(2)*;
- (b) *SYSC 12.1.10R(1)*, so far as it relates to *SYSC 12.1.8R(2)*;
- (c) *SYSC 12.1.10R(2)*; and
- (d) *SYSC 12.1.11R* to *SYSC 12.1.15R*.

(2) The *rules* referred to in (1):

- (a) only apply with respect to a *financial conglomerate* if it an *FSA regulated EEA financial conglomerate*;
- (b) (so far as they apply with respect to a *group* that is not a *financial conglomerate*) do not apply with respect to a *group* for which a *competent authority* in another *EEA state* is lead regulator;
- (c) (so far as they apply with respect to a *financial conglomerate*) do not apply to a *firm* with respect to a *financial conglomerate* of which it is a member if the interest of the *financial conglomerate* in that *firm* is no more than a *participation*;
- (d) (so far as they apply with respect to other *groups*) do not apply to a *firm* with respect to a *group* of which it is a member if the only relationship of the kind set out in paragraph (3) of the definition of *group* between it and the other members of the *group* is nothing more than a *participation*; and
- (e) do not apply with respect to a *third-country group*.

- 12.1.5 G For the purpose of this section, a *group* is defined in the *Glossary*, and includes the whole of a *firm's* group, including financial and non-financial undertakings. It also covers undertakings with other links to *group* members if their omission from the scope of *group* risk systems and controls would be misleading. The scope of the *group* systems and controls requirements may therefore differ from the scope of the quantitative requirements for *groups*.

Purpose

- 12.1.6 G The purpose of this chapter is to set out how the systems and control requirements imposed by *SYSC* (Senior Management Arrangements, Systems and Controls) apply where a *firm* is part of a *group*. If a *firm* is a member of a *group*, it should be able to assess the potential impact of risks arising from other parts of its *group* as well as from its own activities.
- 12.1.7 G This section implements articles 73(3) (Supervision on a consolidated basis of credit institutions) and 138 (Intra-group transactions with mixed activity holding companies) of the *Banking Consolidation Directive*, article 9 of the *Financial Groups Directive* (Internal control mechanisms and risk management processes) and article 8 of the *Insurance Groups Directive* (Intra-group transactions).

General rules

- 12.1.8 R A *firm* must:
- (1) have adequate, sound and appropriate risk management processes and internal control mechanisms for the purpose of assessing and managing its own exposure to *group* risk, including sound administrative and accounting procedures; and
 - (2) ensure that its *group* has adequate, sound and appropriate risk management processes and internal control mechanisms at the level of the *group*, including sound administrative and accounting procedures.
- 12.1.9 G For the purposes of *SYSC* 12.1.8R, the question of whether the risk management processes and internal control mechanisms are adequate, sound and appropriate should be judged in the light of the nature, scale and complexity of the *group's* business.
- 12.1.10 R The internal control mechanisms referred to in *SYSC* 12.1.8R must include:
- (1) mechanisms that are adequate for the purpose of producing any data and information which would be relevant for the purpose of monitoring compliance with any prudential requirements (including any reporting requirements and any requirements relating to capital adequacy, solvency, systems and controls and large exposures):
 - (a) to which the *firm* is subject with respect to its membership of a *group*; or

- (b) that apply to or with respect to that *group* or part of it; and
- (2) mechanisms that are adequate to monitor funding within the *group*.

Financial conglomerates

- 12.1.11 R Where this section applies with respect to a *financial conglomerate*, the risk management processes referred to in SYSC 12.1.8R(2) must include:
- (1) sound governance and management processes, which must include the approval and periodic review by the appropriate managing bodies within the *financial conglomerate* of the strategies and policies of the *financial conglomerate* in respect of all the risks assumed by the *financial conglomerate*, such review and approval being carried out at the level of the *financial conglomerate*;
 - (2) adequate capital adequacy policies at the level of the *financial conglomerate*, one of the purposes of which must be to anticipate the impact of the business strategy of the *financial conglomerate* on its risk profile and on the capital adequacy requirements to which it and its members are subject;
 - (3) adequate procedures for the purpose of ensuring that the risk monitoring systems of the *financial conglomerate* and its members are well integrated into their organisation; and
 - (4) adequate procedures for the purpose of ensuring that the systems and controls of the members of the *financial conglomerate* are consistent and that the risks can be measured, monitored and controlled at the level of the *financial conglomerate*.
- 12.1.12 R Where this section applies with respect to a *financial conglomerate*, the internal control mechanisms referred to in SYSC 12.1.8R(2) must include:
- (1) mechanisms that are adequate to identify and measure all material risks incurred by members of the *financial conglomerate* and appropriately relate capital in the *financial conglomerate* to risks; and
 - (2) sound reporting and accounting procedures for the purpose of identifying, measuring, monitoring and controlling *intra-group transactions and risk concentrations*.

BIPRU firms and other firms to which BIPRU 8 applies

- 12.1.13 R If this *rule* applies under SYSC 12.1.14R to a *firm*, the *firm* must:
- (1) comply with SYSC 12.1.8R(2) in relation to any *UK consolidation group* or *non-EEA sub-group* of which it is a member, as well as in relation to its *group*; and
 - (2) ensure that the risk management processes and internal control mechanisms at the level of any *UK consolidation group* or *non-EEA*

sub-group of which it is a member comply with the obligations set out in the following provisions on a consolidated (or sub-consolidated) basis:

- (a) SYSC 3.2.23R and SYSC 3.2.24R;
- (b) SYSC 3.2.26R;
- (c) SYSC 3.2.28R to SYSC 3.2.36R;
- (d) SYSC 11.1.11R and SYSC 11.1.12R;
- (e) BIPRU 2.3.7R(1);
- (f) BIPRU 9.1.6R and BIPRU 9.13.21R (Liquidity plans);
- (g) BIPRU 10.12.3R (Concentration risk policies).

[Note: article 73(3) of the *Banking Consolidation Directive*]

- 12.1.14 R SYSC 12.1.13R applies to a *firm* that is:
- (1) an *ELMI*;
 - (2) a *BIPRU firm*; or
 - (3) a non-*BIPRU firm* that is a *parent financial holding company* in a *Member State* and is a member of a *UK consolidation group*.

- 12.1.15 R In the case of a *firm* that:
- (1) is an *ELMI* or a *BIPRU firm*; and
 - (2) has a *mixed-activity holding company* as a *parent undertaking*;

the risk management processes and internal control mechanisms referred to in SYSC 12.1.8R must include sound reporting and accounting procedures and other mechanisms that are adequate to identify, measure, monitor and control transactions between the *firm's parent undertaking mixed-activity holding company* and any of the *mixed-activity holding company's subsidiary undertakings*.

Insurance undertakings

- 12.1.16 R In the case of an *insurer* that has a *mixed-activity insurance holding company* as a *parent undertaking*, the risk management processes and internal control mechanisms referred to in SYSC 12.1.8R must include sound reporting and accounting procedures and other mechanisms that are adequate to identify, measure, monitor and control transactions between the *firm's parent undertaking mixed-activity insurance holding company* and any of the *mixed-activity insurance holding company's subsidiary undertakings*.

- 12.1.17 G SYSC 12.1.16R cannot apply to a *building society* as it cannot have a *mixed-*

activity holding company as a parent undertaking. SYSC 12.1.16R cannot apply to a friendly society as it cannot have a mixed-activity insurance holding company as a parent undertaking.

Nature and extent of requirements and allocation of responsibilities within the group

- 12.1.18 G Assessment of the adequacy of a *group's* systems and controls required by this section will form part of the *FSA's* risk management process.
- 12.1.19 G The nature and extent of the systems and controls necessary under SYSC 12.1.8R(1) to address *group* risk will vary according to the materiality of those risks to the *firm* and the position of the *firm* within the *group*.
- 12.1.20 G In some cases the management of the systems and controls used to address the risks described in SYSC 12.1.8R(1) may be organised on a *group-wide* basis. If the *firm* is not carrying out those functions itself, it should delegate them to the *group* members that are carrying them out. However, this does not relieve the *firm* of responsibility for complying with its obligations under SYSC 12.1.8R(1). A *firm* cannot absolve itself of such a responsibility by claiming that any breach of that *rule* is caused by the actions of another member of the *group* to whom the *firm* has delegated tasks. The risk management arrangements are still those of the *firm*, even though personnel elsewhere in the *firm's group* are carrying out these functions on its behalf.
- 12.1.21 G SYSC 12.1.8R(1) deals with the systems and controls that a *firm* should have in respect of the exposure it has to the rest of the *group*. On the other hand, the purpose of SYSC 12.1.8R(2) and the *rules* in this section that amplify it is to require *groups* to have adequate systems and controls. However a *group* is not a single legal entity on which obligations can be imposed. Therefore the obligations have to be placed on individual *firms*. The purpose of imposing the obligations on each *firm* in the *group* is to make sure that the *FSA* can take supervisory action against any *firm* in a *group* whose systems and controls do not meet the standards in this section. Thus responsibility for compliance with the *rules* for *group* systems and controls is a joint one.
- 12.1.22 G If both a *firm* and its *parent undertaking* are subject to SYSC 12.1.8R(2), the *FSA* would not expect systems and controls to be duplicated. In this case, the *firm* should assess whether and to what extent it can rely on its parent's *group* risk systems and controls.

Annex E

Senior Management Arrangements, Systems and Controls Handbook (SYSC)

In this Annex, the place where the text is being inserted is indicated and the text is not underlined.

To be inserted after SYSC 12

- 13 Operational risk: systems and controls
- 13.1 Application
- 13.1.1 G SYSC 13 applies to an *insurer* unless it is:
- (1) a *non-directive friendly society*; or
 - (2) an *incoming EEA firm*; or
 - (3) an *incoming Treaty firm*.
- 13.1.2 G SYSC 13 applies to:
- (1) an *EEA-deposit insurer*; and
 - (2) a *Swiss general insurer*;
- only in respect of the activities of the *firm* carried on from a *branch* in the *United Kingdom*.
- 13.1.3 G SYSC 13 applies to a *UK ISPV*.
- 13.2 Purpose
- 13.2.1 G SYSC 13 provides *guidance* on how to interpret SYSC 3.1.1R and SYSC 3.2.6R, which deal with the establishment and maintenance of systems and controls, in relation to the management of operational risk. Operational risk has been described by the Basel Committee on Banking Supervision as "the risk of loss, resulting from inadequate or failed internal processes, people and systems, or from external events". This chapter covers systems and controls for managing risks concerning any of a *firm's* operations, such as its IT systems and *outsourcing* arrangements. It does not cover systems and controls for managing credit, market, liquidity and insurance risk.
- 13.2.2 G Operational risk is a concept that can have a different application for different *firms*. A *firm* should assess the appropriateness of the *guidance* in this chapter in the light of the scale, nature and complexity of its activities as well as its obligations as set out in *Principle 3*, to organise and control its affairs responsibly and effectively.

- 13.2.3 G A *firm* should take steps to understand the types of operational risk that are relevant to its particular circumstances, and the operational losses to which they expose the *firm*. This should include considering the potential sources of operational risk addressed in this chapter: people; processes and systems; external events.
- 13.2.4 G Operational risk can affect, amongst other things, a *firm's* solvency, or lead to unfair treatment of consumers or lead to financial crime. A *firm* should consider all operational risk events that may affect these matters in establishing and maintaining its systems and controls.
- 13.3 Other related Handbook sections
- 13.3.1 G The following is a non-exhaustive list of *rules* and *guidance* in the *Handbook* that are relevant to a *firm's* management of operational risk:
- (1) *SYSC 14* and *INSPRU 5.1* contain specific *rules* and *guidance* for the establishment and maintenance of operational risk systems and controls in a *prudential context*.
 - (2) *COB* contains *rules* and *guidance* that can relate to the management of operational risk; for example, *COB 2* (Rules which apply to all firms conducting designated investment business), *COB 3* (Financial promotion), *COB 5* (Advising and selling), *COB 7* (Dealing and managing) and *COB 9* (Client assets).
- 13.4 Requirements to notify the FSA
- 13.4.1 G Under *Principle 11* and *SUP 15.3.1R*, a *firm* must notify the *FSA* immediately of any operational risk matter of which the *FSA* would reasonably expect notice. *SUP 15.3.8G* provides *guidance* on the occurrences that this requirement covers, which include a significant failure in systems and controls and a significant operational loss.
- 13.4.2 G Regarding operational risk, matters of which the *FSA* would expect notice under *Principle 11* include:
- (1) any significant operational exposures that a *firm* has identified;
 - (2) the *firm's* invocation of a business continuity plan; and
 - (3) any other significant change to a *firm's* organisation, infrastructure or business operating environment.
- 13.5 Risk management terms
- 13.5.1 G In this chapter, the following interpretations of risk management terms apply:
- (1) a *firm's* risk culture encompasses the general awareness, attitude and behaviour of its *employees* and *appointed representatives* to risk and

the management of risk within the organisation;

- (2) operational exposure means the degree of operational risk faced by a *firm* and is usually expressed in terms of the likelihood and impact of a particular type of operational loss occurring (for example, fraud, damage to physical assets);
- (3) a *firm's* operational risk profile describes the types of operational risks that it faces, including those operational risks within a *firm* that may have an adverse impact upon the quality of service afforded to its *clients*, and its exposure to these risks.

13.6 People

13.6.1 G A *firm* should consult SYSC 3.2.2G to SYSC 3.2.5G for *guidance* on reporting lines and delegation of functions within a *firm* and SYSC 3.2.13G to SYSC 3.2.14G for *guidance* on the suitability of *employees* and *appointed representatives*. This section provides additional *guidance* on management of *employees* and other human resources in the context of operational risk.

13.6.2 G A *firm* should establish and maintain appropriate systems and controls for the management of operational risks that can arise from *employees*. In doing so, a *firm* should have regard to:

- (1) its operational risk culture, and any variations in this or its human resource management practices, across its operations (including, for example, the extent to which the compliance culture is extended to in-house IT staff);
- (2) whether the way *employees* are remunerated exposes the *firm* to the risk that it will not be able to meet its regulatory obligations (see SYSC 3.2.18G). For example, a *firm* should consider how well remuneration and performance indicators reflect the *firm's* tolerance for operational risk, and the adequacy of these indicators for measuring performance;
- (3) whether inadequate or inappropriate training of *client*-facing services exposes *clients* to risk of loss or unfair treatment including by not enabling effective communication with the *firm*;
- (4) the extent of its compliance with applicable regulatory and other requirements that relate to the welfare and conduct of *employees*;
- (5) its arrangements for the continuity of operations in the event of *employee* unavailability or loss;
- (6) the relationship between indicators of 'people risk' (such as overtime, sickness, and *employee* turnover levels) and exposure to operational losses; and
- (7) the relevance of all the above to *employees* of a third party supplier who are involved in performing an *outsourcing* arrangement. As

necessary, a *firm* should review and consider the adequacy of the staffing arrangements and policies of a service provider.

Employee responsibilities

- 13.6.3 G A *firm* should ensure that all *employees* are capable of performing, and aware of, their operational risk management responsibilities, including by establishing and maintaining:
- (1) appropriate segregation of *employees'* duties and appropriate supervision of *employees* in the performance of their responsibilities (see SYSC 3.2.5G);
 - (2) appropriate recruitment and subsequent processes to review the fitness and propriety of *employees* (see SYSC 3.2.13G and SYSC 3.2.14G);
 - (3) clear policy statements and appropriate systems and procedures manuals that are effectively communicated to *employees* and available for *employees* to refer to as required. These should cover, for example, compliance, IT security and health and safety issues;
 - (4) training processes that enable *employees* to attain and maintain appropriate competence; and
 - (5) appropriate and properly enforced disciplinary and employment termination policies and procedures.
- 13.6.4 G A *firm* should have regard to SYSC 13.6.3G in relation to *approved persons*, people occupying positions of high personal trust (for example, security administration, payment and settlement functions); and people occupying positions requiring significant technical competence (for example, *derivatives* trading and technical security administration). A *firm* should also consider the *rules* and *guidance* for *approved persons* in other parts of the *Handbook* (including *APER* and *SUP*) and the *rules* and *guidance* on *senior manager* responsibilities in SYSC 2.1 (Apportionment of Responsibilities).
- 13.7 Processes and systems
- 13.7.1 G A *firm* should establish and maintain appropriate systems and controls for managing operational risks that can arise from inadequacies or failures in its processes and systems (and, as appropriate, the systems and processes of third party suppliers, agents and others). In doing so a *firm* should have regard to:
- (1) the importance and complexity of processes and systems used in the end-to-end operating cycle for products and activities (for example, the level of integration of systems);
 - (2) controls that will help it to prevent system and process failures or identify them to permit prompt rectification (including pre-approval

or reconciliation processes);

- (3) whether the design and use of its processes and systems allow it to comply adequately with regulatory and other requirements;
- (4) its arrangements for the continuity of operations in the event that a significant process or system becomes unavailable or is destroyed; and
- (5) the importance of monitoring indicators of process or system risk (including reconciliation exceptions, compensation payments for *client* losses and documentation errors) and experience of operational losses and exposures.

Internal documentation

- 13.7.2 G Internal documentation may enhance understanding and aid continuity of operations, so a *firm* should ensure the adequacy of its internal documentation of processes and systems (including how documentation is developed, maintained and distributed) in managing operational risk.

External documentation

- 13.7.3 G A *firm* may use external documentation (including contracts, transaction statements or advertising brochures) to define or clarify terms and conditions for its products or activities, its business strategy (for example, including through press statements), or its brand. Inappropriate or inaccurate information in external documents can lead to significant operational exposure.

- 13.7.4 G A *firm* should ensure the adequacy of its processes and systems to review external documentation prior to issue (including review by its compliance, legal and marketing departments or by appropriately qualified external advisers). In doing so, a *firm* should have regard to:
- (1) compliance with applicable regulatory and other requirements (such as *COB* 3 (Financial promotion));
 - (2) the extent to which its documentation uses standard terms (that are widely recognised, and have been tested in the courts) or non-standard terms (whose meaning may not yet be settled or whose effectiveness may be uncertain);
 - (3) the manner in which its documentation is issued; and
 - (4) the extent to which confirmation of acceptance is required (including by *customer* signature or counterparty confirmation).

IT systems

- 13.7.5 G IT systems include the computer systems and infrastructure required for the automation of processes, such as application and operating system software; network infrastructure; and desktop, server, and mainframe hardware. Automation may reduce a *firm's* exposure to some 'people risks' (including by reducing human errors or controlling access rights to enable segregation of duties), but will increase its dependency on the reliability of its IT systems.
- 13.7.6 G A *firm* should establish and maintain appropriate systems and controls for the management of its IT system risks, having regard to:
- (1) its organisation and reporting structure for technology operations (including the adequacy of senior management oversight);
 - (2) the extent to which technology requirements are addressed in its business strategy;
 - (3) the appropriateness of its systems acquisition, development and maintenance activities (including the allocation of responsibilities between IT development and operational areas, processes for embedding security requirements into systems); and
 - (4) the appropriateness of its activities supporting the operation of IT systems (including the allocation of responsibilities between business and technology areas).

Information security

- 13.7.7 G Failures in processing information (whether physical, electronic or known by *employees* but not recorded) or of the security of the systems that maintain it can lead to significant operational losses. A *firm* should establish and maintain appropriate systems and controls to manage its information security risks. In doing so, a *firm* should have regard to:
- (1) confidentiality: information should be accessible only to *persons* or systems with appropriate authority, which may require firewalls within a system, as well as entry restrictions;
 - (2) integrity: safeguarding the accuracy and completeness of information and its processing;
 - (3) availability and authentication: ensuring that appropriately authorised *persons* or systems have access to the information when required and that their identity is verified;
 - (4) non-repudiation and accountability: ensuring that the *person* or system that processed the information cannot deny their actions.
- 13.7.8 G A *firm* should ensure the adequacy of the systems and controls used to protect the processing and security of its information, and should have regard to established security standards such as ISO17799 (Information

Security Management).

Geographic location

- 13.7.9 G Operating processes and systems at separate geographic locations may alter a *firm's* operational risk profile (including by allowing alternative sites for the continuity of operations). A *firm* should understand the effect of any differences in processes and systems at each of its locations, particularly if they are in different countries, having regard to:
- (1) the business operating environment of each country (for example, the likelihood and impact of political disruptions or cultural differences on the provision of services);
 - (2) relevant local regulatory and other requirements regarding data protection and transfer;
 - (3) the extent to which local regulatory and other requirements may restrict its ability to meet regulatory obligations in the *United Kingdom* (for example, access to information by the *FSA* and local restrictions on internal or external audit); and
 - (4) the timeliness of information flows to and from its headquarters and whether the level of delegated authority and the risk management structures of the overseas operation are compatible with the *firm's* head office arrangements.
- 13.8 External events and other changes
- 13.8.1 G The exposure of a *firm* to operational risk may increase during times of significant change to its organisation, infrastructure and business operating environment (for example, following a corporate restructure or changes in regulatory requirements). Before, during, and after expected changes, a *firm* should assess and monitor their effect on its risk profile, including with regard to:
- (1) untrained or de-motivated *employees* or a significant loss of *employees* during the period of change, or subsequently;
 - (2) inadequate human resources or inexperienced *employees* carrying out routine business activities owing to the prioritisation of resources to the programme or project;
 - (3) process or system instability and poor management information due to failures in integration or increased demand; and
 - (4) inadequate or inappropriate processes following business re-engineering.
- 13.8.2 G A *firm* should establish and maintain appropriate systems and controls for the management of the risks involved in expected changes, such as by

ensuring:

- (1) the adequacy of its organisation and reporting structure for managing the change (including the adequacy of senior management oversight);
- (2) the adequacy of the management processes and systems for managing the change (including planning, approval, implementation and review processes); and
- (3) the adequacy of its strategy for communicating changes in systems and controls to its *employees*.

Unexpected changes and business continuity management

- 13.8.3 G *SYSC 3.2.19G* provides high level *guidance* on business continuity. This section provides additional *guidance* on managing business continuity in the context of operational risk.
- 13.8.4 G The high level requirement for appropriate systems and controls at *SYSC 3.1.1R* applies at all times, including when a business continuity plan is invoked. However, the *FSA* recognises that, in an emergency, a *firm* may be unable to comply with a particular *rule* and the conditions for relief are outlined in *GEN 1.3* (Emergency).
- 13.8.5 G A *firm* should consider the likelihood and impact of a disruption to the continuity of its operations from unexpected events. This should include assessing the disruptions to which it is particularly susceptible (and the likely timescale of those disruptions) including through:
- (1) loss or failure of internal and external resources (such as people, systems and other assets);
 - (2) the loss or corruption of its information; and
 - (3) external events (such as vandalism, war and "acts of God").
- 13.8.6 G A *firm* should implement appropriate arrangements to maintain the continuity of its operations. A *firm* should act to reduce both the likelihood of a disruption (including by succession planning, systems resilience and dual processing); and the impact of a disruption (including by contingency arrangements and insurance).
- 13.8.7 G A *firm* should document its strategy for maintaining continuity of its operations, and its plans for communicating and regularly testing the adequacy and effectiveness of this strategy. A *firm* should establish:
- (1) formal business continuity plans that outline arrangements to reduce the impact of a short, medium or long-term disruption, including:
 - (a) resource requirements such as people, systems and other

- assets, and arrangements for obtaining these resources;
 - (b) the recovery priorities for the *firm's* operations; and
 - (c) communication arrangements for internal and external concerned parties (including the *FSA*, *clients* and the press);
- (2) escalation and invocation plans that outline the processes for implementing the business continuity plans, together with relevant contact information;
 - (3) processes to validate the integrity of information affected by the disruption;
 - (4) processes to review and update (1) to (3) following changes to the *firm's* operations or risk profile (including changes identified through testing).
- 13.8.8 G The use of an alternative site for recovery of operations is common practice in business continuity management. A *firm* that uses an alternative site should assess the appropriateness of the site, particularly for location, speed of recovery and adequacy of resources. Where a site is shared, a *firm* should evaluate the risk of multiple calls on shared resources and adjust its plans accordingly.
- 13.9 Outsourcing
- 13.9.1 G As *SYSC 3.2.4G* explains, a *firm* cannot contract out its regulatory obligations and should take reasonable care to supervise the discharge of outsourced functions. This section provides additional *guidance* on managing *outsourcing* arrangements (and will be relevant, to some extent, to other forms of third party dependency) in relation to operational risk. *Outsourcing* may affect a *firm's* exposure to operational risk through significant changes to, and reduced control over, people, processes and systems used in outsourced activities.
- 13.9.2 G *Firms* should take particular care to manage *material outsourcing* arrangements and, as *SUP 15.3.8G(1)(e)* explains, a *firm* should notify the *FSA* when it intends to enter into a *material outsourcing* arrangement.
- 13.9.3 G A *firm* should not assume that because a service provider is either a regulated *firm* or an intra-group entity an *outsourcing* arrangement with that provider will, in itself, necessarily imply a reduction in operational risk.
- 13.9.4 G Before entering into, or significantly changing, an *outsourcing* arrangement, a *firm* should:
- (1) analyse how the arrangement will fit with its organisation and reporting structure; business strategy; overall risk profile; and ability to meet its regulatory obligations;

- (2) consider whether the agreements establishing the arrangement will allow it to monitor and control its operational risk exposure relating to the *outsourcing*;
- (3) conduct appropriate due diligence of the service provider's financial stability and expertise;
- (4) consider how it will ensure a smooth transition of its operations from its current arrangements to a new or changed *outsourcing* arrangement (including what will happen on the termination of the contract); and
- (5) consider any concentration risk implications such as the business continuity implications that may arise if a single service provider is used by several *firms*.

13.9.5 G In negotiating its contract with a service provider, a *firm* should have regard to:

- (1) reporting or notification requirements it may wish to impose on the service provider;
- (2) whether sufficient access will be available to its internal auditors, external auditors or *actuaries* (see section 341 of the *Act*) and to the *FSA* (see *SUP 2.3.5R* (Access to premises) and *SUP 2.3.7R* (Suppliers under material outsourcing arrangements));
- (3) information ownership rights, confidentiality agreements and *Chinese walls* to protect *client* and other information (including arrangements at the termination of the contract);
- (4) the adequacy of any guarantees and indemnities;
- (5) the extent to which the service provider must comply with the *firm's* policies and procedures (covering, for example, information security);
- (6) the extent to which a service provider will provide business continuity for outsourced operations, and whether exclusive access to its resources is agreed;
- (7) the need for continued availability of software following difficulty at a third party supplier;
- (8) the processes for making changes to the *outsourcing* arrangement (for example, changes in processing volumes, activities and other contractual terms) and the conditions under which the *firm* or service provider can choose to change or terminate the *outsourcing* arrangement, such as where there is:
 - (a) a change of ownership or *control* (including insolvency or

- receivership) of the service provider or *firm*; or
- (b) significant change in the business operations (including sub-contracting) of the service provider or *firm*; or
 - (c) inadequate provision of services that may lead to the *firm* being unable to meet its regulatory obligations.
- 13.9.6 G In implementing a relationship management framework, and drafting the service level agreement with the service provider, a *firm* should have regard to:
- (1) the identification of qualitative and quantitative performance targets to assess the adequacy of service provision, to both the *firm* and its *clients*, where appropriate;
 - (2) the evaluation of performance through service delivery reports and periodic self certification or independent review by internal or external auditors; and
 - (3) remedial action and escalation processes for dealing with inadequate performance.
- 13.9.7 G In some circumstances, a *firm* may find it beneficial to use externally validated reports commissioned by the service provider, to seek comfort as to the adequacy and effectiveness of its systems and controls. The use of such reports does not absolve the *firm* of responsibility to maintain other oversight. In addition, the *firm* should not normally have to forfeit its right to access, for itself or its agents, to the service provider's premises.
- 13.9.8 G A *firm* should ensure that it has appropriate contingency arrangements to allow business continuity in the event of a significant loss of services from the service provider. Particular issues to consider include a significant loss of resources at, or financial failure of, the service provider, and unexpected termination of the *outsourcing* arrangement.
- 13.10 Insurance
- 13.10.1 G Whilst a *firm* may take out insurance with the aim of reducing the monetary impact of operational risk events, non-monetary impacts may remain (including impact on the *firm's* reputation). A *firm* should not assume that insurance alone can replace robust systems and controls.
- 13.10.2 G When considering utilising insurance, a *firm* should consider:
- (1) the time taken for the *insurer* to pay claims (including the potential time taken in disputing cover) and the *firm's* funding of operations whilst awaiting payment of claims;
 - (2) the financial strength of the *insurer*, which may determine its ability to pay claims, particularly where large or numerous small claims are

made at the same time; and

- (3) the effect of any limiting conditions and exclusion clauses that may restrict cover to a small number of specific operational losses and may exclude larger or hard to quantify indirect losses (such as lost business or reputational costs).

14 Prudential risk management and associated systems and controls

14.1 Application

14.1.1 R This section applies to an *insurer* unless it is:

- (1) a *non-directive friendly society*; or
- (2) an *incoming EEA firm*; or
- (3) an *incoming Treaty firm*.

14.1.2 R This section applies to:

- (1) an *EEA-deposit insurer*; and
- (2) a *Swiss general insurer*;

only in respect of the activities of the *firm* carried on from a *branch* in the *United Kingdom*.

Purpose

14.1.3 G This section sets out some *rules* and *guidance* on the establishment and maintenance of systems and controls for the management of a *firm's* prudential risks. A *firm's* prudential risks are those that can reduce the adequacy of its financial resources, and as a result may adversely affect confidence in the financial system or prejudice *consumers*. Some key prudential risks are credit, market, liquidity, operational, insurance and group risk.

14.1.4 G The purpose of this section is to serve the *FSA's regulatory objectives* of consumer protection and market confidence. In particular, this section aims to reduce the risk that a *firm* may pose a threat to these *regulatory objectives*, either because it is not prudently managed, or because it has inadequate systems to permit appropriate senior management oversight and control of its business.

14.1.5 G Both adequate financial resources and adequate systems and controls are necessary for the effective management of prudential risks. A *firm* may hold financial resources to help alleviate the financial consequences of minor weaknesses in its systems and controls (to reflect possible impairments in the accuracy or timing of its identification, measurement, monitoring and control of certain risks, for example). However, financial resources cannot adequately compensate for significant weaknesses in a *firm's* systems and controls that could fundamentally undermine its ability to control its affairs effectively.

How to interpret this section

- 14.1.6 G This section is designed to amplify *Principle 3* (Management and control) which requires that a *firm* take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems. This section is also designed to be complementary to *SYSC 2*, *SYSC 3* and *SYSC 13* in that it contains some additional *rules* and *guidance* on senior management arrangements and associated systems and controls for *firms* that could have a significant impact on the *FSA's* objectives in a *prudential context*.
- 14.1.7 G In addition to supporting *PRIN* and *SYSC 2*, *SYSC 3* and *SYSC 13*, this section lays the foundations for the more specific *rules* and *guidance* on the management of credit, market, liquidity, operational, insurance and group risks that are in *SYSC 11*, *SYSC 12*, *SYSC 15*, *SYSC 16* and *INSPRU 5.1*. Many of the elements raised here in general terms are expanded upon in these sections.
- 14.1.8 G Appropriate systems and controls for the management of prudential risk will vary from *firm* to *firm*. Therefore, most of the material in this section is *guidance*. In interpreting this *guidance*, a *firm* should have regard to its own particular circumstances. Following from *SYSC 3.1.2 G*, this should include considering the nature, scale and complexity of its business, which may be influenced by factors such as:
- (1) the diversity of its operations, including geographical diversity;
 - (2) the volume and size of its transactions; and
 - (3) the degree of risk associated with each area of its operation.
- 14.1.9 G The *guidance* contained within this section is not designed to be exhaustive. When establishing and maintaining its systems and controls a *firm* should have regard not only to other parts of the *Handbook*, but also to material that is issued by other industry or regulatory bodies.

The role of systems and controls in a prudential context

- 14.1.10 G In a *prudential context*, a *firm's* systems and controls should provide its senior management with an adequate means of managing the *firm*. As such, they should be designed and maintained to ensure that senior management is able to make and implement integrated business planning and risk management decisions on the basis of accurate information about the risks that the *firm* faces and the financial resources that it has.

The prudential responsibilities of senior management and the apportionment of those responsibilities

- 14.1.11 G Ultimate responsibility for the management of prudential risks rests with a *firm's governing body* and relevant *senior managers*, and in particular with those individuals that undertake the *firm's governing functions* and the

apportionment and oversight function. In particular, these responsibilities should include:

- (1) overseeing the establishment of an appropriate business plan and risk management strategy;
- (2) overseeing the development of appropriate systems for the management of prudential risks;
- (3) establishing adequate *internal controls*; and
- (4) ensuring that the *firm* maintains adequate financial resources.

The delegation of responsibilities within the firm

- 14.1.12 G Although authority for the management of a *firm's* prudential risks is likely to be delegated, to some degree, to individuals at all levels of the organisation, overall responsibility for this activity should not be delegated from its *governing body* and relevant *senior managers*.
- 14.1.13 G Where delegation does occur, a *firm* should ensure that appropriate systems and controls are in place to allow its *governing body* and relevant *senior managers* to participate in and control its prudential risk management activities. The *governing body* and relevant *senior managers* should approve and periodically review these systems and controls to ensure that delegated duties are being performed correctly.

Firms subject to risk management on a group basis

- 14.1.14 G Some *firms* organise the management of their prudential risks on a stand-alone basis. In some cases, however, the management of a *firm's* prudential risks may be entirely or largely subsumed within a whole *group* or *sub-group* basis.
- (1) The latter arrangement may still comply with the *FSA's* prudential policy on systems and controls if the *firm's governing body* formally delegates the functions that are to be carried out in this way to the *persons* or bodies that are to carry them out. Before doing so, however, the *firm's governing body* should have explicitly considered the arrangement and decided that it is appropriate and that it enables the *firm* to meet the *FSA's* prudential policy on systems and controls. The *firm* should notify the *FSA* if the management of its prudential risks is to be carried out in this way.
 - (2) Where the management of a *firm's* prudential risks is largely, but not entirely, subsumed within a whole *group* or *sub-group* basis, the *firm* should ensure that any prudential issues that are specific to the *firm* are:

- (a) identified and adequately covered by those to whom it has delegated certain prudential risk management tasks; or
 - (b) dealt with by the *firm* itself.
- 14.1.15 G Any delegation of the management of prudential risks to another part of a *firm's group* does not relieve it of responsibility for complying with the *FSA's* prudential policy on systems and controls. A *firm* cannot absolve itself of such a responsibility by claiming that any breach of the *FSA's* prudential policy on systems and controls is effected by the actions of a third party *firm* to whom the *firm* has delegated tasks. The risk management arrangements are still those of the *firm*, even though personnel elsewhere in the *firm's group* are carrying out these functions on its behalf. Thus any references in *GENPRU*, *INSPRU* or *SYSC* to what a *firm*, its personnel and its management should and should not do still apply, and do not need any adjustment to cover the situation in which risk management functions are carried out on a *group-wide* basis.
- 14.1.16 G Where it is stated in *GENPRU*, *INSPRU* or *SYSC* that a particular task in relation to a *firm's* systems and controls should be carried out by a *firm's governing body* this task should not be delegated to another part of its *group*. Furthermore, even where the management of a *firm's* prudential risks is delegated as described in *SYSC* 14.1.14G, responsibility for its effectiveness and for ensuring that it remains appropriate remains with the *firm's governing body*. The *firm's governing body* should therefore keep any delegation under review to ensure that delegated duties are being performed correctly.

Business planning and risk management

- 14.1.17 G Business planning and risk management are closely related activities. In particular, the forward-looking assessment of a *firm's* financial resources needs, and of how business plans may affect the risks that it faces, are important elements of prudential risk management. A *firm's* business planning should also involve the creation of specific risk policies which will normally outline a *firm's* strategy and objectives for, as appropriate, the management of its market, credit, liquidity, operational, insurance and group risks and the processes that it intends to adopt to achieve these objectives. *SYSC* 14.1.18R to *SYSC* 14.1.25G set out some *rules* and *guidance* relating to business planning and risk management in a *prudential context* (see also *SYSC* 3.2.17G, which states that a *firm* should plan its business appropriately).
- 14.1.18 R A *firm* must take reasonable steps to ensure the establishment and maintenance of a business plan and appropriate systems for the management of prudential risk.
- 14.1.19 R When establishing and maintaining its business plan and prudential risk management systems, a *firm* must document:

- (1) an explanation of its overall business strategy, including its business objectives;
- (2) a description of, as applicable, its policies towards market, credit (including provisioning), liquidity, operational, insurance and group risk (that is, its risk policies), including its appetite or tolerance for these risks and how it identifies, measures or assesses, monitors and controls these risks;
- (3) the systems and controls that it intends to use in order to ensure that its business plan and risk policies are implemented correctly;
- (4) a description of how the *firm* accounts for assets and liabilities, including the circumstances under which items are netted, included or excluded from the *firm's* balance sheet and the methods and assumptions for valuation;
- (5) appropriate financial *projections* and the results of its stress testing and scenario analysis (see *GENPRU* 1.2 (Adequacy of financial resources)); and
- (6) details of, and the justification for, the methods and assumptions used in financial *projections* and stress testing and scenario analysis.

14.1.20 G The prudential risk management systems referred to in *SYSC* 14.1.18R and *SYSC* 14.1.19R are the means by which a *firm* is able to:

- (1) identify the prudential risks that are inherent in its business plan, operating environment and objectives, and determine its appetite or tolerance for these risks;
- (2) measure or assess its prudential risks;
- (3) monitor its prudential risks; and
- (4) control or mitigate its prudential risks.

INSPRU 4.1.63E is an *evidential provision* relating to *SYSC* 14.1.18R concerning risk management systems in respect of *liquidity risk* arising from substantial exposures in foreign currencies.

14.1.21 G A *firm* should consider the relationship between its business plan, risk policies and the financial resources that it has available (or can readily access), recognising that decisions made in respect of one element may have consequences for the other two.

14.1.22 G A *firm's* business plan and risk management systems should be:

- (1) effectively communicated so that all *employees* and contractors understand and adhere to the procedures related to their own responsibilities;

- (2) regularly updated and revised, in particular when there is significant new information or when actual practice or performance differs materially from the documented strategy, policy or systems.
- 14.1.23 G The level of detail in a *firm's* business plan and its approach to the design of its risk management systems should be appropriate to the scale and complexity of its operations, and the nature and degree of risk that it faces.
- 14.1.24 G A *firm's* business plan and systems documentation should be accessible to the *firm's* management in line with their respective responsibilities and, upon request, to the *FSA*.
- 14.1.25 G *SYSC* 14.1.19R(5) requires a *firm* to *document* its financial projections and the results of its stress testing and scenario analysis. Such financial projections, stress tests and scenario analysis should be used by a *firm's governing body* and relevant *senior managers* when deciding upon how much risk the *firm* is willing to accept in pursuit of its business objectives and how risk limits should be set. Further *rules* and *guidance* on stress testing and scenario analysis are outlined in *GENPRU* 1.2 (Adequacy of financial resources) and *SYSC* 11 (Liquidity risk systems and controls).

Internal controls: introduction

- 14.1.26 G *Internal controls* should provide a *firm* with reasonable assurance that it will not be hindered in achieving its objectives, or in the orderly and legitimate conduct of its business, by events that may reasonably be foreseen. More specifically in a *prudential context*, *internal controls* should be concerned with ensuring that a *firm's* business plan and risk management systems are operating as expected and are being implemented as intended. The following *rule* (*SYSC* 14.1.27R) reflects the importance of *internal controls* in a *prudential context*.
- 14.1.27 R A *firm* must take reasonable steps to establish and maintain adequate *internal controls*.
- 14.1.28 G The precise role and organisation of *internal controls* can vary from *firm* to *firm*. However, a *firm's internal controls* should normally be concerned with assisting its *governing body* and relevant *senior managers* to participate in ensuring that it meets the following objectives:
- (1) safeguarding both the assets of the *firm* and its *customers*, as well as identifying and managing liabilities;
 - (2) maintaining the efficiency and effectiveness of its operations;
 - (3) ensuring the reliability and completeness of all accounting, financial and management information; and
 - (4) ensuring compliance with its internal policies and procedures as well as all applicable laws and regulations.
- 14.1.29 G When determining the adequacy of its *internal controls*, a *firm* should

consider both the potential risks that might hinder the achievement of the objectives listed in SYSC 14.1.28G, and the extent to which it needs to control these risks. More specifically, this should normally include consideration of:

- (1) the appropriateness of its reporting and communication lines (see SYSC 3.2.2G);
- (2) how the delegation or contracting of functions or activities to *employees, appointed representatives* or other third parties (for example *outsourcing*) is to be monitored and controlled (see SYSC 3.2.3G to SYSC 3.2.4G, SYSC 14.1.12G to SYSC 14.1.16G and SYSC 14.1.33G; additional guidance on the management of *outsourcing* arrangements is also provided in SYSC 13.9);
- (3) the risk that a *firm's employees* or contractors might accidentally or deliberately breach a *firm's* policies and procedures (see SYSC 13.6.3G);
- (4) the need for adequate segregation of duties (see SYSC 3.2.5G and SYSC 14.1.30G to SYSC 14.1.33G);
- (5) the establishment and control of risk management committees (see SYSC 14.1.34G to SYSC 14.1.37G);
- (6) the need for risk assessment and the establishment of a risk assessment function (see SYSC 3.2.10G and SYSC 14.1.38G to SYSC 14.1.41G);
- (7) the need for internal audit and the establishment of an internal audit function and audit committee (see SYSC 3.2.15G to SYSC 3.2.16G and SYSC 14.1.42G to SYSC 14.1.45G).

Internal controls: segregation of duties

14.1.30 G The effective segregation of duties is an important internal control in the *prudential context*. In particular, it helps to ensure that no one individual is completely free to commit a *firm's* assets or incur liabilities on its behalf. Segregation can also help to ensure that a *firm's governing body* receives objective and accurate information on financial performance, the risks faced by the *firm* and the adequacy of its systems. In this regard, a *firm* should ensure that there is adequate segregation of duties between *employees* involved in:

- (1) taking on or controlling risk (which could involve risk mitigation);
- (2) risk assessment (which includes the identification and analysis of risk); and
- (3) internal audit.

14.1.31 G In addition, a *firm* should normally ensure that no single individual has

unrestricted authority to do all of the following:

- (1) initiate a transaction;
- (2) bind the *firm*;
- (3) make payments; and
- (4) account for it.

14.1.32 G Where a *firm* is unable to ensure the complete segregation of duties (for example, because it has a limited number of staff), it should ensure that there are adequate compensating controls in place (for example, frequent review of an area by relevant *senior managers*).

14.1.33 G Where a *firm* outsources a *controlled function*, such as *internal audit*, it should take reasonable steps to ensure that every individual involved in the performance of this service is independent from the individuals who perform its external audit. This should not prevent services from being undertaken by a *firm's* external auditors provided that:

- (1) the work is carried out under the supervision and management of the *firm's* own internal staff; and
- (2) potential conflicts of interest between the provision of external audit services and the provision of *controlled functions* are properly managed.

Internal controls: risk management committees

14.1.34 G In many *firms*, especially if there are multiple business lines, it is common for the *governing body* to delegate some tasks related to risk control and management to committees such as asset and liability committees (ALCO), credit risk committees and market risk committees.

14.1.35 G Where a *firm* decides to create one or more risk management committee(s), adequate *internal controls* should be put in place to ensure that these committees are effective and that their actions are consistent with the objectives outlined in SYSC 14.1.28G. This should normally include consideration of the following:

- (1) setting clear terms of reference, including membership, reporting lines and responsibilities of each committee;
- (2) setting limits on their authority;
- (3) agreeing routine reporting and non-routine reporting escalation procedures;
- (4) agreeing the minimum frequency of committee meetings; and

- (5) reviewing the performance of these risk management committees.
- 14.1.36 G The decision to delegate risk management tasks, along with the terms of reference of the committees and their performance, should be reviewed periodically by the *firm's governing body* and revised as appropriate.
- 14.1.37 G The effective use of risk management committees can help to enhance a *firm's internal controls*. In establishing and maintaining its risk management committees, a *firm* should consider:
- (1) their membership, which should normally include relevant *senior managers* (such as the head of group risk, head of legal, and the heads of market, credit, liquidity and operational risk, etc.), business line managers, risk management personnel and other appropriately skilled people, for example, actuaries, lawyers, accountants, IT specialists, etc.;
 - (2) using these committees to:
 - (i) inform the decisions made by a *firm's governing body* regarding its appetite or tolerance for risk taking;
 - (ii) highlight risk management issues that may require attention by the *governing body*;
 - (iii) consider risk at the firm-wide level and, within delegated limits, to determine the allocation of risk limits and financial resources across business lines; and
 - (iv) consider how exposures may be unwound, hedged, or otherwise mitigated, as appropriate.

Internal controls: risk assessment

- 14.1.38 G Risk assessment is the process through which a *firm* identifies and analyses (using both qualitative and quantitative methodologies) the risks that it faces. A *firm's* risk assessment activities should normally include consideration of:
- (1) its total exposure to risk at the *firm-wide* level (that is, its exposure across business lines and risk categories);
 - (2) capital allocation and the need to calculate risk weighted returns for different business lines;
 - (3) the potential correlations that can exist between the risks in different business lines; this should also include looking for risks to which a *firm's* business plan is particularly sensitive, such as interest rate risk, or multiple dealings with the same *counterparty*;
 - (4) the use of stress tests and scenario analysis;

- (5) whether there are risks inherent in the *firm's* business that are not being addressed adequately;
 - (6) the risk adjusted return that the *firm* is achieving; and
 - (7) the adequacy and timeliness of management information on market, credit, insurance, liquidity, operational and group risks from the business lines, including risk limit utilisation.
- 14.1.39 G In accordance with SYSC 3.2.10G a *firm* should consider whether it needs to set up a separate *risk assessment function* (or functions) that is responsible for assessing the risks that the *firm* faces and advising its *governing body* and *senior managers* on them.
- 14.1.40 G Where a *firm* does decide that it needs a separate *risk assessment function*, the *employees* or contractors that carry out this function should not normally be involved in risk taking activities such as business line management (see SYSC 14.1.30G to SYSC 14.1.33G on the segregation of duties).
- 14.1.41 G A summary of the results of the analysis undertaken by a *firm's risk assessment function* (including, where necessary, an explanation of any assumptions that were adopted) should normally be reported to relevant *senior managers* as well as to the *firm's governing body*.

Internal audit

- 14.1.42 G A *firm* should ensure that it has appropriate mechanisms in place to assess and monitor the appropriateness and effectiveness of its systems and controls. This should normally include consideration of:
- (1) adherence to and effectiveness of, as appropriate, its market, credit, liquidity, operational, insurance, and group risk policies;
 - (2) whether departures and variances from its documented systems and controls and risk policies have been adequately documented and appropriately reported, including whether appropriate pre-clearance authorisation has been sought for material departures and variances;
 - (3) adherence to and effectiveness of its accounting policies, and whether accounting records are complete and accurate;
 - (4) adherence to and effectiveness of its management reporting arrangements, including the timeliness of reporting, and whether information is comprehensive and accurate; and
 - (5) adherence to *FSA rules* and regulatory prudential standards.
- 14.1.43 G In accordance with SYSC 3.2.15G and SYSC 3.2.16G, a *firm* should consider whether it needs to set up a dedicated *internal audit function*.
- 14.1.44 G Where a *firm* decides to set up an *internal audit function*, this function should provide independent assurance to its *governing body*, audit

committee or an appropriate *senior manager* of the integrity and effectiveness of its systems and controls.

- 14.1.45 G In forming its judgements, the *person* performing the *internal audit function* should test the practical operation of a *firm's* systems and controls as well as its accounting and risk policies. This should include examining the adequacy of supporting records.

Management information

- 14.1.46 G Many individuals, at various levels of a *firm*, need management information relating to their activities. However, SYSC 14.1.47G to SYSC 14.1.50G concentrates on the management information that should be available to those at the highest level of a *firm*, that is, the *firm's governing body* and relevant *senior managers*. In so doing SYSC 14.1.47G to SYSC 14.1.50G amplify SYSC 3.2.11G and SYSC 3.2.12G (which outline the FSA's high level policy on senior management information) by providing some additional *guidance* on the management information that should be available in a *prudential context*.

- 14.1.47 G The role of management information should be to help a *firm's governing body* and *senior managers* to understand risk at a firm-wide level. In so doing, it should help them to:

- (1) determine whether a *firm* is prudently managed with adequate financial resources;
- (2) make the decisions that fall within their ambit (for example, the high level business plans, strategy and risk tolerances of the *firm*); and
- (3) oversee the execution of tasks for which they are responsible.

- 14.1.48 G A *firm* should consider what information needs to be made available to its *governing body* and *senior managers*. Some possible examples include:

- (1) firm-wide information such as the overall profitability and value of a *firm* and its total exposure to risk;
- (2) reports from committees to which the *governing body* has delegated risk management tasks, if applicable;
- (3) reports from a *firm's internal audit* and *risk assessment functions*, if applicable, including exception reports, where risk limits and policies have been breached or systems circumvented;
- (4) financial projections under expected and abnormal (that is, stressed) conditions;
- (5) reconciliation of actual profit and loss to previous financial projections and an analysis of any significant variances;
- (6) matters which require a decision from the *governing body* or *senior*

managers, for example a significant variation to a business plan, amendments to risk limits, the creation of a new business line, etc;

- (7) compliance with *FSA rules* and regulatory prudential standards;
- (8) risk weighted returns; and
- (9) liquidity and funding requirements.

14.1.49 G The management information that is provided to a *firm's governing body* and *senior managers* should have the following characteristics:

- (1) it should be timely, its frequency being determined by factors such as:
 - (a) the volatility of the business in which the *firm* is engaged (that is, the speed at which its risks can change);
 - (b) any time constraints on when action needs to be taken; and
 - (c) the level of risk that the *firm* is exposed to, compared to its available financial resources and tolerance for risk;
- (2) it should be reliable, having regard to the fact that it may be necessary to sacrifice a degree of accuracy for timeliness; and
- (3) it should be presented in a manner that highlights any relevant issues on which those undertaking *governing functions* should focus particular attention.

14.1.50 G The production of management and other information may require the collation of data from a variety of separate manual and automated systems. In such cases, responsibility for the integrity of the information may be spread amongst a number of operational areas. A *firm* should ensure that it has appropriate processes to validate the integrity of its information.

Record keeping

14.1.51 G *SYSC 3.2.20R* requires a *firm* to take reasonable care to make and retain adequate records. The following policy on record keeping supplements *SYSC 3.2.20R* by providing some additional *rules* and *guidance* on record keeping in a *prudential context*. The purpose of this policy is to:

- (1) facilitate the prudential supervision of a *firm* by ensuring that adequate information is available regarding its past/current financial situation and business activities (which includes the design and implementation of systems and controls); and
- (2) help the *FSA* to satisfy itself that a *firm* is operating in a prudent manner and is not prejudicing the interests of its *customers* or market confidence.

- 14.1.52 G In addition to the record keeping requirements in *GENPRU*, *INSPRU* and *SYSC*, a *firm* should remember that it may be obliged, under other applicable laws or regulations, to keep similar or additional records.
- 14.1.53 R (1) A *firm* must make and regularly update accounting and other records that are sufficient to enable the *firm* to demonstrate to the *FSA*:
- (a) that the *firm* is financially sound and has appropriate systems and controls;
 - (b) the *firm's* financial position and exposure to risk (to a reasonable degree of accuracy); and
 - (c) the *firm's* compliance with the *rules* in *GENPRU*, *INSPRU* and *SYSC*.
- (2) The records in (1) must be retained for a minimum of three years, or longer as appropriate.
- 14.1.54 G A *firm* should be able to make available the records described in *SYSC* 14.1.53 R within a reasonable timeframe when requested to do so by the *FSA*.
- 14.1.55 G The *FSA* recognises that not all records are specific to a particular point in time. As such, while it may be appropriate to update some records on a daily or continuous basis, for example expenditure and details of certain transactions, it may not be appropriate to update other records as regularly as this, for example those relating to its business plan and risk policies. A *firm* should decide how regularly it should update particular records.
- 14.1.56 G A *firm* should decide which records it needs to hold, noting that compliance with *SYSC* 14.1.53R does not require it to hold records on every single aspect of its activities. Some specific *guidance* on the types of records that a *firm* should hold is set out in each of the risk specific sections on systems and controls (see *SYSC* 11, *SYSC* 12, *SYSC* 14.1.65G, *SYSC* 15 to *SYSC* 17 and *INSPRU* 5.1).
- 14.1.57 G In deciding which records to hold, a *firm* should also take into account that failure to keep adequate records could make it harder for it to satisfy the *FSA* that it is compliant with the *rules* in *GENPRU*, *INSPRU* or *SYSC*, and to defend any enforcement action taken against it.
- 14.1.58 G A *firm* should keep the records required in *GENPRU*, *INSPRU* and *SYSC* in an appropriate format and language (in terms of format this could include holding them on paper or in electronic or some other form). However, whatever format or language a *firm* chooses, *SYSC* 3.2.20R requires that records be capable of being reproduced on paper and in English (except where they relate to business carried on from an establishment situated in a country where English is not an official language).
- 14.1.59 G In accordance with *SYSC* 3.2.20R, a *firm* should retain the records that it needs to comply with *SYSC* 14.1.53R for as long as they are relevant for the

purposes for which they were made.

- 14.1.60 R A *firm* must keep the *records* required in SYSC 14.1.53R in the *United Kingdom*, except where:
- (1) they relate to business carried on from an establishment in a country or territory that is outside the *United Kingdom*; and
 - (2) they are kept in that country or territory.
- 14.1.61 R When a *firm* keeps the records required in SYSC 14.1.53R outside the *United Kingdom*, it must periodically send an adequate summary of those records to the *United Kingdom*.
- 14.1.62 G Where a *firm* outsources the storage of some or all of its records to a third party service provider, it should ensure that these records are readily accessible and can be reproduced within a reasonable time period. The *firm* should also ensure that these records are stored in compliance with the *rules* and *guidance* on record keeping in *GENPRU*, *INSPRU* or *SYSC*. Additional *guidance* on the management of *outsourcing* agreements is provided in SYSC 13.
- 14.1.63 G A *firm* may rely on records that have been produced by a third party (for example, another *group* company or an external agent, such as an outsource service provider). However where the *firm* does so it should ensure that these records are readily accessible and can be reproduced within a reasonable time period. The *firm* should also ensure that these records comply with the *rules* and *guidance* on record keeping in *GENPRU*, *INSPRU* or *SYSC*.
- 14.1.64 G In accordance with SYSC 3.2.21G, a *firm* should have adequate systems and controls for maintaining the security of its records so that they are reasonably safeguarded against loss, unauthorised access, alteration or destruction.
- Operational risk
- 14.1.65 G As well as covering other types of risk, the *rules* and *guidance* set out in this chapter deal with a *firm's* approach to operational risk. In particular:
- (1) SYSC 14.1.18R requires a *firm* to take reasonable steps to ensure that the risk management systems put in place to identify, assess, monitor and control operational risk are adequate for that purpose;
 - (2) SYSC 14.1.19R(2) requires a *firm* to document its policy for operational risk, including its risk appetite and how it identifies, assesses, monitors and controls that risk; and
 - (3) SYSC 14.1.27R requires a *firm* to take reasonable steps to establish and maintain adequate *internal controls* to enable it to assess and

monitor the effectiveness and implementation of its business plan and prudential risk management systems.

- 15 Credit risk management systems and controls
- 15.1 Application
- 15.1.1 G SYSC 15.1 applies to an *insurer* unless it is:
- (1) a *non-directive friendly society*; or
 - (2) an *incoming EEA firm*; or
 - (3) an *incoming Treaty firm*.
- 15.1.2 G SYSC 15.1 applies to:
- (1) an *EEA-deposit insurer*; and
 - (2) a *Swiss general insurer*;
- only in respect of the activities of the *firm* carried on from a *branch* in the *United Kingdom*.

Purpose

- 15.1.3 G This section provides *guidance* on how to interpret SYSC 14 insofar as it relates to the management of credit risk.
- 15.1.4 G Credit risk is incurred whenever a *firm* is exposed to loss if another party fails to perform its financial obligations to the *firm*, including failing to perform them in a timely manner. It arises from both on and off balance sheet items. For contracts for traded *financial instruments*, for example the purchase and sale of *securities* or *over the counter derivatives*, risks may arise if the *firm's counterparty* does not honour its side of the contract. This constitutes counterparty risk, which can be considered a subset of credit risk. Another risk is issuer risk, which could potentially result in a *firm* losing the full price of a market instrument since default by the issuer could result in the value of its bonds or stocks falling to nil. In insurance *firms*, credit risk can arise from *premium* debtors, where cover under *contracts of insurance* may either commence before premiums become due or continue after their non-payment. Credit risk can also arise if a *reinsurer* fails to fulfil its financial obligation to repay a *firm* upon submission of a *claim*.
- 15.1.5 G Credit risk concerns the *FSA* in a *prudential context* because inadequate systems and controls for credit risk management can create a threat to the *regulatory objectives* of market confidence and consumer protection by:
- (1) the erosion of a *firm's* capital due to excessive credit losses thereby threatening its viability as a going concern;
 - (2) an inability of a *firm* to meet its own obligations to depositors, *policyholders* or other market *counterparties* due to its capital

erosion.

- 15.1.6 G Appropriate systems and controls for the management of credit risk will vary with the scale, nature and complexity of the *firm's* activities. Therefore the material in this section is *guidance*. A *firm* should assess the appropriateness of any particular item of *guidance* in the light of the scale, nature and complexity of its activities as well as its obligations as set out in *Principle 3* to organise and control its affairs responsibly and effectively.

Requirements

- 15.1.7 G High level requirements for prudential systems and controls, including those for credit risk, are set out in SYSC 14. In particular:
- (1) SYSC 14.1.19R(2) requires a *firm* to document its policy for credit risk, including its risk appetite and how it identifies, measures, monitors and controls that risk;
 - (2) SYSC 14.1.19R(2) requires a *firm* to document its provisioning policy. Documentation should describe the systems and controls that it intends to use to ensure that the policy is correctly implemented;
 - (3) SYSC 14.1.18R requires it to establish and maintain risk management systems to identify, measure, monitor and control credit risk (in accordance with its credit risk policy), and to take reasonable steps to ensure that its systems are adequate for that purpose; or
 - (4) in line with SYSC 14.1.11G, the ultimate responsibility for the management of credit risk should rest with a *firm's governing body*. Where delegation of authority occurs the *governing body* and relevant *senior managers* should approve and periodically review systems and controls to ensure that delegated duties are being performed correctly.

Credit risk policy

- 15.1.8 G SYSC 14.1.18R requires a *firm* to establish, maintain and document a business plan and risk policies. They should provide a clear indication of the amount and nature of credit risk that the *firm* wishes to incur. In particular, they should cover for credit risk:
- (1) how, with particular reference to its activities, the *firm* defines and measures credit risk;
 - (2) the *firm's* business aims in incurring credit risk including:
 - (a) identifying the types and sources of credit risk to which the *firm* wishes to be exposed (and the limits on that exposure) and those to which the *firm* wishes not to be exposed (and how that is to be achieved, for example how exposure is to be avoided or mitigated);

- (b) specifying the level of diversification required by the *firm* and the *firm's* tolerance for risk concentrations (and the limits on those exposures and concentrations); and
 - (c) drawing the distinction between activities where credit risk is taken in order to achieve a return (for example, lending) and activities where credit exposure arises as a consequence of pursuing some other objective (for example, the purchase of a *derivative* in order to mitigate *market risk*);
- (3) how credit risk is assessed both when credit is granted or incurred and subsequently, including how the adequacy of any security and other risk mitigation techniques is assessed;
- (4) the detailed limit structure for credit risk which should:
- (a) address all key risk factors, including *intra-group* exposures and indirect exposures (for example, exposures held by *related* and *subsidiary undertakings*);
 - (b) be commensurate with the volume and complexity of activity; and
 - (c) be consistent with the *firm's* business aims, historical performance, and its risk appetite;
- (5) procedures for:
- (a) approving new or additional exposures to *counterparties*;
 - (b) approving new products and activities that give rise to credit risk;
 - (c) regular risk position and performance reporting;
 - (d) limit exception reporting and approval; and
 - (e) identifying and dealing with the problem exposures caused by the failure or downgrading of a *counterparty*;
- (6) the methods and assumptions used for the stress testing and scenario analysis required by *GENPRU* 1.2 (Adequacy of financial resources), including how these methods and assumptions are selected and tested; and
- (7) the allocation of responsibilities for implementing the credit risk policy and for monitoring adherence to, and the effectiveness of, the policy.

Counterparty assessment

- 15.1.9 G The *firm* should make a suitable assessment of the risk profile of the *counterparty*. The factors to be considered will vary according to both the type of credit and the *counterparty* being considered. This may include:
- (1) the purpose of the credit, the duration of the agreement and the source of repayment;
 - (2) an assessment and continuous monitoring of the credit quality of the *counterparty*;
 - (3) an assessment of the *claims* payment record where the *counterparty* is a *reinsurer*;
 - (4) an assessment of the nature and amount of risk attached to the *counterparty* in the context of the industrial sector or geographical region or country in which it operates, as well as the potential impact on the *counterparty* of political, economic and market changes; and
 - (5) the proposed terms and conditions attached to the granting of credit, including ongoing provision of information by the *counterparty*, covenants attached to the facility as well as the adequacy and enforceability of *collateral*, security and guarantees.
- 15.1.10 G It is important that sound and legally enforceable documentation is in place for each agreement that gives rise to credit risk as this may be called upon in the event of a default or dispute. A *firm* should therefore consider whether it is appropriate for an independent legal opinion to be sought on documentation used by the *firm*. Documentation should normally be in place before the *firm* enters into a contractual obligation or releases funds.
- 15.1.11 G Where *premium* payments are made via *brokers* or *intermediaries*, the *firm* should describe how it monitors and controls its exposure to those *brokers* and *intermediaries*. In particular, the policy should identify whether the risk of default by the *broker* or *intermediary* is borne by the *firm* or the *policyholder*.
- 15.1.12 G Any variation from the usual credit policy should be documented.
- 15.1.13 G A *firm* involved in loan syndications or consortia should not rely on other parties' assessment of the credit risks involved. It will remain responsible for forming its own judgement on the appropriateness of the credit risk thereby incurred with reference to its stated credit risk policy. Similarly a *firm* remains responsible for assessing the credit risk associated with any insurance or *reinsurance* placed on its behalf by other parties.
- 15.1.14 G Where a credit scoring approach or other *counterparty* assessment process is used, the *firm* should periodically assess the particular approach taken in the light of past and expected future *counterparty* performance and ensure that any statistical process is adjusted accordingly to ensure that the business

written complies with the *firm's* risk appetite.

- 15.1.15 G In assessing its contingent exposure to a *counterparty*, the *firm* should identify the amount which would be due from the *counterparty* if the value, index or other factor upon which that amount depends were to change.

Credit risk measurement

- 15.1.16 G A *firm* should measure its credit risk using a robust and consistent methodology which should be described in its credit risk policy; the appropriate method of measurement will depend upon the nature of the credit product provided. The *firm* should consider whether the measurement methodologies should be backtested and the frequency of such backtesting.
- 15.1.17 G A *firm* should also be able to measure its credit exposure across its entire portfolio or within particular categories such as exposures to particular industries, economic sectors or geographical areas.
- 15.1.18 G Where a *firm* is a member of a *group* that is subject to consolidated reporting, the *group* should be able to monitor credit exposures on a consolidated basis. See *SYSC 12*, *INSPRU 6.1* and *GENPRU 3*.
- 15.1.19 G A *firm* should have the capability to measure its credit exposure to individual *counterparties* on at least a daily basis.

Risk monitoring

- 15.1.20 G A *firm* should implement an effective system for monitoring its credit risk which should be described in its credit risk policy.
- 15.1.21 G A *firm* should have a system of management reporting which provides clear, concise, timely and accurate credit risk reports to relevant functions within the *firm*. The reports could cover exceptions to the *firm's* credit risk policy, non-performing exposures and changes to the level of credit risk within the *firm's* credit portfolio. A *firm* should have procedures for taking appropriate action according to the information within the management reports, such as a review of *counterparty* limits, or of the overall credit policy.
- 15.1.22 G Individual credit facilities and overall limits should be periodically reviewed in order to check their appropriateness for both the current circumstances of the *counterparty* and the *firm's* current internal and external economic environment. The frequency of review should be appropriate to the nature of the facility.
- 15.1.23 G A *firm* should utilise appropriate stress testing and scenario analysis of credit exposures to examine the potential effects of economic or industry downturns, market events, changes in interest rates, changes in foreign exchange rates, changes in liquidity conditions and changes in levels of insurance losses where relevant.

Problem exposures

- 15.1.24 G A *firm* should have systematic processes for the timely identification, management and monitoring of problem exposures. These processes should be described in the credit risk policy.
- 15.1.25 G A *firm* should have adequate procedures for recovering exposures in arrears or that have had provisions made against them. A *firm* should allocate responsibility, either internally or externally, for its arrears management and recovery.

Provisioning

- 15.1.26 G SYSC 14.1.19R(2) requires a *firm* to document its provisioning policy. A *firm's* provisioning policy can be maintained either as a separate document or as part of its credit risk policy.
- 15.1.27 G At intervals that are appropriate to the nature, scale and complexity of its activities a *firm* should review and update its provisioning policy and associated systems.
- 15.1.28 G In line with SYSC 15.1.6G, the *FSA* recognises that the frequency with which a *firm* reviews its provisioning policy once it has been established will vary from *firm* to *firm*. However, the *FSA* expects a *firm* to review at least annually whether its policy remains appropriate for the business it undertakes and the economic environment in which it operates.
- 15.1.29 G In line with SYSC 14.1.12G, the provisioning policy referred to in SYSC 15.1.26G must be approved by the *firm's governing body* or another appropriate body to which the *firm's governing body* has delegated this responsibility.
- 15.1.30 G In line with SYSC 14.1.24G, the *FSA* may request a *firm* to provide it with a copy of its current provisioning policy.
- 15.1.31 G Provisions may be general (against the whole of a given portfolio), specific (against particular exposures identified as bad or doubtful) or both. The *FSA* expects contingent liabilities (for example guarantees) and anticipated losses to be recognised in accordance with accepted accounting standards at the relevant time, such as those embodied in the Financial Reporting Standards issued by the Accounting Standards Board.

Risk mitigation

- 15.1.32 G A *firm* may choose to use various credit risk mitigation techniques including the taking of *collateral*, the use of letters of credit or guarantees, or *counterparty netting* agreements to manage and control their *counterparty* exposures. The use of such techniques does not obviate the need for thorough credit analysis and procedures. The reliance placed by a *firm* on *risk* mitigation should be described in the credit risk policy.

- 15.1.33 G A *firm* should consider the legal and financial ability of a guarantor to fulfil the guarantee if called upon to do so.
- 15.1.34 G A *firm* should monitor the validity and enforceability of its *collateral* arrangements.
- 15.1.35 G The *firm* should analyse carefully the protection afforded by risk mitigants such as netting agreements or credit *derivatives*, to ensure that any residual risk is identified, measured, monitored and controlled.

Record keeping

- 15.1.36 G Prudential records made under SYSC 14.1.53R should include appropriate records of:
- (1) credit exposures, including aggregations of credit exposures, as appropriate, by:
 - (a) groups of connected *counterparties*; or
 - (b) types of *counterparty* as defined, for example, by the nature or geographical location of the *counterparty*;
 - (2) credit decisions, including details of the decision and the facts or circumstances upon which it was made; and
 - (3) information relevant to assessing current *counterparty* and risk quality.
- 15.1.37 G Credit records should be retained as long as they are needed for the purpose described in SYSC 15.1.36G (subject to the minimum three year retention period). In particular, a *firm* should consider whether it is appropriate to retain information regarding *counterparty* history such as a record of credit events as well as a record indicating how credit decisions were taken.

- 16 Market risk management systems and controls
- 16.1 Application
- 16.1.1 G SYSC 16.1 applies to an *insurer* unless it is:
- (1) a *non-directive friendly society*; or
 - (2) an *incoming EEA firm*; or
 - (3) an *incoming Treaty firm*.
- 16.1.2 G SYSC 16.1 applies to:
- (1) an *EEA-deposit insurer*; and
 - (2) a *Swiss general insurer*;
- only in respect of the activities of the *firm* carried on from a *branch* in the *United Kingdom*.
- 16.1.3 G *Firms* should also see *GENPRU* 1.2 (*GENPRU* 1.2.64G to *GENPRU* 1.2.78G) and *INSPRU* 3.1.
- Purpose
- 16.1.4 G
- (1) The purpose of this section is to amplify *SYSC* 14 insofar as it relates to *market risk*.
 - (2) *Market risk* includes equity, interest rate, foreign exchange (FX), commodity risk and interest rate risk on *long-term insurance contracts*. The price of *financial instruments* may also be influenced by other risks such as *spread risk*, *basis risk*, correlation, *specific risk* and *volatility risk*.
 - (3) This section does not deal with the risk management of *market risk* in a *group* context. A *firm* that is a member of a *group* should also read *SYSC* 12 (Group risk systems and controls) which outlines the *FSA's* requirements for the risk management of *market risk* within a *group*.
 - (4) Appropriate systems and controls for the management of *market risk* will vary with the scale, nature and complexity of the *firm's* activities. Therefore the material in this section is *guidance*. A *firm* should assess the appropriateness of any particular item of *guidance* in the light of the scale, nature and complexity of its activities as well as its obligations as set out in *Principle 3* to organise and control its affairs responsibly and effectively.

Requirements

- 16.1.5 G High level requirements for prudential systems and controls, including those for *market risk*, are set out in SYSC 14. In particular:
- (1) SYSC 14.1.19R(2) requires a *firm* to document its policy for *market risk*, including its risk appetite and how it identifies, measures, monitors and controls that risk;
 - (2) SYSC 14.1.19R(4) requires a *firm* to document its asset and liability recognition policy. Documentation should describe the systems and controls that it intends to use to comply with the policy;
 - (3) SYSC 14.1.19R requires a *firm* to establish and maintain risk management systems to identify, measure, monitor and control *market risk* (in accordance with its *market risk* policy), and to take reasonable steps to establish systems adequate for that purpose; and
 - (4) In line with SYSC 14.1.11G, the ultimate responsibility for the management of *market risk* should rest with a *firm's governing body*. Where delegation of authority occurs the *governing body* and relevant *senior managers* should approve and adequately review systems and controls to check that delegated duties are being performed correctly.

Market risk policy

- 16.1.6 G SYSC 14 requires a *firm* to establish, maintain and document a business plan and risk policies. They should provide a clear indication of the amount and nature of *market risk* that the *firm* wishes to incur. In particular, they should cover for *market risk*:
- (1) how, with particular reference to its activities, the *firm* defines and measures *market risk*;
 - (2) the *firm's* business aims in incurring *market risk* including:
 - (a) identifying the types and sources of *market risk* to which the *firm* wishes to be exposed (and the limits on that exposure) and those to which the *firm* wishes not to be exposed (and how that is to be achieved, for example how exposure is to be avoided or mitigated); and
 - (b) specifying the level of diversification required by the *firm* and the *firm's* tolerance for risk concentrations (and the limits on those exposures and concentrations).
- 16.1.7 G The *market risk* policy of a *firm* should be endorsed by the *firm's governing body* and implemented by its senior management, who should take adequate steps to disseminate the policy and train the relevant staff such that they can effectively implement the policy.

- 16.1.8 G The *market risk* policy of a *firm* should enforce the risk management and control principles and include detailed information on:
- (1) the *financial instruments*, commodities, assets and liabilities (and mismatches between assets and liabilities) that a *firm* is exposed to and the limits on those exposures;
 - (2) the *firm's* investment strategy as applicable between each insurance fund;
 - (3) activities that are intended to hedge or mitigate *market risk* including mismatches caused by for example differences in the assets and liabilities and maturity mismatches; and
 - (4) the methods and assumptions used for measuring linear, non-linear and geared *market risk* including the rationale for selection, ongoing validation and testing. Methods might include stress testing and scenario analysis, asset/liability analysis, correlation analysis, Value-at-Risk (VaR) and *options* such as delta, gamma, vega, rho and theta. Exposure to non-linear or geared *market risk* is typically through the use of *derivatives*.

Risk identification

- 16.1.9 G A *firm* should have in place appropriate risk reporting systems that enable it to identify the types and amount of *market risk* to which it is, and potentially could be, exposed. The information that systems should capture may include but is not limited to:
- (1) position information which may include a description of individual *financial instruments* and their cash flows; and
 - (2) market data which may consist of raw time series of market rates, index levels and prices and derived time series of benchmark yield curves, spreads, implied volatilities, historical volatilities and correlations.

Risk measurement

- 16.1.10 G Having identified the *market risk* that the *firm* is exposed to on at least a daily basis, a *firm* should be able to measure and manage that *market risk* on a consistent basis. This may be achieved by:
- (1) regularly stress testing all or parts of the *firm's* portfolio to estimate potential economic losses in a range of market conditions including abnormal markets. Corporate level stress test results should be discussed regularly by risk monitors, senior management and risk takers, and should guide the *firm's market risk* appetite (for example, stress tests may lead to discussions on how best to unwind or hedge a position), and influence the internal capital allocation process;

- (2) measuring the *firm's* exposure to particular categories of *market risk* (for example, equity, interest rate, foreign exchange and commodities) as well as across its entire portfolio of *market risks*;
- (3) analysing the impact that new transactions or businesses may have on its *market risk* position on an on-going basis; and
- (4) regularly backtesting realised results against internal model generated *market risk* measures in order to evaluate and assess its accuracy. For example, a *firm* should keep a database of daily risk measures such as VaR and *options* such as delta, gamma, vega, rho and theta, and use these to back test predicted profit and loss against actual profit and loss for all trading desks and business units, and monitor the number of exceptions from agreed confidence bands.

Valuation

- 16.1.11 G A *firm* should take reasonable steps to establish systems and control procedures such that the *firm* complies with the requirements of *GENPRU* 1.3 (Valuation).
- 16.1.12 G The systems and controls referred to in *SYSC* 16.1.11G should include the following:
- (1) the department responsible for the validation of the value of assets and liabilities should be independent of the business trading area, and should be adequately resourced by suitably qualified staff. The department should report to a suitably qualified individual, independent from the business trading area, who has sufficient authority to enforce the systems and controls policies and any alterations to valuation treatments where necessary;
 - (2) all valuations should be checked and validated at appropriate intervals. Where a *firm* has chosen not to validate all valuations on a daily basis this should be agreed by senior management;
 - (3) a *firm* should establish a review procedure to check that the valuation procedures are followed and are producing valuations in compliance with the requirements in this section. The review should be undertaken by suitably qualified staff independent of the business trading area, on a regular and ad hoc basis. In particular, this review procedure should include:
 - (a) the quality and appropriateness of the price sources used;
 - (b) valuation reserves held; and
 - (c) the valuation methodology employed for each product and consistent adherence to that methodology;
 - (4) where a valuation is disputed and the dispute cannot be resolved in a timely manner it should be reported to senior management. It should

continue to be reported to senior management until agreement is reached;

- (5) where a *firm* is marking positions to market it should take reasonable steps to establish a price source that is reliable and appropriate to enable compliance with the provisions in this section on an ongoing basis;
- (6) a *firm* should document its policies and procedures relating to the entire valuation process. In particular, the following should be documented:
 - (a) the valuation methodologies employed for all product categories;
 - (b) details of the price sources used for each product;
 - (c) the procedures to be followed where a valuation is disputed;
 - (d) the valuation adjustment and reserving policies;
 - (e) the level at which a difference between a valuation assigned to an asset or liability and the valuation used for validation purposes will be reported on an exceptions basis and investigated;
 - (f) where a *firm* is using its own internal estimate to produce a valuation, it should document in detail the process followed in order to produce the valuation; and
 - (g) the review procedures established by a *firm* in relation to the requirements of this section should be adequately documented and include the rationale for the policy;
- (7) a *firm* should maintain records which demonstrate:
 - (a) senior management's approval of the policies and procedures established; and
 - (b) management sign-off of the reviews undertaken in accordance with SYSC 16.1.11G.

Risk monitoring

- 16.1.13 G Risk monitoring is the operational process by which a *firm* monitors compliance with defined policies and procedures of the *market risk* policy. The *firm's* risk monitoring system should be independent of the *employees* who are responsible for exposing the *firm* to *market risk*.
- 16.1.14 G The *market risk* policy of a *firm* may require the production of *market risk* reports at various levels within the *firm*. These reports should provide sufficiently accurate *market risk* data to relevant functions within the *firm*,

and should be timely enough to allow any appropriate remedial action to be proposed and taken, for example:

- (1) at a *firm* wide level, a *market risk* report may include information:
 - (a) summarising and commenting on the total *market risk* that a *firm* is exposed to and *market risk* concentrations by business unit, asset class and country;
 - (b) on VaR reports against risk limits by business unit, asset class and country;
 - (c) commenting on significant risk concentrations and market developments; and
 - (d) on *market risk* in particular legal entities and geographical regions;
- (2) at the business unit level, a *market risk* report may include information summarising *market risk* by currency, trading desk, maturity or duration band, or by instrument type;
- (3) at the trading desk level, a *market risk* report may include detailed information summarising *market risk* by individual trader, instrument, position, currency, or maturity or duration band; and
- (4) all risk data should be readily reconcilable back to the prime books of entry with a fully documented audit trail.

16.1.15 G Risk monitoring may also include information on:

- (1) the procedures for taking appropriate action in response to the information within the *market risk* reports;
- (2) ensuring that there are controls and procedures for identifying and reporting trades and positions booked at off-market rates;
- (3) the process for new product approvals;
- (4) the process for dealing with situations (authorised and unauthorised) where particular *market risk* exposures exceed predetermined risk limits and criteria; and
- (5) the periodic review of the risk monitoring process in order to check its suitability for both current market conditions and the *firm's* overall risk appetite.

16.1.16 G Risk monitoring should be subject to periodic independent review by suitably qualified staff.

Risk control

- 16.1.17 G Risk control is the independent monitoring, assessment and supervision of business units within the defined policies and procedures of the *market risk* policy. This may be achieved by:
- (1) setting an appropriate *market risk* limit structure to control the *firm's* exposure to *market risk*; for example, by setting out a detailed *market risk* limit structure at the corporate level, the business unit level and the trading desk level which addresses all the key *market risk* factors and is commensurate with the volume and complexity of activity that the *firm* undertakes;
 - (2) setting limits on risks such as price or rate risk, as well as those factors arising from *options* such as delta, gamma, vega, rho and theta;
 - (3) setting limits on net and gross positions, *market risk* concentrations, the maximum allowable loss (also called "stop-loss"), VaR, potential risks arising from stress testing and scenario analysis, gap analysis, correlation, liquidity and volatility; and
 - (4) considering whether it is appropriate to set intermediate (early warning) thresholds that alert management when limits are being approached, triggering review and action where appropriate.

Record keeping

- 16.1.18 G High level requirements for record keeping are set out in SYSC 14.
- 16.1.19 G In relation to *market risk*, a *firm* should retain appropriate prudential records of:
- (1) off and on market trades in *financial instruments*;
 - (2) the nature and amounts of off and on balance sheet exposures, including the aggregation of exposures;
 - (3) trades in *financial instruments* and other assets and liabilities; and
 - (4) methods and assumptions used in stress testing and scenario analysis and in VaR models.
- 16.1.20 G A *firm* should keep a data history to enable it to perform back testing of methods and assumptions used for stress testing and scenario analysis and for VaR models.

17 Insurance risk systems and controls

17.1 Application

17.1.1 G SYSC 17.1 applies to an *insurer* unless it is:

- (1) a *non-directive friendly society*; or
- (2) an *incoming EEA firm*; or
- (3) an *incoming Treaty firm*.

17.1.2 G SYSC 17.1 applies to:

- (1) an *EEA-deposit insurer*; and
- (2) a *Swiss general insurer*;

only in respect of the activities of the *firm* carried on from a *branch* in the *United Kingdom*.

Purpose

17.1.3 G This section provides *guidance* on how to interpret SYSC 14 (Prudential risk management and associated systems and controls) in so far as it relates to the management of insurance risk. Insurance risk refers to fluctuations in the timing, frequency and severity of insured events, relative to the expectations of the *firm* at the time of underwriting. Insurance risk can also refer to fluctuations in the timing and amount of *claim* settlements. For *general insurance business* some specific examples of insurance risk include variations in the amount or frequency of *claims* or the unexpected occurrence of multiple *claims* arising from a single cause. For *long-term insurance business* examples include variations in the mortality and persistency rates of *policyholders*, or the possibility that guarantees could acquire a value that adversely affects the finances of a *firm* and its ability to treat its *policyholders* fairly consistent with the *firm's* obligations under *Principle 6*. More generally, insurance risk includes the potential for expense overruns relative to pricing or provisioning assumptions.

17.1.4 G Insurance risk concerns the *FSA* in a *prudential context* because inadequate systems and controls for its management can create a threat to the *regulatory objectives* of market confidence and consumer protection. Inadequately managed insurance risk may result in:

- (1) the inability of a *firm* to meet its contractual insurance liabilities as they fall due; and
- (2) the inability of a *firm* to treat its *policyholders* fairly consistent with the *firm's* obligations under *Principle 6* (for example, in relation to bonus payments).

- 17.1.5 G *Guidance* on the application of this section to a *firm* that is a member of a *group* is provided in SYSC 12 (Group risk systems and controls).
- 17.1.6 G The *guidance* contained within this section should be read in conjunction with the rest of SYSC.
- 17.1.7 G Appropriate systems and controls for the management of insurance risk will vary with the scale, nature and complexity of a *firm's* activities. Therefore, the material in this section is *guidance*. A *firm* should assess the appropriateness of any particular item of *guidance* in the light of the scale, nature and complexity of its activities as well as its obligations, as set out in *Principle 3*, to organise and control its affairs responsibly and effectively.

General requirements

- 17.1.8 G High level *rules* and *guidance* for prudential systems and controls for insurance risk are set out in SYSC 14. In particular:
- (1) SYSC 14.1.18R requires a *firm* to take reasonable steps to establish and maintain a business plan and appropriate risk management systems;
 - (2) SYSC 14.1.19R(2) requires a *firm* to document its policy for insurance risk, including its risk appetite and how it identifies, measures, monitors and controls that risk; and
 - (3) SYSC 14.1.27R requires a *firm* to take reasonable steps to establish and maintain adequate *internal controls* to enable it to assess and monitor the effectiveness and implementation of its business plan and prudential risk management systems.

Insurance risk policy

- 17.1.9 G A *firm's* insurance risk policy should outline its objectives in carrying out *insurance business*, its appetite for insurance risk and its policies for identifying, measuring, monitoring and controlling insurance risk. The insurance risk policy should cover any activities that are associated with the creation or management of insurance risk. For example, underwriting, *claims* management and settlement, assessing *technical provisions* in the balance sheet, risk mitigation and risk transfer, record keeping and management reporting. Specific matters that should normally be in a *firm's* insurance risk policy include:
- (1) a statement of the *firm's* willingness and capacity to accept insurance risk;
 - (2) the classes and characteristics of *insurance business* that the *firm* is prepared to accept;
 - (3) the underwriting criteria that the *firm* intends to adopt, including how these can influence its rating and pricing decisions;

- (4) its approach to limiting significant aggregations of insurance risk, for example, by setting limits on the amount of business that can be underwritten in one region or with one *policyholder*;
- (5) where relevant, the *firm's* approach to pricing *long-term insurance contracts*, including the determination of the appropriate level of any reviewable *premiums*;
- (6) the *firm's* policy for identifying, monitoring and managing risk when it has delegated underwriting authority to another party (additional *guidance* on the management of *outsourcing* arrangements is provided in SYSC 13.9);
- (7) the *firm's* approach to managing its expense levels, including acquisition costs, recurring costs, and one-off costs, taking account of the margins available in both the prices for products and in the *technical provisions* in the balance sheet;
- (8) the *firm's* approach to the exercise of any discretion (e.g. on charges or the level of benefits payable) that is available in its *long-term insurance contracts*, in the context also of the legal and regulatory constraints existing on the application of this discretion;
- (9) the *firm's* approach to the inclusion of options within new *long-term insurance contracts* and to the possible exercise by *policyholders* of options on existing contracts;
- (10) the *firm's* approach to managing persistency risk;
- (11) the *firm's* approach to managing risks arising from timing differences in taxation or from changes in tax laws;
- (12) the *firm's* approach to the use of *reinsurance* or the use of some other means of risk transfer;
- (13) how the *firm* intends to assess the effectiveness of its risk transfer arrangements and manage the residual or transformed risks (for example, how it intends to handle disputes over contract wordings, potential payout delays and *counterparty* performance risks);
- (14) a summary of the data and information to be collected and reported on underwriting, *claims* and risk control (including internal accounting records), management reporting requirements and external data for risk assessment purposes;
- (15) the risk measurement and analysis techniques to be used for setting underwriting *premiums*, *technical provisions* in the balance sheet, and assessing capital requirements; and
- (16) the *firm's* approach to stress testing and scenario analysis, as required by GENPRU 1.2 (Adequacy of financial resources), including the methods adopted, any assumptions made and the use that is to be

made of the results.

- 17.1.10 G Further, more detailed, *guidance* is given in SYSC 17.1.11G to SYSC 17.1.37G on the identification, measurement, monitoring and control (including the use of *reinsurance* and other forms of risk transfer) of insurance risk. A *firm* should consider what additional material to that set out above should be included in its insurance risk policy on each of these for its various activities.

Risk identification

- 17.1.11 G A *firm* should seek to identify the causes of fluctuations in the occurrence, amount and timing of its insurance liabilities. A *firm* should also seek to identify aggregations of risk that may give rise to large single or multiple *claims*.
- 17.1.12 G The identification of insurance risk should normally include:
- (1) in connection with the *firm's* business plan:
 - (a) processes for identifying the types of insurance risks that may be associated with a new product and for comparing the risk types that are present in different classes of business (in order to identify possible aggregations in particular insurance risks); and
 - (b) processes for identifying business environment changes (for example landmark legal rulings) and for collecting internal and external data to test and modify business plans;
 - (2) at the point of sale, processes for identifying the underwriting risks associated with a particular *policyholder* or a group of *policyholders* (for example, processes for identifying potential *claims* for mis-selling and for collecting information on the *claims* histories of *policyholders*, including whether they have made any potentially false or inaccurate claims, to identify possible adverse selection or moral hazard problems);
 - (3) after the point of sale, processes for identifying potential and emerging *claims* for the purposes of *claims* management and *claims* provisioning; this could include:
 - (a) identifying possible judicial rulings;
 - (b) keeping up to date with developments in market practice; and
 - (c) collecting information on industry wide initiatives and settlements.
- 17.1.13 G A *firm* should also identify potential pricing risks, where the liabilities or costs arising from the sale of a product may not be as expected.

Risk measurement

- 17.1.14 G A *firm* should have in place appropriate systems for collecting the data it needs to measure insurance risk. At a minimum this data should be capable of allowing a *firm* to evaluate the types of *claims* experienced, *claims* frequency and severity, expense levels, persistency levels and, where relevant, potential changes in the value of guarantees and options in *long-term insurance contracts*.
- 17.1.15 G A *firm* should ensure that the data it collects and the measurement methodologies that it uses are sufficient to enable it to evaluate, as appropriate:
- (1) its exposure to insurance risk at all relevant levels, for example, by contract, *policyholder*, product line or insurance class;
 - (2) its exposure to insurance risk across different geographical areas and time horizons;
 - (3) its total, *firm-wide*, exposure to insurance risk and any other risks that may arise out of the *contracts of insurance* that it issues;
 - (4) how changes in the volume of business (for example via changes in *premium* levels or the number of new contracts that are underwritten) may influence its exposure to insurance risk;
 - (5) how changes in *policy* terms may influence its exposure to insurance risk; and
 - (6) the effects of specific loss scenarios on the insurance liabilities of the *firm*.
- 17.1.16 G A *firm* should hold data in a manner that allows for it to be used in a flexible way. For example, data should be sufficiently detailed and disaggregated so that contract details may be aggregated in different combinations to assess different risks.
- 17.1.17 G A *firm* should be able to justify its choice of measurement methodologies. This justification should normally be documented.
- 17.1.18 G A *firm* should periodically review the appropriateness of the measurement methodologies that it uses. This could, for example, include back testing (that is, by comparing actual versus expected results) and updating for changes in market practice.
- 17.1.19 G A *firm* should ensure that it has access to the necessary skills and resources that it needs to measure insurance risk using its chosen methodology.
- 17.1.20 G When measuring its insurance risks, a *firm* should consider how emerging experience could be used to update its underwriting process, in particular in relation to contract terms and pricing and also its assessment of the *technical*

provisions in the balance sheet.

- 17.1.21 G A *firm* should have the capability to measure its exposure to insurance risk on a regular basis. In deciding on the frequency of measurement, a *firm* should consider:
- (1) the time it takes to acquire and process all necessary data;
 - (2) the speed at which exposures could change; and
 - (3) that it may need to measure its exposure to certain types of insurance risk on a daily basis (for example, weather catastrophes).

Risk monitoring

- 17.1.22 G A *firm* should provide regular and timely information on its insurance risks to the appropriate level of management. This could include providing reports on the following:
- (1) a statement of the *firm's* profits or losses for each class of business that it underwrites (with an associated analysis of how these have arisen for any *long-term insurance contracts*), including a variance analysis detailing any deviations from budget or changes in the key performance indicators that are used to assess the success of its business plan for insurance;
 - (2) the *firm's* exposure to insurance risk at all relevant levels (see SYSC 17.1.15G(1)), as well as across different geographical areas and time zones (see SYSC 17.1.15G(2)), also senior management should be kept informed of the *firm's* total exposure to insurance risk (see SYSC 17.1.15G(3));
 - (3) an analysis of any internal or external trends that could influence the *firm's* exposure to insurance risk in the future (e.g. new weather patterns, socio-demographic changes, expense overruns etc);
 - (4) any new or emerging developments in *claims* experience (e.g. changes in the type of *claims*, average *claim* amounts or the number of similar *claims*);
 - (5) the results of any stress testing or scenario analyses;
 - (6) the amount and details of new business written and the amount of business that has lapsed or been cancelled;
 - (7) identified fraudulent *claims*;
 - (8) a watch list, detailing, for example, material/catastrophic events that could give rise to significant numbers of new *claims* or very large *claims*, contested *claims*, client complaints, legal and other developments;

- (9) the performance of any *reinsurance*/risk transfer arrangements; and
 - (10) progress reports on matters that have previously been referred under escalation procedures (see SYSC 17.1.23G).
- 17.1.23 G A *firm* should establish and maintain procedures for the escalation of appropriate matters to the relevant level of management. Such matters may include:
- (1) any significant new exposures to insurance risk, including for example any landmark rulings in the courts;
 - (2) a significant increase in the size or number of *claims*;
 - (3) any breaches of the limits set out in SYSC 17.1.27G and SYSC 17.1.28G, in particular senior management should be informed where any maximum limits have been breached (see SYSC 17.1.29G); and
 - (4) any unauthorised deviations from its insurance risk policy (including those by a *broker*, *appointed representative* or other delegated authority).
- 17.1.24 G A *firm* should regularly monitor the effectiveness of its analysis techniques for setting provisions for *claims* on *general insurance contracts*.
- 17.1.25 G A *firm* should have appropriate procedures in place to allow managers to monitor the application (and hence the effect) of its *reinsurance* programme. This would include, for a general *insurer*, procedures for monitoring how its *reinsurance* programme affects the gross provisions that it makes for outstanding *claims* (including *claims* that are incurred but not reported).

Risk control

- 17.1.26 G A *firm* should take appropriate action to ensure that it is not exposed to insurance risk in excess of its risk appetite. In so doing, the *firm* should be both reactive, responding to actual increases in exposure, and proactive, responding to potential future increases. Being proactive should involve close co-ordination between the processes of risk control, risk identification and risk measurement, as potential future exposures need to be identified and understood before effective action can be taken to control them.
- 17.1.27 G A *firm* should consider setting limits for its exposure to insurance risk, which trigger action to be taken to control exposure. Periodically these limits should be amended in the light of new information (e.g. on the expected number or size of *claims*). For example, limits could be set for:
- (1) the *firm's* aggregate exposure to a single source of insurance risk or for events that may be the result of a number of different sources;

- (2) the *firm's* exposure to specific geographic areas or any other groupings of risks whose outcomes may be positively correlated;
 - (3) the number of fraudulent *claims*;
 - (4) the number of very large *claims* that could arise;
 - (5) the number of unauthorised deviations from its insurance risk policy;
 - (6) the amount of insurance risk than can be transferred to a particular *reinsurer*;
 - (7) the level of expenses incurred in respect of each relevant business area; and
 - (8) the level of persistency by product line or distribution channel.
- 17.1.28 G A *firm* should also consider setting individual underwriting limits for all *employees* and agents that have the authority to underwrite insurance risk. This could include both monetary limits and limits on the types of risk that they can underwrite. Where individual underwriting limits are set, the *firm* should ensure that they are adhered to.
- 17.1.29 G In addition to setting some 'normal' limits for insurance risk, a *firm* should consider setting some maximum limits, beyond which immediate, emergency action should be taken. These maximum limits could be determined through stress testing and scenario analysis.
- 17.1.30 G A *firm* should pay close attention to the wording of its *policy* documentation to ensure that these wordings do not expose it to more, or higher, *claims* than it is expecting. In so doing, the *firm* should consider:
- (1) whether it has adequate in-house legal resources;
 - (2) the need for periodic independent legal review of *policy* documentation;
 - (3) the use of standardised documentation and referral procedures for variation of terms;
 - (4) reviewing the documentation used by other insurance companies;
 - (5) revising documentation for new *policies* in the light of past experience; and
 - (6) the operation of law in the jurisdiction of the *policyholder*.
- 17.1.31 G A *firm* should ensure that it has appropriate systems and controls for assessing the validity of *claims*. This could involve consideration of the evidence that will be required from *policyholders* and how this evidence is to be tested as well as procedures to determine when experts such as loss

adjusters, lawyers or accountants should be used.

- 17.1.32 G Particular care should be taken to ensure that a *firm* has appropriate systems and controls to deal with large *claims* or large groups of *claims* that could significantly deplete its financial resources. This should include systems to ensure that senior management (that is, the *governing body* and relevant *senior managers*) is involved in the processing of such *claims* from the outset.
- 17.1.33 G A *firm* should consider how it intends to use *reinsurance* or some other form of insurance risk transfer agreement to help to control its exposure to insurance risk. Additional *guidance* on the use of *reinsurance*/risk transfer is provided below.

Reinsurance and other forms of risk transfer

- 17.1.34 G Before entering into or significantly changing a *reinsurance* agreement, or any other form of insurance risk transfer agreement, a *firm* should:
- (1) analyse how the proposed *reinsurance*/risk transfer agreement will affect its exposure to insurance risk, its underwriting strategy and its ability to meet its regulatory obligations;
 - (2) ensure there are adequate legal checking procedures in respect of the draft agreement;
 - (3) conduct an appropriate due diligence of the *reinsurer's* financial stability (that is, solvency) and expertise; and
 - (4) understand the nature and limits of the agreement (particular attention should be given to the wording of contracts to ensure that all of the required risks are covered, that the level of available cover is appropriate, and that all the terms, conditions and warranties are unambiguous and understood).
- 17.1.35 G In managing its *reinsurance* agreements, or any other form of insurance risk transfer agreement, a *firm* should have in place appropriate systems that allow it to maintain its desired level of cover. This could involve systems for:
- (1) monitoring the risks that are covered (that is, the scope of cover) by these agreements and the level of available cover;
 - (2) keeping underwriting staff informed of any changes in the scope or level of cover;
 - (3) properly co-ordinating all *reinsurance*/risk transfer activities so that, in aggregate, the desired level and scope of cover is maintained;
 - (4) ensuring that the *firm* does not become overly reliant on any one *reinsurer* or other risk transfer provider; or

- (5) conducting regular stress testing and scenario analysis to assess the resilience of its *reinsurance* and risk transfer programmes to catastrophic events that may give rise to large and or numerous *claims*.
- 17.1.36 G In making a claim on a *reinsurance* contract (that is, its *reinsurance* recoveries) or some other risk transfer contract a *firm* should ensure:
- (1) that it is able to identify and recover any money that it is due in a timely manner; and
- (2) that it makes adequate financial provision for the risk that it is unable to recover any money that it expected to be due, as a result of either a dispute with or a default by the *reinsurer*/risk transfer provider. Additional *guidance* on credit risk in *reinsurance*/risk transfer contracts is provided in *INSPRU* 2.1 (Credit risk in insurance)].
- 17.1.37 G Where the planned level or scope of cover from a *reinsurance*/risk transfer contract is not obtained, a *firm* should consider revising its underwriting strategy.

Record keeping

- 17.1.38 G The *FSA's* high level *rules* and *guidance* for record keeping are outlined in *SYSC* 3.2.20R (Records). Additional *rules* and *guidance* in relation to the *prudential context* are set out in *SYSC* 14.1.51G to *SYSC* 14.1.64G. In complying with these *rules* and *guidance*, a *firm* should retain an appropriate record of its insurance risk management activities. This may, for example, include records of:
- (1) each new risk that is underwritten (noting that these records may be held by agents or cedants, rather than directly by the *firm* provided that the *firm* has adequate access to those records);
- (2) any material aggregation of exposure to risk from a single source, or of the same kind or to the same potential catastrophe or event;
- (3) each notified *claim* including the amounts notified and paid, precautionary notices and any re-opened *claims*;
- (4) *policy* and contractual documents and any relevant representations made to *policyholders*;
- (5) other events or circumstances relevant to determining the risks and commitments that arise out of *contracts of insurance* (including discretionary benefits and charges under any *long-term insurance contracts*);
- (6) the formal wordings of *reinsurance* contracts; and

- (7) any other relevant information on the *firm's reinsurance* or other risk-transfer arrangements, including the extent to which they:
 - (a) have been exhausted by recoveries on paid *claims*; and
 - (b) will be exhausted by recoveries on reported *claims* and, to the extent known, on incurred but not reported *claims*.

17.1.39 G A *firm* should retain its underwriting and *claims* histories for as long as they may be needed to inform pricing or provisioning decisions.

- 18 Guidance on Public Interest Disclosure Act: whistleblowing
- 18.1 Application
- 18.1.1 G This chapter is relevant to every *firm* to the extent that the Public Interest Disclosure Act 1998 ("PIDA") applies to it.
- Purpose
- 18.1.2 G (1) The purposes of this chapter are:
- (a) to remind *firms* of the provisions of PIDA; and
 - (b) to encourage *firms* to consider adopting and communicating to workers appropriate internal procedures for handling workers' concerns as part of an effective risk management system.
- (2) In this chapter "worker" includes, but is not limited to, an individual who has entered into a contract of employment.
- 18.1.3 G The *guidance* in this chapter concerns the effect of PIDA in the context of the relationship between *firms* and the *FSA*. It is not comprehensive guidance on PIDA itself.
- 18.2 Practical measures
- Effect of Public Interest Disclosure Act 1998
- 18.2.1 G (1) Under PIDA, any clause or term in an agreement between a worker and his employer is void in so far as it purports to preclude the worker from making a protected disclosure (that is, "blow the whistle").
- (2) In accordance with section 1 of PIDA:
- (a) a protected disclosure is a qualifying disclosure which meets the relevant requirements set out in that section;
 - (b) a qualifying disclosure is a disclosure, made in good faith, of information which, in the reasonable belief of the worker making the disclosure, tends to show that one or more of the following (a "failure") has been, is being, or is likely to be, committed:
 - (i) a criminal offence; or
 - (ii) a failure to comply with any legal obligation; or
 - (iii) a miscarriage of justice; or

- (iv) the putting of the health and safety of an individual in danger; or
- (v) damage to the environment; or
- (vi) deliberate concealment relating to any of (i) to (v);

it is immaterial whether the relevant failure occurred, occurs or would occur in the *United Kingdom* or elsewhere, and whether the law applying to it is that of the *United Kingdom* or of any other country or territory.

Internal procedures

- 18.2.2 G (1) *Firms* are encouraged to consider adopting (and encouraged to invite their *appointed representatives* to consider adopting) appropriate internal procedures which will encourage workers with concerns to blow the whistle internally about matters which are relevant to the functions of the *FSA*.
- (2) Smaller *firms* may choose not to have as extensive procedures in place as larger *firms*. For example, smaller *firms* may not need written procedures. The following is a list of things that larger and smaller *firms* may want to do.
- (a) For larger *firms*, appropriate internal procedures may include:
- (i) a clear statement that the *firm* takes failures seriously (see SYSC 18.2.1G(2)(b));
 - (ii) an indication of what is regarded as a failure;
 - (iii) respect for the confidentiality of workers who raise concerns, if they wish this;
 - (iv) an assurance that, where a protected disclosure has been made, the *firm* will take all reasonable steps to ensure that no *person* under its control engages in victimisation;
 - (v) the opportunity to raise concerns outside the line management structure, such as with the Compliance Director, Internal Auditor or Company Secretary;
 - (vi) penalties for making false and malicious allegations;
 - (vii) an indication of the proper way in which concerns may be raised outside the *firm* if necessary (see (3));
 - (viii) providing access to an external body such as an independent charity for advice;

- (ix) making whistleblowing procedures accessible to staff of key contractors; and
 - (x) written procedures.
- (b) For smaller *firms*, appropriate internal procedures may include:
- (i) telling workers that the *firm* takes failures seriously (see SYSC 18.2.1G(2)(b)) and explaining how wrongdoing affects the organisation;
 - (ii) telling workers what conduct is regarded as failure;
 - (iii) telling workers who raise concerns that their confidentiality will be respected, if they wish this;
 - (iv) making it clear that concerned workers will be supported and protected from reprisals;
 - (v) nominating a senior officer as an alternative route to line management and telling workers how they can contact that individual in confidence;
 - (vi) making it clear that false and malicious allegations will be penalised by the *firm*;
 - (vii) telling workers how they can properly blow the whistle outside the *firm* if necessary (see (3));
 - (viii) providing access to an external body for advice such as an independent charity for advice; and
 - (ix) encouraging managers to be open to concerns.
- (3) (a) *Firms* should also consider telling workers (through the *firm's* internal procedures, or by means of an information sheet available from the *FSA's* website, or by some other means) that they can blow the whistle to the *FSA*, as the regulator prescribed in respect of financial services and markets matters under PIDA.
- (b) The *FSA* will give priority to live concerns or matters of recent history, and will emphasise that the worker's first port of call should ordinarily be the *firm* (see Frequently Asked Questions on <http://www.fsa.gov.uk/Pages/Doing/Contact/Whistle/FAQ/index.shtml>).
- (c) For the *FSA's* treatment of confidential information, see SUP 2.2.4G.

Link to fitness and propriety

- 18.2.3 G The *FSA* would regard as a serious matter any evidence that a *firm* had acted to the detriment of a worker because he had made a protected disclosure (see *SYSC 18.2.1G(2)*) about matters which are relevant to the functions of the *FSA*. Such evidence could call into question the fitness and propriety of the *firm* or relevant members of its staff, and could therefore, if relevant, affect the *firm's* continuing satisfaction of *threshold condition 5* (Suitability) or, for an *approved person*, his status as such.

Annex F

Senior Management Arrangements, Systems and Controls Handbook (SYSC) coming into force on 1 November 2007

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

Amend SYSC 1.1 as follows

1.1 Application of SYSC 2 and SYSC 3

....

1.1.1 R Who?

SYSC 2 and SYSC 3 apply to every firm except that:

...

- (6) ~~*SYSC 3.2.23R to SYSC 3.2.36R apply only to a BIPRU firm for a common platform firm, SYSC 3 does not apply.*~~

...

1.3.1A G ~~From 1 January 2007 until 1 November 2007, the application of the common platform requirements is limited by SYSC TP 1.~~[deleted]

...

1.3.4 R ~~[To follow.]~~ The provisions on record-keeping in SYSC 9 apply as set out in SYSC 1.3.2R, except that they only apply to the carrying on of *ancillary activities* that are performed in relation to:

- (1) *designated investment business;*
- (2) *home finance activity; and*
- (3) *insurance mediation activity.*

...

Amend SYSC 3 as follows

...

3.1.1A R [deleted]

...

3.2.23R R [deleted]

3.2.24 R [deleted]

3.2.25 R [deleted]

3.2.26 R [deleted]

3.2.27 R [deleted]

3.2.28 R [deleted]

3.2.29 R [deleted]

3.2.30 R [deleted]

3.2.31 R [deleted]

3.2.32 R [deleted]

3.2.33 R [deleted]

3.2.34 R [deleted]

3.2.35 R [deleted]

3.2.36 R [deleted]

Amend SYSC 12 as follows

...

12.1.13 R If this *rule* applies under SYSC 12.1.14R to a *firm*, the *firm* must:

(1) ...; and

(2) ensure that the risk management processes and internal control mechanisms at the level of any *UK consolidation group* or *non-EEA sub-group* of which it is a member comply with the obligations set out in the following provisions on a consolidated (or sub-consolidated) basis:

- (a) ~~SYSC 3.2.23R and SYSC 3.2.24R~~ SYSC 4.1.1R and SYSC 4.1.2R;
- (b) ~~SYSC 3.2.26R~~ SYSC 4.1.7R;
- (c) ~~SYSC 3.2.28R to SYSC 3.2.36R~~ SYSC 5.1.7R;
- (d) ~~SYSC 11.1.11R and SYSC 11.1.12R~~ SYSC 7;
- (e) ~~BIPRU 2.3.7R(1)~~ SYSC 11.1.11R and SYSC 11.1.12R;
- (f) ~~BIPRU 9.1.6R and BIPRU 9.13.21R (Liquidity plans)~~ BIPRU 2.3.7R(1);
- (g) ~~BIPRU 10.12.3R (Concentration risk policies)~~ BIPRU 9.1.6R and BIPRU 9.13.21R (Liquidity plans);
- (h) BIPRU 10.12.3R (Concentration risk policies).

Annex G

Principles for Businesses sourcebook (PRIN)

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

...

- 1.2.5 G A *firm* is therefore not required to classify its *clients* (because *COB* 4.1.4 R does not apply) and may choose to comply with *Principles* 6, 7, 8 and 9 as if all its *clients* were *customers*. Alternatively, it may choose to distinguish between *market counterparties* and *customers* in complying with those *Principles*. But, in that case, the *firm* would need to classify any *client* treated as a *market counterparty*. In doing this, the requirements in *SYSC* will apply, including the requirement to establish appropriate systems and controls ~~*SYSC* 3.1.1 R~~ and the requirement to make and retain adequate records ~~*SYSC* 3.2.20 R~~. In classifying its *market counterparties*, it would be open to such a *firm*, although not obligatory, to permit *intermediate customers* to opt up to *market counterparty* status in accordance with *COB* 4.1.12 R. It would also have to treat a *market counterparty* as a *customer* if the *firm* had chosen to treat the *client* as a *private customer* in the circumstances set out in *COB* 4.1.14 R.

...

Annex H

Threshold Conditions (COND)

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

...

2.4.4(2) G (2) ...

- (d) whether the *firm* has taken reasonable steps to identify and measure any risks of regulatory concern that it may encounter in conducting its business (see *COND* 2.4.6 G) and has installed appropriate systems and controls and appointed appropriate human resources to measure them prudently at all times; see *SYSC* 3.1 (Systems and Controls), ~~and~~ *SYSC* 3.2 (Areas covered by systems and controls) and *SYSC* 4.1.1R (Organisational requirements); and

...

2.4.5 G In complying with ~~*SYSC* 3.1.1R~~ (Systems and controls), a *firm* should plan its business appropriately so that it is able to identify, measure and manage the likely risks of regulatory concern it will face (*SYSC* 3.2.17 G (Business strategy) and *SYSC* 7 (Risk control)).

...

2.4.6 G (3) The *FSA* would expect the level of detail in a *firm's* business plan or strategy plan in (2) to be appropriate to the complexity of the *firm's* proposed *regulated activities* and *unregulated activities* and the risks of regulatory concern it is likely to face (see *SYSC* 3.2.11 G (Management information) and *SYSC* 7 (Risk control)). Notes on the contents of a business plan are given in the business plan section of the application pack for *Part IV permission*. A *firm* requiring specific *guidance* on the contents and level of detail of its business plan should contact the Corporate Authorisation department (see *AUTH* 3: Applications for *Part IV permission*), or, if relevant, its usual supervisory contact at the *FSA*, or seek professional assistance.

...

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

...

- (6) the *firm* has taken reasonable care to establish and maintain effective systems and controls for compliance with applicable requirements

and standards under the regulatory system that apply to the *firm* and the *regulated activities* for which it has, or will have, permission (see SYSC 3.2.6 R to SYSC 3.2.8 R (Compliance) and SYSC 6.1.1 to SYSC 6.1.5);

...

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

...

(3) the *governing body* of the *firm* is organised in a way that enables it to address and control the *regulated activities* of the *firm*, including those carried on by *managers* to whom particular functions have been delegated (see SYSC 2.1 (Apportionment of responsibilities) and SYSC 3.2 (Areas covered by systems and controls) and SYSC 4.1.1 (General organisational requirements));

...

(5) the *firm* has made arrangements to put in place an adequate system of internal control to comply with the requirements and standards under the *regulatory system* (see SYSC 3.1 (Systems and Controls) and SYSC 4.1 (General organisational requirements));

(6) the *firm* has approached the control of financial and other risk in a prudent manner (for example, by not assuming risks without taking due account of the possible consequences) and has taken reasonable care to ensure that robust information and reporting systems have been developed, tested and properly installed (see SYSC 3.2.10G (Risk assessment) and SYSC 7.1 (Risk control));

...

(8) the *firm* has developed human resources policies and procedures that are reasonably designed to ensure that it employs only individuals who are honest and committed to high standards of integrity in the conduct of their activities (see, for example, SYSC 3.2.13G (Employees and agents) and SYSC 5.1 (Employees, agents and other relevant persons));

...

(10) the *firm* has in place systems and controls against *money laundering* of the sort described in SYSC 3.2.6 R to SYSC 3.2.6J G and SYSC 6.3 (Financial crime);

Annex I

Conduct of Business sourcebook (COB)

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

...

2.4.1A R This section does not apply to a *common platform firm* if SYSC 10.2 (Chinese walls) applies to the *firm*.

...

5.10.1A R This section does not apply to a *common platform firm* if SYSC 10.1 (conflicts of interest) applies to the *firm*.

....

Application

- 7.1.1 R
- (1) This section applies to a *firm* when it is conducting *designated investment business* with or for a *customer*.
 - (2) COB 7.1.4 E (1) do not apply in relation to *investment research* (see COB 7.3 (Dealing ahead of investment research)).
 - (3) This section does not apply to a *common platform firm* if SYSC 10.1 (conflicts of interest) applies to the *firm*.

Annex J

Insurance: Conduct of Business sourcebook (ICOB)

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

...

1.2.2 G ...

- (3) *Firms* which outsource *regulated activities* are reminded of the guidance on *outsourcing* in SYSC 3.2.4 G and the rules in SYSC 8.

...

7.4.7A R ICOB 7.4.5R to ICOB 7.4.7G do not apply to a common platform firm if SYSC 10.1 (conflicts of interest) applies to the firm.

...

Summary of Handbook provisions for insurance intermediaries

Annex 2	High level standards	Senior management arrangements, Systems and Controls, SYSC	Applies in respect of (1) and (2), except SYSC 3.2.6A R to SYSC 3.2.6J G1 <u>and SYSC 4-10</u>
---------	----------------------	------------------------------------------------------------	------------------------------------------------------------------------------------------------

...

...

3.3.9 G (1) A *firm* is reminded that *non-investment financial promotions* (including those which are exempt) may be subject to more general *rules* including *Principle 7* (Communications with clients), SYSC 3 (Systems and controls) ICOB 2.2.3 R (Clear, fair and not misleading communication) and ICOB 5 (Product disclosure).

...

Annex K

Mortgages: Conduct of Business sourcebook (MCOB)

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

...

1.2.1A G *Firms* which outsource *regulated activities* are reminded of the *guidance* on *outsourcing* in SYSC 3.2.4G and SYSC 8.

...

3.2.8 G *Firms* are reminded that *qualifying credit promotions* (including those which are exempt) may be subject to more general *rules*, including *Principle 7* (Communications with clients), SYSC 3 to SYSC 10 (Systems and controls) and MCOB 2.2.6 R (Clear, fair and not misleading communication).

...

4.3.3 G SYSC 3.2.6 R and SYSC 6.1.1R (Compliance) require a *firm* (including a *common platform firm*) to ~~'take reasonable care to establish, implement and maintain effective systems and controls for compliance with applicable requirements and standards under the *regulatory system*'~~. In meeting this requirement in relation to MCOB 4.3.2 R , a *firm* which states that it provides a service based on a limited number of *mortgage lenders* (see MCOB 4.3.1 R (1)(b)) should have adequate systems and controls in place to monitor whether business is actually placed with those *mortgage lenders*.

...

13.3.8 G *Firms* that propose to outsource aspects of *customer* relationships (including debt collection) should note that, as set out in SYSC 3.2.4 G(1) and SYSC 8, the *FSA* will continue to hold them responsible for the way in which this work is carried on.

...

Annex L

Client Assets sourcebook (CASS)

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

...

- 2.2.20 G A *firm* that holds *safe custody investments* with a *custodian* or *recommends custodians to private customers*, is expected to establish and maintain a system for assessing the appropriateness of its selection of the *custodian* and to assess the continued appointment of that *custodian* periodically as often as is reasonable in the relevant market. In order to comply with SYSC 3.2.20R and SYSC 9 (Records), the *firm* is also expected to make and retain a record of the grounds on which it satisfies itself as to the appropriateness of its selection or, following a periodic assessment, continued appropriateness of the *custodian*.

...

Annex M

Market Conduct sourcebook (MAR)

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

...

- 3.6.1 G (1) ...
- (2) *MAR* 3.6 also provides additional *guidance* on the record-keeping requirements of *SYSC* 3.2.20R and *SYSC* 9 (Records).

...

- 3.6.6 G If the records identified in *MAR* 3.6.3G are substituted by written or electronic confirmations produced in accordance with *SYSC* 3.2.20 R and *SYSC* 9 (Records), then that confirmation may be an adequate record of the transaction.

...

Annex N

Training and Competence sourcebook (TC)

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

...

- 1.1.4 G *Principle 3* is amplified in SYSC. A *firm* must take reasonable care to establish and maintain such systems and controls as are appropriate to its business (SYSC 3.1.1R and SYSC 4.1.1R to SYSC 4.1.5R). Also, a *firm's* systems and controls should enable it to satisfy itself of the suitability of anyone who acts for it (SYSC 3.2.13G and SYSC 5.1.2G). This would include the competence of the individual for the role.

Annex O

Supervision manual (SUP)

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

...

Rules which can be waived (see SUP 8.2.6 G)

8.2.7	G	Rules	Section of the Act or other provision under which rules are made	Chapters of the Handbook where such rules appear (Note 1)
		...		
		Money laundering rules	Section 146	<u>SYSC 3.2</u> and <u>SYSC 6.3</u>
		...		
10.7.13A	G	A <i>firm's</i> obligations in respect of its <i>money laundering reporting officer</i> are set out in <u>SYSC 3.2.6I R</u> and <u>SYSC 6.3.9R</u> .		
		...		
10.12.3	G	... See also <u>SYSC 3.2.4G</u> and <u>SYSC 8.1.1R</u> , and for <i>insurers</i> <u>SYSC 3A.9 13.9</u> .		
10.12.4	G	<i>Outsourcing arrangements</i>		<i>Submitting form</i>
		...		
		(i) ...	Responsibility for (as opposed to the performance of) any activity <i>outsourced</i> to B will remain with A. See <u>SYSC 3.2.4G</u> and <u>SYSC 8</u>	
12.6.7	G	The senior management of a <i>firm</i> should be aware that the activities of <i>appointed representatives</i> are an integral part of the business that they manage. The responsibility for the control and monitoring of the activities of <i>appointed representatives</i> rests with the senior management of the <i>firm</i> . <i>Guidance</i> is set out in <u>SYSC</u> SYSC 3 on delegation (for example, SYSC SYSC 3.2.3 G and SYSC 3.2.4 G) and in the <i>Statements of Principle</i> and <i>Code of Practice for Approved Persons</i> in <i>APER</i> (for example, <i>APER</i> 4.5 and <i>APER</i> 4.6).		

...

Application of the handbook to incoming EEA firms

13A Annex 1	G	(1) Module of Handbook	(2) Potential application to an incoming EEA firm with respect to activities carried on from an establishment of the firm (or its appointed representative) in the United Kingdom	(3) Potential application to an incoming EEA firm with respect to activities carried on other than from an establishment of the firm (or its appointed representative) in the United Kingdom
		...		
		<i>SYSC</i>	<i>SYSC</i> 1 contains application provisions only. <i>SYSC</i> 2 and <i>SYSC</i> 3 apply as set out in <i>SYSC</i> 1.1.1 R (1): (1) <i>SYSC</i> 2.1.1 R (1) and <i>SYSC</i> 2.1.2 G do not apply; (2) ... (3) <i>SYSC</i> 3 applies, but only in so far as responsibility for the matter in question is not reserved by a European Community instrument to the <i>firm's Home State regulator</i> . <i>SYSC</i> 1.1.7 R (Where?) further restricts the territorial application of <i>SYSC</i> 1 to <i>SYSC</i> 3 for an <i>incoming EEA firm</i> . Further <i>guidance</i> is contained in <i>SYSC</i> 2.1.6 G, Question 12. <i>SYSC</i> 4 <i>SYSC</i> 18 applies to the extent that the Public Interest Disclosure Act 1998 applies to the <i>firm</i>.	...

Annex P

Enforcement manual (ENF)

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

...

- 11.5.2 G However, in some cases, it will not be appropriate to take disciplinary measures against a *firm* for the actions of an *approved person* (for example, if the *firm* can show that it took all reasonable steps to prevent the breach). In other cases, it may be appropriate for the *FSA* to take action against both the *firm* and the *approved person*. For example, a *firm* may have breached the rule requiring it to take reasonable care to establish and maintain such systems and controls as are appropriate to its business *SYSC 3.1.1 R* or *SYSC 4.1.1R*), and an *approved person* may have taken advantage of those deficiencies to front run orders or misappropriate assets.

...

- 11.7.1 G In a number of circumstances the *regulatory system* requires a *firm* to take reasonable care in relation to particular behaviour. For example, *Principle 3* requires a *firm* to take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems, and *SYSC 3.1.1 R* (taken with *SYSC 3.1.2 G*) and *SYSC 4.1.1R* (taken with *4.1.2G*) requires a *firm* to take reasonable care to establish and maintain such systems and controls as are appropriate to the nature, scale and complexity of its business.

...

- 11.9.1 G The *FSA*'s money laundering *rules* are set out in *SYSC 3.2* and *SYSC 6.3 (Financial crime)* The *FSA*, when considering whether to take disciplinary action in respect of a breach of those *rules*, will have regard to whether a *firm* has followed relevant provisions in the Joint Money Laundering Steering Group's Guidance Notes for the Financial Sector.

Annex Q

Credit Unions sourcebook (CRED)

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

...

- 4.1.3 G SYSC 1 to SYSC 3 apply to all credit unions in respect of the carrying on of their regulated activities and unregulated activities in a prudential context. ~~SYSC 4~~ SYSC 18 applies to all credit unions without restriction.

...

- 4.1.8 G ~~SYSC 4~~ SYSC 18 reminds firms of the provisions of the Public Interest Disclosure Act 1998 and encourages them to consider adopting appropriate internal whistleblowing procedures. This applies equally to *credit unions* but is not the subject of further *guidance* in this chapter.

...

Annex R

Professional Firms sourcebook (PROF)

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

...

5.3.4 G *SYSC 3.2.6A R to SYSC 3.2.6J G and SYSC 6.3 (Financial crime), in relation to money laundering, do not apply to authorised professional firms when carrying on non-mainstream regulated activities.*

...

Annex S

Recognised Investment Exchanges and Recognised Clearing Houses sourcebook (REC)

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

...

2.5A.6 G (2) In considering appropriate internal procedures, *UK recognised bodies* may find the *guidance* provided to *firms* in SYSC 18.2.2G(2) and (3) ~~4.2.2G(2) and (3)~~ helpful.

...

Annex T

Glossary of Definitions

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

<u>ancillary service</u>	<u>any of the services listed in Section B of Annex I to MiFID.</u>
broker	(in MAR , <u>SYSC</u> and INSPRU) any person when dealing as agent.
collateral	(2) ... (3) (in INSPRU <u>and SYSC</u>) (a) ...
<u>CRD</u>	<u>the Capital Adequacy Directive and the Banking Consolidation Directive.</u>
client	(1) (except in PROF , [;] in relation to a <u>regulated mortgage contract and SYSC 10</u>) any person with or for whom a firm conducts or intends to conduct <u>designated investment business</u> or any other <u>regulated activity</u> ; and: ... (3A) <u>(in SYSC 10) any person to whom a common platform firm provides, or intends to provide, a service in the course of carrying on a regulated activity for that person, but does not include:</u> (a) <u>a trust beneficiary; or</u> (b) <u>a corporate finance contact; or</u> (c) <u>a venture capital contact;</u> (4) (in relation to a <u>regulated mortgage contract</u> , except in PROF <u>and SYSC 10</u>) the individual or trustee who is the borrower or potential borrower under that contract.
<u>common platform firm</u>	<u>a firm that is:</u> (a) <u>a BIPRU firm; or</u> (b) <u>an exempt CAD firm; or</u> (c) <u>a UK MiFID investment firm which falls within the definition of 'local firm' in article 3.1P of the Capital Adequacy Directive.</u>

<u>common platform organisational requirements</u>	<u>SYSC 4 to SYSC 9.</u>
<u>common platform record-keeping requirements</u>	<u>SYSC 9.</u>
<u>common platform requirements</u>	<u>SYSC 4 to SYSC 10.</u>
<u>common platform requirements on financial crime</u>	<u>SYSC 6.3.</u>
<i>competent authority</i> ¹	<p>(1) (in relation to the functions referred to in Part VI of the Act <u>admission to an official listing</u>):</p> <p>(a) the authority designated under Schedule 8 to the Act (Transfer of functions under Part VI (Official listing)) as responsible for performing those functions under the Act <u>admitting securities to, and for removing securities from, the official list</u>; for the time being, the FSA in its capacity as such; or</p> <p>(b) an authority exercising functions corresponding to those functions under the laws of <u>in (a) in another EEA State.</u></p> <p>(2) (in relation to the exercise of an <i>EEA right</i>) a competent authority for the purposes of the relevant <i>Single Market Directive</i>.</p> <p>(3) ...</p>
<u>conflicts of interest policy</u>	<u>the policy established and maintained in accordance with SYSC 10.1.10R.</u>
<i>control</i>	<p>(1) <u>(except for a common platform firm)</u> (in relation to the acquisition, increase or reduction of control of a <i>firm</i>) the relationship between a <i>person</i> and the <i>firm</i> or other <i>undertaking</i> of which the <i>person</i> is a controller.</p> <p>(2) <u>(for a common platform firm) control as defined in article 1 of Directive 83/349/EEC.</u></p>

[Note: article 4 (1)(30) of *MiFID*]

¹ This definition is based on the definition contained in the CRD (Consequential Amendments) Instrument 2006 which was consulted on in the consultation paper Strengthening Capital Standards 2 (CP 06/3)

durable medium (a) paper; or

(b) ~~(in accordance with article 2(f) of the *Distance Marketing Directive* and article 2(12) of the *Insurance Mediation Directive*)~~ any instrument which enables the recipient to store information addressed personally to him in a way accessible for future reference for a period of time adequate for the purposes of the information and which allows the unchanged reproduction of the information stored; this includes, in particular, floppy disks, CD-ROMs, DVDs and the hard drive of the recipient's computer on which the electronic mail is stored, but not Internet websites unless they fulfill the criteria in this definition.

(in relation to *MiFID business* or *equivalent business of a third country investment firm*, if the relevant rule implements the *MiFID implementing Directive*) the instrument used must be:

- (i) appropriate to the context in which the business is to be carried on; and
- (ii) chosen by the consumer when offered the choice between that instrument and paper.

[Note: article 2(f) and Recital 20 of the *Distance Marketing Directive*, article 2(12) of the *Insurance Mediation Directive* and article 2(2) of the *MiFID implementing Directive*]

eligible counterparty means a market counterparty.

equivalent business of a third country investment firm the business of a *third country investment firm* carried on from an establishment in the *United Kingdom* that would be *MiFID business* if that firm were a *MiFID investment firm*.

financial instrument ...

- (2) (for the purposes of *BIPRU* and *GENPRU*) an instrument listed in Section B of the Annex to the *ISD*; and
- (3) (for the *common platform requirements*) any of the instruments specified in Section C of Annex I of *MiFID*.

group ...

- (5) (in relation to a *common platform firm*) means the group of which that *firm* forms a part, consisting of a parent undertaking, its subsidiaries and the entities in which the parent undertaking or its subsidiaries hold a participation, as well as undertakings linked to each other by a relationship within the meaning of article 12(1) of

Directive 83/349/EEC on consolidated accounts.

[Note: article 2(5) of the *MiFID implementing Directive*]

investment service

- (1) ...
- (2) (for the *common platform requirements*) any of the services and activities listed in Section A of Annex 1 to *MiFID* involving the provision of a service in relation to a *financial instrument*.

investment services and activities; or

any of the services and activities listed in Section A of Annex I to *MiFID* relating to any *financial instrument*.

investment services or activities; or

investment services and/or activities

MiFID

The European Parliament and Council Directive on markets in financial instruments (No. 2004/39/EC).

See also *MiFID Regulation* and *MiFID implementing Directive*.

MiFID business

investment services and activities and, where relevant, *ancillary services* carried on by a *MiFID investment firm*.

MiFID implementing Directive

Commission Directive No. 2006/73/EC implementing Directive 2004/39/EC of the European Parliament and of the Council as regards *organisational requirements and operating conditions* for investment firms and defined terms for the purposes of that Directive.

MiFID investment firm

(in summary) a *firm* to which *MiFID* applies including, for some purposes only, a *credit institution* and *UCITS investment firm*.

(in full) a *firm* which is:

- (1) an *investment firm* with its head office in the *EEA* (or, if it has a registered office, that office);
- (2) a *BCD credit institution* (only when providing an *investment service or activity* in relation to the *rules implementing the articles referred to in article 1(2) of MiFID*);
- (3) a *UCITS investment firm* (only when providing the services referred to in article 5(3) of the *UCITS Directive* in relation to the *rules implementing the articles of MiFID* referred to in article 5(4) of that Directive);

unless, and to the extent that, *MiFID* does not apply to it as a result of article 2 (Exemptions) or article 3 (Optional exemptions) of *MiFID*.

MiFID Regulation

Commission Regulation (EC) 1287/2006 implementing Directive 2004/39/EC of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive

outsourcing

- (1) (except in *SYSC* 8) the use of a *person* to provide customised services to a *firm* other than:
- (a) a member of the *firm's* governing body acting in his capacity as such; or
 - (b) an individual employed by a *firm* under a contract of service.
- (2) (in *SYSC* 8) an arrangement of any form between a *firm* and a service provider by which that service provider performs a process, a service or an activity which would otherwise be undertaken by the *firm* itself.

[Note: article 2(6) of the *MiFID implementing Directive*]

professional client

means an *intermediate customer*.

regulatory system

the arrangements for regulating a *firm* or other *person* in or under the *Act*, including the *threshold conditions*, the *Principles* and other *rules*, the *Statements of Principle*, codes and *guidance* and including any relevant directly applicable provisions of a European Regulation such as those contained in the *MiFID Regulation*.

relevant person

- (1) (in *COMP*) a *person* for *claims* against whom the *compensation scheme* provides cover, as defined in *COMP* 6.2.1R.
- (2) any of the following:
- (a) a *director, partner* or equivalent, *manager* or *appointed representative* (or where applicable, *tier agent*) of the *firm*;
 - (b) a *director, partner* or equivalent, or *manager* of any *appointed representative* (or where applicable, *tier agent*) of the *firm*;
 - (c) an *employee* of the *firm* or of an *appointed representative* (or where applicable, *tier agent*) of the *firm*; as well as any other natural person whose

services are placed at the disposal and under the control of the *firm* or a *tiered agent* of the *firm* and who is involved in the provision by the *firm* of *regulated activities*;

- (d) a natural person who is involved in the provision of services to the *firm* or its *appointed representative* (or where applicable, *tiered agent*) under an *outsourcing* arrangement for the purpose of the provision by the *firm* of *regulated activities*.

[Note: article 2(3) of the *MiFID implementing Directive*]

retail client

means a *private customer*.

senior personnel

those *persons* who effectively direct the business of the *firm*, which could include a *firm's governing body* and other *persons* who effectively direct the business of the *firm*.

supervisory function

any function within a *common platform firm* that is responsible for the supervision of its *senior personnel*.

third country investment firm

a *firm* which would be a *MiFID investment firm* if it had its head office in the *EEA*.

tiered agent

a *person* who, under the full and unconditional responsibility of only one *MiFID investment firm* on whose behalf it acts, promotes *investment services* and/or *ancillary services* to *clients* or prospective *clients*, receives and transmits instructions or orders from the *client* in respect of *investment services* or *financial instruments*, places *financial instruments* and/or provides *investment advice* to *clients* or prospective *clients* in respect of those *financial instruments* or *investment services*.

[Note: article 4(1)(25) of *MiFID*]

**THE GENERAL PRUDENTIAL SOURCEBOOK (TRANSITIONAL PROVISIONS
AND SCHEDULES) INSTRUMENT 2006**

Powers exercised

- A. The Financial Services Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):
- (1) section 138 (General rule-making power);
 - (2) section 150(2) (Actions for damages);
 - (3) section 156 (General supplementary powers); and
 - (4) section 157(1) (Guidance).
- B. The rule-making powers listed above are specified for the purpose of section 153(2) (Rule-making instruments) of the Act.

Commencement

- C. This instrument comes into force as follows:
- (1) The following provisions of the General Prudential Sourcebook (GENPRU) come into force on 31 December 2006:
 - (a) GENPRU TP 1 to GENPRU TP 6 and GENPRU TP 10 to GENPRU TP 13;
 - (b) Schedules 1 to 6 to GENPRU.
 - (2) The remainder of this instrument comes into force on 1 January 2007.

Amendments to the Handbook

- D. The Financial Services Authority creates a new chapter TP (Transitional provisions) and Schedules to GENPRU in accordance with Annex A to this instrument.

Citation

- E. This instrument may be cited as the General Prudential Sourcebook (Transitional Provisions and Schedules) Instrument 2006.

By order of the Board
23 November 2006

Annex A

Chapter TP of GENPRU and GENPRU Schedules

In this Annex all the text is new and is not underlined.

TP Transitional provisions

1 Application of GENPRU TP 1 to GENPRU TP 6 and other general provisions for insurers

Application of GENPRU TP 1 to GENPRU TP 6

1.1 R *GENPRU* TP 1 - *GENPRU* TP 6 apply to an *insurer*.

1.2 G *GENPRU* TP 1 - *GENPRU* TP 6 apply to an *insurer* to whom the relevant *GENPRU rule* listed in *GENPRU* TP Table 3R, *GENPRU* TP 4.3R, *GENPRU* TP 5.2R or *GENPRU* TP 6.2R applies. An *insurer* to whom *GENPRU* does not apply is not subject to *GENPRU* TP.

Version of IPRU to be used

1.3 R Any reference in *GENPRU* TP 1 - *GENPRU* TP 6 to *IPRU (INS)* or to *IPRU (FSOC)* is to the version in force on 30 December 2004.

2 IPRU(INS) waivers

Duration of transitional

2.1 R *GENPRU* TP 2 applies until the relevant *GENPRU* rule is revoked.

Continuing effect of waivers

2.2 R A rule in *GENPRU* listed in the Table at *GENPRU* TP 3 is disapplied, or is modified in its application, to a firm:

- (1) in order to produce the same effect, including any conditions, as a waiver had on the corresponding rule in *IPRU (INS)*;
- (2) for the same period as the waiver would have lasted, if shorter than the period in *GENPRU* TP 2.1R;

provided the conditions set out in *GENPRU* TP 2.3R are satisfied.

2.3 R The conditions referred to in *GENPRU* TP 2.2R are:

- (1) the rule is shown in the Table at *GENPRU* TP 3 as corresponding with the rule in *IPRU (INS)* in relation to which the waiver was granted to the firm;
- (2) the waiver was current as respects the firm immediately before 31 December 2004; and
- (3) there is no specific transitional rule relating to the waiver.

2.4 R *GENPRU* TP 2.2R does not have effect if, and to the extent that, it would be inconsistent with any community obligation of the *United Kingdom*.

2.5 R A firm which has the benefit of a waiver to which *GENPRU* TP 2.2R applies must:

- (1) notify the *FSA* immediately if it becomes aware of any matter which is material to the relevance or appropriateness of the waiver;
- (2) maintain a written record of the rule in *GENPRU* to which it considers the waiver applies; and
- (3) make the record available to the *FSA* on request.

3 Table: IPRU(INS) waivers

3.1 R This table belongs to *GENPRU* TP 2.

Rules in GENPRU	Corresponding rules in IPRU (INS)
1.3.47R	4.2 (3)
2.1.13R	2.9 (3)
2.1.24R	2.9
2.1.25R	2.9
2.1.34R	2.4 (6)
2.2.107R	2.10 (7)
2.2.251R	4.14
	4.5 (7)

4 Capital instruments

Duration

- 4.1 R *GENPRU* TP 4 applies until the relevant *rule* is revoked

Application

- 4.2 R Subject to *GENPRU* TP 4.4R, *GENPRU* TP 4 applies to a *firm* which immediately before 31 December 2004 had the benefit of a *waiver* in relation to *IPRU (INS)* rule 2.10 or 5.2, or a written concession in relation to a pre-commencement provision listed in *GENPRU* TP 4.7R, in either case allowing the *firm* to exclude from the calculation of its liabilities obligations under a particular capital instrument issued by the *firm*.

Waivers

- 4.3 R Subject to *GENPRU* TP 4.4R and to compliance with the conditions set out in *GENPRU* TP 4.6R, a *firm* will be treated as complying with *GENPRU* 2.2.271R(3), *GENPRU* 2.2.177R(2), *GENPRU* 2.2.177R(3), *GENPRU* 2.2.180R and *GENPRU* 2.2.181R, in relation to the capital instrument to which the *waiver* or written concession referred to in *GENPRU* TP 4.2R related, so long as the *firm* is not obliged to pay any interest under the terms of the capital instrument in circumstances where the *firm* does not have *capital resources* equal to or in excess of its required margin of solvency under the *Insurance Directives*.
- 4.4 R *GENPRU* TP 4.3R ceases to apply to a *firm*:
- (1) once the *firm* has redeemed the capital instrument; or
 - (2) on or after any date upon which the *firm* has the option to redeem the capital instrument and may prudently do so.
- 4.5 R Subject to compliance with the conditions set out in *GENPRU* TP 4.6R, a *firm* will be treated as complying with *GENPRU* 2.2.159R(6), *GENPRU* 2.2.159R(10), *GENPRU* 2.2.159R(12), and *GENPRU* 2.2.163R in relation to the capital instrument to which the *waiver* or written concession referred to in *GENPRU* TP 4.2R related.
- 4.6 R The conditions referred to in *GENPRU* TP 4.3R and *GENPRU* TP 4.5R are:
- (1) the *firm* must notify the *FSA* immediately if it becomes aware of any matter which is material to the relevance or appropriateness of the *waiver* or written concession;
 - (2) the *firm* must maintain a written record of the *rule* in *GENPRU* to which it considers the *waiver* or written concession applies; and
 - (3) the *firm* must make the record available to the *FSA* on request.

- 4.7 R The pre-*commencement* provisions referred to in *GENPRU* TP 4.2R are those contained in:
- (1) the Insurance Companies Act 1982 and relevant secondary legislation; and
 - (2) the Friendly Societies Act 1992 and relevant secondary legislation.

5 Calls for supplementary contributions

Duration

5.1 R *GENPRU* TP 5 applies until the relevant *rule* is revoked

Application

5.2 R *GENPRU* TP 5 applies to a *firm* which immediately before 31 December 2004 had the benefit of a *waiver* in relation to *IPRU (INS)* rule 2.10 (4).

Waivers

5.3 R For the period specified in *GENPRU* TP 5.1R or the same period as the *waiver* would have lasted if shorter, subject to *GENPRU* TP 5.4R and to compliance with the conditions set out in *GENPRU* TP 5.5R, for the purposes of calculating its *capital resources* a *firm* may include the value of claims against its members by way of calls for supplementary contributions as *core tier one capital* to the same extent as it was permitted by the *waiver* to include the value of those claims in the calculation of its margin of solvency.

5.4 R *GENPRU* TP 5.3R does not apply for the purposes of *GENPRU* 2.2.34R (Guarantee fund) or *SUP* Appendix 2.4 (Capital resources below guarantee fund).

5.5 R The conditions referred to in *GENPRU* TP 5.3R are:

- (1) the limits specified in the *waiver* on the extent to which the *firm's* claim against its members by way of call for supplementary contributions may be brought into account apply as if the reference (if any) in the *waiver* to the *firm's* required margin of solvency referred to its *general insurance capital requirement* and the reference (if any) in the *waiver* to the *firm's* margin of solvency referred to its *capital resources*; and
- (2) the *firm* must comply with any further conditions imposed by the *waiver*.

6 Implicit items waivers

Duration

6.1 R *GENPRU* TP 6 applies until the relevant *rule* is revoked

Application

6.2 R *GENPRU* TP 6 applies to a *firm* which immediately before 31 December 2004 had the benefit of a *waiver* in relation to *IPRU (INS)* rule 2.10 (5) or *IPRU (FSOC)* rule 4.7 (3).

Waivers

6.3 R For the period specified in *GENPRU* TP 6.1R or the same period as the *waiver* would have lasted if shorter, subject to *GENPRU* TP 6.4R and to compliance with the conditions set out in *GENPRU* TP 6.5R, for the purpose of calculating its *capital resources* a *firm* may include the value of *implicit items* at Stage B of the *capital resources table* applicable to the *firm* to the same extent to which it was permitted by the *waiver* to include the value of those *implicit items* in the calculation of its margin of solvency.

6.4 R *GENPRU* TP 6.3R does not apply for the purposes of *GENPRU* 2.2.41R (Limits on forms of capital apply separately to long-term insurance business and general insurance business).

6.5 R The conditions referred to in *GENPRU* TP 6.3R are:

- (1) the limits specified in the *waiver* on the extent to which the value of *implicit items* may be brought into account apply as if the reference (if any) in the *waiver* to the *firm's* required margin of solvency referred to its *minimum capital requirement* and the reference (if any) in the *waiver* to the *firm's* margin of solvency referred to its *capital resources*; and
- (2) the *firm* must comply with any further conditions imposed by the *waiver*.

- 7 Pillar 3 capital resources
- Application
- 7.1 R This section applies to a *BIPRU firm*.
- Purpose
- 7.2 G This section implements Article 154(4) of the *Banking Consolidation Directive*.
- Duration
- 7.3 R This section applies until 31 December 2012.
- Transitional provision
- 7.4 R A *firm* may elect not to apply *GENPRU 2.2.239R(2) to (4)* (50:50 split between deductions from *tier one capital* and *tier two capital*) to *material insurance holdings* acquired before 1 January 2007.

8 Miscellaneous capital resources definitions for BIPRU firms

Application

8.1 R This section applies to a *BIPRU firm*.

8.2 R Any provision of this section that applies on a consolidated basis under *GENPRU* TP 8.3R applies to any *firm* to which *BIPRU* 8 (Group risk – consolidation) applies.

Consolidation

8.3 R A provision of this section applies on a consolidated basis for the purpose of *BIPRU* 8 (Group risk – consolidation) to the extent that, and in the same way that, the provision in *BIPRU* to which it relates applies on a consolidated basis.

Specific issues of TONS and other securities

8.4 R A *bank* may treat a *security* forming part of an issue of *securities* listed in *GENPRU* TP 8.5R as eligible for inclusion within stage B of the *capital resources table* (Perpetual non-cumulative preference shares) if it would not otherwise be eligible if:

- (1) on 31 December 2006 the *bank* was subject to *IPRU(BANK)*;
- (2) the *bank* issued it on or before 31 December 2006; and
- (3) as at 31 December 2006 the *bank* included it, and was entitled to include it, in the calculation of its capital resources under *IPRU(BANK)* as permanent share capital and tier one capital as referred to in chapter CA of *IPRU(BANK)*.

8.5 R The issues of *securities* referred to in *GENPRU* TP 8.4R are as follows:

- (1) Barclays £400mn 6% perpetual TONs;
- (2) Abbey National £175m 6.984% perpetual TOPIC;
- (3) Northern Rock £200m 7.053% perpetual TONs;
- (4) Barclays \$1bn 6.86% perpetual TONs;
- (5) Lloyds TSB \$850m 6.90% perpetual capital securities; and
- (6) Abbey National \$500m 7.375% T1MBS.

PIBS

8.6 R A *building society* may treat a *PIBS* as eligible for inclusion within stage B of the *capital resources table* (Perpetual non-cumulative preference shares) if it would not otherwise be eligible if:

- (1) on 31 December 2006 the *firm* was subject to *IPRU(BSOC)*;
- (2) the *building society* issued it before 18 November 2004; and
- (3) as at 31 December 2006 the *building society* included it, and was entitled to include it, in the calculation of its capital resources under *IPRU(BSOC)* as tier one capital as referred to in Annex 1A of chapter 1 of volume 1 of *IPRU(BSOC)*.

Preference shares

8.7 R A *bank* or *BIPRU investment firm* may treat a *preference share* as eligible for inclusion within stage B of the *capital resources table* (Perpetual non-cumulative preference shares) if it would not otherwise be eligible if:

- (1) on 31 December 2006 the *firm* was subject to *IPRU(BANK)* or *IPRU(INV)*;
- (2) the *firm* issued it on or before 31 December 2006;
- (3) as at 31 December 2006 the *firm* included it, and was entitled to include it, in the calculation of its capital resources under *IPRU(BANK)* or *IPRU(INV)* as capital of a type that corresponded to *tier one capital resources*;
- (4) it would have been eligible for inclusion within stage B of the *capital resources table* except for the fact that it does not meet *GENPRU 2.2.64R(4)(b)* (Restrictions on mandatory *coupons* for *tier one capital*) or *GENPRU 2.2.109R(1)* (Restrictions on mandatory *coupons* for perpetual non-cumulative *preference shares*) or both of those *rules*;
- (5) the only reason that it does not meet *GENPRU 2.2.64R(4)(b)* or *GENPRU 2.2.109R(1)* is because a mandatory cash *coupon* is payable;
- (6) the *firm* has the right not to pay the cash *coupon* if it is in breach of any of the *main BIPRU firm Pillar 1 rules* or to the extent that paying such *coupon* would result in a breach of any of those *rules*; and
- (7) any amount not paid under (6) does not accumulate.

Innovative tier one capital

- 8.8 R A *bank* may treat an item of a *capital instrument* as eligible for inclusion within stage C of the *capital resources table* (Innovative tier one capital) if it would not otherwise be eligible if:
- (1) on 31 December 2006 the *firm* was subject to *IPRU(BANK)*;
 - (2) the *bank* issued it on or before 31 December 2006;
 - (3) as at 31 December 2006 the *bank* included it, and was entitled to include it, in the calculation of its capital resources under *IPRU(BANK)* as innovative tier one capital as referred to in chapter CA of *IPRU(BANK)*;
 - (4) it would have been eligible for inclusion within stage C of the *capital resources table* except for the fact that it does not meet *GENPRU 2.2.64R(4)(b)* (Restrictions on mandatory *coupons* for *tier one capital*);
 - (5) the only reason that it does not meet *GENPRU 2.2.64R(4)(b)* is because a mandatory cash *coupon* is payable;
 - (6) the *bank* has the right not to pay the cash *coupon* if it is in breach of any of the *main BIPRU firm Pillar 1 rules* or to the extent that paying such *coupon* would result in a breach of any of those *rules*; and
 - (7) any amount not paid under (6) does not accumulate.

Upper tier 2 instruments: Deferral of interest

- 8.9 R A *bank* or *BIPRU investment firm* may treat a *capital instrument* as eligible for inclusion within stage G of the *capital resources table* (Upper tier two capital) if it would not otherwise be eligible if:
- (1) on 31 December 2006 the *firm* was subject to *IPRU(BANK)* or *IPRU(INV)*;
 - (2) the *firm* issued it on or before 31 December 2006;
 - (3) as at 31 December 2006 the *firm* included it, and was entitled to include it, in the calculation of its capital resources under *IPRU(BANK)* or *IPRU(INV)* as capital of a type that corresponded to *upper tier two capital resources*;
 - (4) it would have been eligible for inclusion within stage G of the *capital resources table* except for the fact that it does not meet *GENPRU 2.2.177R(2)*;
 - (5) the only reason that it does not meet *GENPRU 2.2.177R(2)* is because a mandatory cash *coupon* is payable;

(6) the *firm* has the right not to pay the cash *coupon* if it is in breach of any of the *main BIPRU firm Pillar 1 rules* or to the extent that paying such *coupon* would result in a breach of any of those *rules*; and

(7) any amount not paid under (6) does not accumulate.

Lower tier 2 instruments: Additional events of default for building societies

8.10 R A *building society* may treat a *capital instrument* as eligible for inclusion within stage H of the *capital resources table* (Lower tier two capital) if it would not otherwise be eligible if:

(1) on 31 December 2006 the *building society* was subject to *IPRU(BSOC)*;

(2) the *building society* issued it on or before 31 December 2006;

(3) as at 31 December 2006 the *building society* included it, and was entitled to include it, in the calculation of its capital resources under *IPRU(BSOC)* as Term Subordinated Debt falling within its Tier Two Capital (as referred to in Annex 1A of Chapter 1 and Chapter 2 of *IPRU(BSOC)*);

(4) it would have been eligible for inclusion within stage H of the *capital resources table* except for the fact that it does not meet *GENPRU 2.2.159R(2)* (Events of default); and

(5) the only reason that it does not meet *GENPRU 2.2.159R(2)* is because it contains an event of default permitted by paragraph 2.8.10G(3) of Volume 1 of *IPRU(BSOC)* (cancellation of a society's registration under the Building Societies Act 1986 otherwise than under section 103(1)(a) of that Act).

Conversion ratio

8.11 R *GENPRU 2.2.138R(2)* (Tier one capital: Conversion ratio) does not apply to a *capital instrument* issued by a *firm* if:

(1) on 31 December 2006 the *firm* was subject to *IPRU(BANK)*, *IPRU(BSOC)* or *IPRU(INV)*;

(2) the *firm* issued it on or before 31 December 2006; and

(3) as at 31 December 2006 the *firm* included it, and was entitled to include it, in the calculation of its capital resources under:

(a) (in the case of a *bank*) *IPRU(BANK)* as innovative tier one capital as referred to in chapter CA of *IPRU(BANK)*; or

- (b) (in the case of any other type of *firm*) *IPRU(BSOC)* or *IPRU(INV)* as capital of a type that corresponded to *tier one capital*.

Legal opinions

8.12 R *GENPRU 2.2.118R* (Legal opinions for *innovative tier one capital*) does not apply to a *capital instrument* issued by a *firm* if:

- (1) on 31 December 2006 the *firm* was subject to *IPRU(BANK)*, *IPRU(BSOC)* or *IPRU(INV)*;
- (2) the *firm* issued the *capital instrument* on or before 31 December 2006;
- (3) (in the case of a *bank*) as at 31 December 2006 the *bank* included the *capital instrument*, and was entitled to include it, in the calculation of its capital resources under *IPRU(BANK)* as innovative tier one capital as referred to in chapter CA of *IPRU(BANK)*; and
- (4) (in any other case) the *firm* included the *capital instrument*, and was entitled to include it, in the calculation of its capital resources under *IPRU(BSOC)* or *IPRU(INV)* as capital of a type that corresponded to *tier one capital*.

8.13 R The following *rules*:

- (1) *GENPRU 2.2.159R(12)* (Legal opinions for *tier two capital*);
- (2) *GENPRU 2.2.163R* (Legal opinions for *tier two capital* governed by a foreign law);
- (3) *GENPRU 2.2.181R* (Legal opinions for *upper tier two capital*); and
- (4) *GENPRU 2.2.244R* (Application of certain *rules* about *tier two capital* to *tier three capital*) so far as it applies the *rules* in (1) to (3);

do not apply to a *capital instrument* issued by a *firm* if:

- (5) on 31 December 2006 the *firm* was subject to *IPRU(BANK)*, *IPRU(BSOC)* or *IPRU(INV)*;
- (6) the *firm* issued the *capital instrument* on or before 31 December 2006; and
- (7) as at 31 December 2006 the *firm* included the *capital instrument*, and was entitled to include it, in the calculation of its capital resources under *IPRU(BANK)*, *IPRU(BSOC)* or *IPRU(INV)* as capital of the type that corresponds to:

- (a) (where the *firm* disapplies the *rule* in (1) or (2)) *tier two capital*; or
- (b) (where the *firm* disapplies the *rule* in (3)) *upper tier two capital*; or
- (c) (where the *firm* disapplies the *rule* in (4)) *tier three capital*.

Version of IPRU

- 8.14 R Any reference in this section to a type of capital in *IPRU* is to a type of capital in *IPRU* in the form *IPRU* was in on 31 December 2006.

Eligibility

- 8.15 G If this section says that an item of capital is eligible for inclusion within a particular stage of the *capital resources table* this is still subject to the application of the *capital resources gearing rules*.

Waivers and concessions

- 8.16 G A reference to a *firm* being entitled to include *capital instruments* in the calculation of its capital resources under *IPRU* at a particular level includes the *firm* being able to do this under a *waiver* or, in the case of *IPRU(BANK)* or *IPRU(BSOC)*, a written approval by the *FSA*.

Combinations of provisions

- 8.17 G A *firm* may combine the use of two or more of the provisions in this section.

9 Individual capital guidance for BIPRU firms

Application

9.1 G This section applies to a *BIPRU firm* that is a *bank* or *building society* for which the *FSA* has given:

(1) (in the case of a *building society*) a threshold ratio under *IPRU(BSOC)*; or

(2) (in the case of a *bank*) an individual capital ratio under *IPRU(BANK)*;

that was in effect on 31 December 2006 but to which the *FSA* has not yet given *individual capital guidance*.

Duration

9.2 G This section applies to a *firm* until it receives *individual capital guidance*.

9.3 G *GENPRU TP 9.4G - GENPRU TP 9.6G* only apply until 31 December 2007. Thereafter (if they do not already apply) *GENPRU TP 9.7G - GENPRU TP 9.10G* apply.

Pre 2007 capital requirements

9.4 G *GENPRU TP 9.5G - GENPRU TP 9.6G* apply if, and for as long as, a *firm* applies the treatment in *BIPRU TP 3.4R* (Pre CRD capital requirements applying on a solo basis during 2007) to all its *exposures*.

9.5 G If *GENPRU TP 9.4G* applies, any threshold ratio or individual capital ratio remains in force. However compliance with such ratios should be measured by reference to *capital resources*.

9.6 G Where necessary, a *firm* should apply the adjustment set out in section 4.1.3 of chapter CO of *IPRU(BANK)* (CAD banks) as it stood on 31 December 2006 to its *trading book* capital requirements.

BIPRU capital requirements

9.7 G *GENPRU TP 9.8G - GENPRU TP 9.10G* apply to a *firm* if *GENPRU TP 9.5G - GENPRU TP 9.6G* do not apply.

9.8 G Any threshold ratio or individual capital ratio remains in force adjusted as follows:

(1) the *firm* should work out the percentage of its *capital resources requirement* as at the date in *GENPRU TP 9.10G* represented by the absolute amount in *GENPRU TP 9.9G*; and

- (2) the *firm* should hold *capital resources* of an amount at least equal to the percentage specified in (1) of its *capital resources requirement* from time to time.
- 9.9 G The absolute amount referred to in *GENPRU* TP 9.8G is:
- (1) (if *GENPRU* TP 9.7G - *GENPRU* TP 9.10G apply to the *firm* on 1 January 2007) the amount of capital resources it had to hold under *IPRU* on 31 December 2006 in order to meet the ratio referred to in *GENPRU* TP 9.1G; and
- (2) (in any other case) the amount of *capital resources* it had to hold immediately prior to the date in *GENPRU* TP 9.10G in order to meet the ratio referred to in *GENPRU* TP 9.1G.
- 9.10 G The date referred to in *GENPRU* TP 9.8G and *GENPRU* TP 9.9G is:
- (1) (if *GENPRU* TP 9.9G(1) applies) 1 January 2007; and
- (2) (if *GENPRU* TP 9.9G(2) applies) the date on which *GENPRU* TP 9.7G - *GENPRU* TP 9.10G first apply to the *firm*.
- 9.11 G The following illustrates how *GENPRU* TP 9.8G - *GENPRU* TP 9.10G work. This example relates to a *bank* to which *GENPRU* TP 9.7G - *GENPRU* TP 9.10G apply from 1 January 2007. The example is as follows (all figures in £millions):
- (1) as at 31 December 2006:
- (a) the *bank* has risk-weighted assets of £1250;
- (b) its Pillar 1 capital resources requirement was £100 (8% of £1250);
- (c) its individual capital ratio was 10%; and
- (d) its capital resources requirement expressed as an absolute amount and including the individual capital ratio is £125;
- (2) on 1 January 2007 its *capital resources requirement* is £80;
- (3) the result is that the new individual capital ratio is 156.25% (£125m/£80m); and
- (4) its capital resources requirement expressed as an absolute amount and including the individual capital ratio remains at £125 despite the fall in the Pillar 1 charge.
- 9.12 G Continuing the example, say that the *bank's capital resources requirement* falls to £70 on 31 July 2007. Its capital resources requirement, expressed as an amount and including the individual capital ratio, now falls to £109.375.

Adjustments

- 9.13 G No adjustment should be made to take into account differences between the calculation of capital resources under *IPRU* and of *capital resources*.

Consolidation

- 9.14 G This section also applies to threshold ratios and individual capital ratios that apply on a consolidated basis.

10 Assets of former underwriting members

Application

10.1 R *GENPRU* TP 10 applies to the *Society*.

Duration

10.2 R *GENPRU* TP 10 applies until the *Society* is no longer required to identify or value assets of *individual members* that became *former underwriting members* before 1 January 2003.

Valuation and identification of assets

10.3 R For the purposes of *GENPRU* 1 and 2, the *Society* must identify and value the assets of *individual members* that became *former underwriting members* before 1 January 2003 in accordance with the requirements for the identification and valuation of assets contained in the "Conditions and Requirements Relating to Solvency and Reporting" which were approved by the *FSA*, exercising the powers of HM Treasury under section 83 of the Insurance Companies Act 1982, and which were applicable immediately before *commencement*.

11 PRU waivers

Application

- 11.1 R *GENPRU* TP 11 applies to an *insurer* to whom a *GENPRU rule* listed in the Table in *GENPRU* TP 12 applies.

Version of PRU to be used

- 11.2 R A reference in *GENPRU* TP 11 to *PRU* is to the version in force on 30 December 2006.

Duration of transitional

- 11.3 R *GENPRU* TP 11 applies until the relevant *GENPRU rule* is revoked.

Continuing effect of waivers

- 11.4 R A *rule* in *GENPRU* listed in the Table at *GENPRU* TP 12 is disapplied, or is modified in its application, to a *firm*:

- (1) in order to produce the same effect, including any conditions, as a *waiver* had on the corresponding *rule* in *PRU*;
- (2) for the same period as the *waiver* would have lasted, if shorter than the period in *GENPRU* TP 11.3R;

provided the conditions set out in *GENPRU* TP 11.5R are satisfied.

- 11.5 R The conditions referred to in *GENPRU* TP 11.4R are:

- (1) the *rule* is shown in the Table at *GENPRU* TP 12 as corresponding with the *rule* in *PRU* in relation to which the *waiver* was granted to the *firm*;
- (2) the *waiver* was current as respects the *firm* immediately before 31 December 2006; and
- (3) there is no specific transitional *rule* relating to the *waiver*.

- 11.6 R *GENPRU* TP 11.4 does not have effect if, and to the extent that, it would be inconsistent with any community obligation of the *United Kingdom*.

- 11.7 R A *firm* which has the benefit of a *waiver* to which *GENPRU* TP 11.4R applies must:

- (1) notify the *FSA* immediately if it becomes aware of any matter which is material to the relevance or appropriateness of the *waiver*;
- (2) maintain a written record of the *rule* in *GENPRU* to which it considers the *waiver* applies; and

- (3) make the record available to the *FSA* on request.

12 Table: PRU waivers

12.1 R This table belongs to *GENPRU* TP 11.

Rules in GENPRU	Corresponding rules in PRU
1.2.1R(2)	1.2.1R
1.2.2R(1)	1.2.3R(3)
1.2.2R(2)	1.2.3R(5)
1.2.6R	1.2.6R
1.3.4R	1.3.5R
2.1	2.1
2.1.3R	2.1.3R
2.1.13R	2.1.9R
2.1.17R	2.1.14R
2.1.24R	2.1.21R
2.1.25R	2.1.22R
2.1.29R	2.1.25R
2.1.30R	2.1.26R
2.1.30R	2.1.27R
2.1.34R	2.1.30R
2.1.38R	2.1.34R
2.2	2.2
2 Ann 1R	2.2.14R
2.2.32R	2.2.16R
2.2.33R	2.2.17R
2.2.34R	2.2.18R
2.2.118R	2.2.58R
2.2.64R(2)	2.2.40R
2.2.159R(7)	2.2.108R(7)
2.2.159R(8)	2.2.108R(8)
2.2.159R(9)	2.2.108R(9)
2.2.159R(10)	2.2.108R(10)
2.2.159R(12)	2.2.108R(11)
2.2.181R	2.2.105R
2.2.255R	2.2.89R

13 EEA pure reinsurers

Application

13.1 R *GENPRU* TP 13 applies to a *pure reinsurer*:

- (1) whose head office is in an *EEA State* other than the *United Kingdom*; and
- (2) which is not an *incoming Treaty firm*.

Duration of transitional

13.2 R *GENPRU* TP 13 has effect in relation to a *firm* until 10 December 2008 or, if earlier, the date on which it becomes:

- (1) an *incoming EEA firm* by reason of having exercised its right to carry on the *regulated activity* of *effecting or carrying out contracts of insurance* in the *United Kingdom* in accordance with Schedule 3 to the *Act* (EEA Passport Rights); or
- (2) an *incoming Treaty firm* by reason of having exercised its right to carry on the *regulated activity* of *effecting or carrying out contracts of insurance* in the *United Kingdom* in accordance with Schedule 4 to the *Act* (Treaty Rights).

Capital resources and discounting of technical provisions

13.3 R *GENPRU* 2.2.107R does not apply to a *firm*.

14 Continued use of IPRU expenditure requirements by BIPRU investment firms

Application

14.1 R This section applies to a *BIPRU investment firm*.

Transitional rule

14.2 R If a *firm*:

(1) is subject to the *fixed overheads requirement*; and

(2) was on 31 December 2006 subject to one of the expenditure based requirements under *IPRU* listed in the table in *GENPRU* TP 14.3R;

the *firm* may treat that expenditure based requirement as being its *fixed overheads requirement*.

14.3 R Table: Continuing IPRU expenditure requirements
This table belongs to *GENPRU* TP 14.2R

<i>IPRU</i> expenditure requirement	Remarks
Expenditure based requirement under Chapter 5 of <i>IPRU(INV)</i>	If the <i>firm</i> is subject to an expenditure based requirement of 6/52 of its annual audited expenditure, the <i>firm</i> must, for the purposes of this section, use the requirement of one quarter of its annual audited expenditure under <i>rule</i> 5.2.3(4)(c)(i)
The capital requirement of 13/52 of annual audited expenditure under <i>rule</i> 7.2.3R(1) of Chapter 7 of <i>IPRU(INV)</i>	
The expenditure requirement under <i>rule</i> 10-73(1)(b) of Chapter 10 of <i>IPRU(INV)</i>	

<i>IPRU</i> expenditure requirement	Remarks
Financial Resources Test 2 for Category A firms under section 13.5 of Chapter 13 of <i>IPRU(INV)</i> (Expenditure-based requirement)	A <i>firm</i> must, for the purposes of this section, calculate its requirement as 13/52 of its relevant annual expenditure even if the fraction that applies to it under Chapter 13 would otherwise be 4/52 or 8/52.
Note (1): A reference to annual expenditure covers expenditure based on a forecast, pro-rated expenditure based on a period shorter than twelve months or any other expenditure figures for which the <i>IPRU rules</i> in this table provide.	
Note (2): Any <i>waiver</i> that a <i>firm</i> has in relation to the <i>rules</i> in <i>IPRU</i> in this table has effect for the purposes of this section. Any condition, limitation or requirement to which such a <i>waiver</i> is subject also continues to apply.	

Duration

- 14.4 R A *firm* must stop applying this section at the date when, under the *IPRU* expenditure requirements that apply to it as described in *GENPRU* TP 14.3R, it would have had to start using figures for the period following the one on which the expenditure requirements to which it was subject on 31 December 2006 were based.
- 14.5 G Say for example that a *firm's accounting reference date* is 31 December. As at 31 December 2006 the *firm's IPRU* expenditure requirement was based on its annual accounts for the year ended 31 December 2005. Its annual accounts for the year ending 31 December 2006 are completed on 15 March 2007. From 1 January 2007 to 14 March 2007 the *firm* may treat its *IPRU* expenditure requirements as being its *fixed overheads requirement*. On 15 March 2007 the *firm* should switch to calculating its *fixed overheads requirement* under *GENPRU* 2.1 (Calculation of capital resources requirement).

Capital resources

- 14.6 G The expenditure requirement under *IPRU* is measured against the *firm's capital resources* as calculated under *GENPRU* 2.2 (Capital resources) and not capital resources calculated under *IPRU*.

General prudential sourcebook (*GENPRU*)

Schedule 1

Record keeping requirements

G

1 The aim of the *guidance* in the following table is to give the reader a quick overall view of the relevant record keeping requirements.

2 It is not a complete statement of those requirements and should not be relied on as if it were.

3 Table

Handbook reference	Subject of Record	Contents of record	When record must be made	Retention Period
<i>GENPRU</i> 1.2.60R – <i>GENPRU</i> 1.2.61R	<i>Firm's</i> assessment of its financial resources	(1) The major sources of risk the <i>firm</i> has identified (2) How the <i>firm</i> intends to deal with those risks (3) Details of the stress and scenario analyses carried out and the resulting financial resources estimated to be required	Not specified	At least three years
<i>GENPRU</i> 1.3.22R	Valuation models for marking to model	Secure copy of <i>firm's</i> own valuation model	When model is in use	Not specified

General prudential sourcebook (*GENPRU*)

Schedule 2

Notification and reporting requirements

G

1 The aim of the *guidance* in the following table is to give the reader a quick overall view of the relevant notification requirements.

2 It is not a complete statement of those requirements and should not be relied on as if it were.

3 Table

Handbook reference	Matter to be notified	Contents of notification	Trigger events	Time allowed
<i>GENPRU</i> 1.5.19R	Intention to change maximum amount of <i>callable contribution</i>	Fact of intention and details of the change	Intention to change the maximum amount	Adequate advance notice, normally not less than 6 months
<i>GENPRU</i> 2.1.11R	Breach or expected breach of <i>GENPRU</i> 2.1.13R or <i>main BIPRU firm Pillar 1 rules</i>	Fact of breach or expectation of breach	Breach or expectation of breach	Immediately
<i>GENPRU</i> 2.2.19R	Intention to deduct <i>illiquid assets</i> rather than <i>material holdings</i>	Fact of intention	Intention to start or stop using method in column 2	One month prior to change of method
<i>GENPRU</i> 2.2.74R	Intention to redeem <i>tier one instrument</i> included in <i>tier one capital resources</i>	Fact of intention	Intention to redeem	At least one month prior to intended redemption
<i>GENPRU</i> 2.2.135R	Intention to include an unusual transaction in capital under <i>GENPRU</i> 2.2.124R	Fact of intention	Intention to include in capital	At least one month prior to inclusion of that capital in <i>capital resources</i>
<i>GENPRU</i>	Proposal to amend a	Details of the	Proposal to	One month

Handbook reference	Matter to be notified	Contents of notification	Trigger events	Time allowed
2.2.171R	tier two instrument	proposed amendment	amend	before amendment is due to take effect
<i>GENPRU</i> 2.2.174R	Intention to repay (other than on contractual repayment date) <i>tier two instrument</i>	Fact of intention and details of how the <i>firm</i> will meet <i>capital resources requirement</i> after such repayment	Intention to repay	Six months or one month prior to repayment
<i>GENPRU</i> 2.2.243R	Intention to pay interest or principal on subordinated debt included in <i>tier three capital resources</i> if the <i>firm's capital resources</i> are less than 120% of its <i>capital resources requirement</i>	Fact of intention	Intention to pay	One month prior to any payment of interest or principal
<i>GENPRU</i> 2.2.245R	Intention to repay (other than on contractual repayment date) <i>tier three capital resources</i>	Fact of intention and details of how the <i>firm</i> will meet its <i>capital resources requirement</i> after such repayment	Intention to repay	One month prior to repayment

General prudential sourcebook (*GENPRU*)

Schedule 3

Fees and other requirement payments

G

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

General prudential sourcebook (*GENPRU*)

Schedule 4

Powers exercised

G

1 The following powers and related provisions in the *Act* have been exercised by the *FSA* to make the rules in *GENPRU*:

- (1) section 138 (General rule-making power);
- (2) section 149 (Evidential provisions);
- (3) section 150(2) (Actions for damages);
- (4) section 156 (General supplementary powers); and
- (5) section 316(1) (Direction by Authority).

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

- (1) section 157(1) (Guidance).

General prudential sourcebook (*GENPRU*)

Schedule 5

Rights of action for damages

G

1. The table below sets out the rules in *GENPRU* contravention of which by an *authorised person* may be actionable under section 150 of the *Act* (Actions for damages) by a person who suffers loss as a result of the contravention.

2. If a "Yes" appears in the column headed "For private person", the rule may be actionable by a private person under section 150 (or, in certain circumstances, his fiduciary or representative; see article 6(2) and (3)(c) of the Financial Services and Markets Act 2000 (Rights of Action) Regulations 2001 (SI 2001/2256)). A "Yes" in the column headed "Removed" indicates that the *FSA* has removed the right of action under section 150(2) of the *Act*. If so, a reference to the rule in which it is removed is also given.

3. The column headed "For other person" indicates whether the rule may be actionable by a person other than a private person (or his fiduciary or representative) under article 6(2) and (3) of those Regulations. If so, an indication of the type of person by whom the rule may be actionable is given.

Chapter/ Appendix	Section/ Annex	Right of action under section 150		
		For private person	Removed	For other person
All rules in <i>GENPRU</i>		No	Yes – <i>GENPRU</i> 1.4.1R	No

General prudential sourcebook (*GENPRU*)

Schedule 6

Rules that can be waived

G

The rules in *GENPRU* may be waived by the *FSA* under section 148 of the *Act* (Modification or waiver of rules). However, if the *rules* incorporate requirements laid down in European directives, it will not be possible for the *FSA* to grant a *waiver* that would be incompatible with the *United Kingdom's* responsibilities under those directives. It therefore follows that if a *rule* in *GENPRU* contains provisions which derive partly from a directive, and partly not, the *FSA* will be able to consider a *waiver* of the latter requirements only, unless the directive provisions are optional rather than mandatory.

**THE PRUDENTIAL SOURCEBOOK FOR BANKS, BUILDING SOCIETIES AND
INVESTMENT FIRMS (TRANSITIONAL PROVISIONS AND SCHEDULES)
INSTRUMENT 2006**

Powers exercised

- A. The Financial Services Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):
- (1) section 138 (General rule-making power);
 - (2) section 149 (Evidential provisions);
 - (3) section 150(2) (Actions for damages);
 - (4) section 156 (General supplementary powers); and
 - (5) section 157(1) (Guidance).
- B. The rule-making powers listed above are specified for the purpose of section 153(2) (Rule-making instruments) of the Act.

Commencement

- C. This instrument comes into force as follows:
- (1) The following provisions of the Prudential sourcebook for Banks, Building Societies and Investment Firms (BIPRU) come into force on 1 November 2007:
 - (a) BIPRU TP 15 (Commodities firm transitionals: Exemption from capital requirements); and
 - (b) BIPRU TP 16 (Commodities firm transitionals: large exposures).
 - (2) The remainder of this instrument comes into force on 1 January 2007.

Amendments to the Handbook

- D. The Financial Services Authority creates a new chapter TP (Transitional provisions) and Schedules to BIPRU in accordance with Annex A to this instrument.

Citation

- E. This instrument may be cited as the Prudential sourcebook for Banks, Building Societies and Investment Firms (Transitional Provisions and Schedules) Instrument 2006.

By order of the Board

23 November 2006

Annex A

Chapter TP of BIPRU and BIPRU Schedules

In this Annex all the text is new and is not underlined.

- TP Transitional provisions
- TP 1 Applicable chapter of IPRU and other general provisions
- Application
- 1.1 R *BIPRU* TP 1 applies to:
- (1) a *BIPRU firm*; and
 - (2) any *firm* to which *BIPRU* 8 (Group risk – consolidation) applies.
- Version of IPRU to be used
- 1.2 R Any reference in *BIPRU* TP to *IPRU* is to the version in force on 31 December 2006.
- Categorisation of *BIPRU* investment firms
- 1.3 R For the purposes of *BIPRU* TP the definitions of *securities and futures firm*, *investment management firm* and *personal investment firm* are amended as follows:
- (1) if a *firm* fell into one of those categories on 31 December 2006 it remains in that category unless changed under (2);
 - (2) if a *firm* has got a *permission* that includes a *requirement* that it comply with the provisions of *BIPRU* TP applicable to one of those categories, that *firm* falls into that category; and
 - (3) a *BIPRU investment firm* that is not an *investment management firm*, *UCITS investment firm* or a *personal investment firm* is a *securities and futures firm*.
- Applicable part of IPRU on a solo basis
- 1.4 R
- (1) This *rule* identifies which part of *IPRU* applies where *BIPRU* TP applies *IPRU* to a *firm* on a solo basis.
 - (2) *IPRU(BANK)* applies to a *bank*.
 - (3) *IPRU(BSOC)* applies to a *building society*.
 - (4) *IPRU(INV)* applies to a *BIPRU investment firm* as follows:
 - (a) Chapter 5 applies to an *investment management firm*;
 - (b) Chapter 7 applies to a *UCITS investment firm*;
 - (c) Chapter 10 applies to a *securities and futures firm*; and

(d) Chapter 13 applies to a *personal investment firm*.

General provisions about consolidation

- 1.5 R Each provision of *BIPRU* TP that applies on a solo basis also applies for the purposes of *BIPRU* 8 (Group risk – consolidation). This is subject to the provisions of *BIPRU* TP concerned.
- 1.6 G Many sections of *BIPRU* TP deal specifically with when and how they apply on a consolidated basis. However *BIPRU* TP will still apply for consolidation purposes even where this is not the case. *BIPRU* TP 1.5R does not apply to *BIPRU* TP 2.1 (Solo consolidation) as solo consolidation is a concept that only applies to solo requirements.

Classification of groups for certain consolidation rules

- 1.7 R (1) This *rule* sets out how to classify a *UK consolidation group* or *non-EEA sub-group* ("group") to which consolidated requirements are applied under certain parts of *BIPRU* TP.
- (2) If the answer to the question at stage 1 of the decision tree in *BIPRU* 8 Annex 5R (Decision tree for identifying the consolidated capital resources requirement of a UK consolidation group or a non-EEA sub-group) with respect to the group is Yes and there is a *building society* in the group, the group is referred to in *BIPRU* TP as a building society group.
- (3) If a *non-EEA sub-group* is part of a *UK consolidation group* that is a building society group then the *non-EEA sub-group* is also a building society group. However a *firm* may use (2) for the purposes of calculating the consolidated capital resources of the *non-EEA sub-group* where capital resources are calculated under *IPRU*.
- (4) If the answer to the question at stage 1 of the decision tree in *BIPRU* 8 Annex 2R with respect to the group is Yes and the group is not a building society group, the group is referred to in *BIPRU* TP as a banking group.
- (5) In any other case the group is referred to in *BIPRU* TP as an investment services group.

- TP 2 Capital floors for a firm using the IRB or AMA approaches
- Application
- 2.1 R Subject to *BIPRU* TP 2.2R, this section applies to a *BIPRU* firm that applies the *IRB approach* or the *advanced measurement approach*.
- 2.2 R *BIPRU* TP 2.30R to *BIPRU* TP 2.34G apply to any firm to which *BIPRU* 8 (Group risk – consolidation) applies and which applies the *IRB approach* or the *advanced measurement approach* on a consolidated basis.
- Purpose
- 2.3 G This section implements Articles 152(1) – (7) of the *Banking Consolidation Directive* and Article 43 of the *Capital Adequacy Directive*.
- 2.4 G The purpose of this section is to limit the amount of capital reduction arising from the implementation of the *Banking Consolidation Directive* and the *Capital Adequacy Directive* compared with the requirements arising from the previous versions of those Directives. As such it is effectively a comparison of the capital resource requirements arising from *BIPRU* with those arising from the appropriate *IPRU* sourcebook that would have applied as at 31 December 2006. However the effect of changes to the market risk requirements is removed by requiring *BIPRU* 7 (Market risk) to be used for both sides of the comparison.
- How to apply the capital floors
- 2.5 G This section does not require a firm to continue to have capital resources equal to a fixed percentage of the capital requirement that applied to it as at 31 December 2006. Instead a firm should apply the requirements in this section to its business as it changes over time. So for example if a firm is calculating its capital requirements as at 31 December 2008 it will have two calculations. The first is carried out under *BIPRU* and *GENPRU*. The second is carried out under *IPRU* and this section. Both sets of requirements are applied to the firm's figures as at 31 December 2008.
- 2.6 G The Directive provisions on which this section is based are written as a floor on a firm's capital resources requirement. This section however is written as a second capital resources requirement that sits beside the general capital resources requirements of *BIPRU* and *GENPRU*. The reason for this is that a firm should meet the general capital resources requirements of *BIPRU* and *GENPRU* using *capital resources* calculated under *GENPRU* 2.2 (Capital resources). On the other hand a firm should meet the capital resources requirements of this section (which are based on *IPRU*) using the relevant *IPRU* definition. In practice the two sets of definitions of capital resources are similar apart from the provisions about *expected loss*. Therefore as shown by the example in *BIPRU* TP 2.12G and *BIPRU* TP 2.13G, in practice a firm is subject to a single capital resources requirement.

- 2.7 G *BIPRU* TP 9 explains how the general principle in this section is applied to a *personal investment firm*.
- Capital floors: solo
- 2.8 R A *firm* calculating *risk weighted exposure amounts* in accordance with the *IRB approach* must during the first, second and third twelve-month periods after 31 December 2006 provide capital resources that equal or exceed the following amounts:
- (1) for the first twelve-month period, 95%;
 - (2) for the second twelve-month period, 90%; and
 - (3) for the third twelve-month period, 80%;
- of the solo capital resources requirement that applies to the *firm* under whichever part of *IPRU* applies under *BIPRU* TP 1.4R.
- 2.9 R A *firm* using the *advanced measurement approach* must, during the second and third twelve-month periods after 31 December 2006, provide capital resources which are at all times more than or equal to the amounts indicated in *BIPRU* TP 2.8R(2) and *BIPRU* TP 2.8R(3).
- Capital resources: solo
- 2.10 R A *firm* must calculate its capital resources in accordance with whichever part of *IPRU* applies under *BIPRU* TP 1.4R.
- 2.11 R Compliance with the requirements of this section must be on the basis of amounts of capital resources fully adjusted to reflect differences in the calculation of capital resources under *IPRU* and the calculation of *capital resources* under *GENPRU* and *BIPRU* deriving from the separate treatments of *expected loss* and *unexpected loss* under the *IRB approach*.
- Explanation of the calculation
- 2.12 G The following provides an illustrative example of the application of this section to a *bank* in a period in which *BIPRU* TP 2.8R(1) applies (i.e. the 95% requirement). Say that under *IPRU*(*BANK*) the *firm's* capital resources requirement would be £8.00mn and this would be met in part by general/collective provisions of £0.5mn. This establishes the capital resources requirement under this section at 95% times (£8.0mn less £0.5mn), which equals £7.125mn.

- 2.13 G Say that in the absence of this section, the Pillar 1 capital resources requirement of the *firm* in *BIPRU* TP 2.12G would be £6.4m, and the sum of value adjustments and provisions are £0.25mn less than *expected losses*. For the purposes of the *expected loss* calculation, if the result is negative (i.e. value adjustments and provisions are less than *expected losses*) that amount is deducted from *capital resources* (which is equivalent to an increase in the *capital resources requirement*). If the result is positive it is added to *capital resources* (which is equivalent to a decrease in the *capital resources requirement*). In this example the result is negative. As the sum of these two amounts (£6.65mn) is still less than the *IPRU* capital resources requirement of £7.125mn, the effect of this section is that the *firm* is subject to the (higher) *IPRU* requirement. If the sum of the *BIPRU* requirements had been greater than £7.125mn, then the *firm* would not have been subject to the capital resources requirement in this section.

Adjustments to the calculation of capital resources

- 2.14 R A *firm* may treat any *capital instrument* that complies with the requirements of *GENPRU* 2.2 (Capital resources) as complying with the corresponding requirements of *IPRU*.
- 2.15 G An example of *BIPRU* TP 2.14R is that a *firm* may treat subordinated debt with a term of five years or over that qualifies as *lower tier two capital* for the purposes of *GENPRU* as complying with the corresponding provisions for five year subordinated debt under *IPRU*.

Market risk

- 2.16 R A *firm* must substitute the requirements in *BIPRU* for the calculation of the *market risk capital requirement* (excluding those provisions to the extent that they would involve using the *IRB approach*) for the corresponding provisions of *IPRU*.
- 2.17 G *BIPRU* TP 4 to *BIPRU* TP 9 (Pre CRD capital requirements applying on a solo basis during 2007) explain which parts of *IPRU* correspond to the *market risk capital requirement*.

CAD 1 model and VaR model

- 2.18 R If a *firm* has a *CAD 1 permission* or a *VaR model permission* it must also use it for the purposes of the capital floor calculations in this section.
- 2.19 G In applying *BIPRU* TP 2.18R, a *firm* should not adjust the *CAD 1 permission approach* or *VaR model approach* (including the scope of the *CAD 1 permission* or *VaR model permission*) so that it is consistent with Directive 93/6 (the Capital Adequacy Directive) as it stood on 31 December 2006.

Individual capital guidance

- 2.20 R The *IPRU* capital resources requirement does not include any individual capital ratio notified to a *bank* under Chapter CO of *IPRU(BANK)* or any similar notification by the *FSA* to any other *firm*.
- 2.21 G Any further capital resource requirements that a *firm* is required to meet under *GENPRU* 1.2 (Adequacy of financial resources) (i.e. Pillar 2) should not be taken into account.
- How to apply IPRU
- 2.22 R If the part of *IPRU* that applies to a *firm* applies different calculations to different types of *firm* the *firm* must use the calculations that it would have to use under *BIPRU* TP 3 (Pre CRD capital requirements applying on a solo basis during 2007).
- 2.23 R If the part of *IPRU* that applies to a *firm* gives the *firm* a choice between methods of calculating capital resources or capital resources requirements it must exercise that choice consistently with the corresponding choices it makes in calculating *capital resources* or *capital resources requirement* under *GENPRU* and *BIPRU*.
- 2.24 G *BIPRU* TP 4 to *BIPRU* TP 9 (Pre CRD capital requirements applying on a solo basis during 2007) explain how concepts in *IPRU* and *GENPRU* map onto the ones in *IPRU*. This will enable a *firm* to decide which calculations it should use for the purposes of *BIPRU* TP 2.22R and *BIPRU* TP 2.23R.
- 2.25 G An example of the effect of *BIPRU* TP 2.22R and *BIPRU* TP 2.23R is that a *securities and futures firm* that calculates its *capital resources* under *GENPRU* 2 Ann 4R (Capital resources table for a *BIPRU* investment firm deducting material holdings) should calculate its capital resources under *IPRU* using table 10-62(2)A of chapter 10 of *IPRU(INV)*.
- 2.26 R For the purpose of calculating the part of the *IPRU* capital resources requirement that corresponds to the *concentration risk capital component* a *firm* may identify the *trading book exposures* on which that requirement is based using *BIPRU* 10 (Concentration risk requirements) except to the extent that *BIPRU* 10 involves the *IRB approach*.
- 2.27 G The *concentration risk capital component* is the capital requirement for a *firm* that chooses to have *trading book exposures* that exceed the concentration risk limits for the *non-trading book*. In most cases *IPRU* has a similar capital requirement. The purpose of *BIPRU* TP 2.26R is to allow a *firm* to calculate the amount of the excess *trading book exposures* for which it calculates the additional capital charge using *BIPRU* 10 (Concentration risk requirements) in order to avoid having to apply the *IPRU* large exposure requirements for this purpose only.
- 2.28 R The calculations under this section do not take into account the *base capital resources requirement* or the part of the *IPRU* solo capital resources requirement that corresponds to the *base capital resources requirement*.

Solo consolidation

- 2.29 R If a *firm* has a *solo consolidation waiver* it also applies for the purpose of this section in place of any corresponding provision of *IPRU*.

Capital floors: consolidation

- 2.30 R If a *firm* calculates *risk weighted exposure amounts* on a consolidated basis in accordance with the *IRB approach* or uses the *advanced measurement approach* on a consolidated basis, *BIPRU* TP 2.8R to *BIPRU* TP 2.27G apply on a consolidated basis in accordance with *BIPRU* TP 2.30R to *BIPRU* TP 2.31R.
- 2.31 R A *firm* must calculate the consolidation requirements under *BIPRU* TP 2.30R for the group in question (the group in question is specified in *BIPRU* TP 2.32R) in accordance with the following:
- (1) if the group is a banking group as defined in *BIPRU* TP 1.7R (Classification of groups for certain consolidation rules), the consolidation provisions of *IPRU(BANK)* apply;
 - (2) if the group is a building society group as defined in *BIPRU* TP 1.7R, the consolidation provisions of *IPRU(BSOC)* apply; and
 - (3) if the group is an investment firm group as defined in *BIPRU* TP 1.7R, chapter 14 of *IPRU(INV)* applies.
- 2.32 R The scope of the consolidation under *BIPRU* TP 2.30R and any exemption from consolidation is determined in accordance with *BIPRU* 8 (Group risk – consolidation) rather than *IPRU*. In particular, the following adjustments apply:
- (1) if a *firm* is a member of a *UK consolidation group* and applies the *IRB approach* or the *AMA* with respect to that *UK consolidation group*, *BIPRU* TP 2.30R applies with respect to that *UK consolidation group*; and
 - (2) if a *firm* is a member of a *non-EEA sub-group* and applies the *IRB approach* or the *AMA* with respect to that *non-EEA sub-group*, *BIPRU* TP 2.30R applies with respect to that *non-EEA sub-group*.
- 2.33 G If for example the consolidation *rules* that apply for the purposes of this section are those in chapter 14 of *IPRU(INV)* (Consolidated supervision of *investment firms*) then *IPRU(INV)* 14.1 (Application) and 14.2 (Scope of consolidation) do not apply. *BIPRU* 8.2 (Scope and basic consolidation requirements for UK consolidation groups), *BIPRU* 8.3 (Scope and basic consolidation requirements for non-EEA sub-groups), *BIPRU* 8.4 (CAD Article 22 groups and investment firm consolidation waiver) and *BIPRU* 8.5 (Basis of consolidation) apply instead.

Capital floors: waiver from consolidation

- 2.34 G If a *firm* has an *investment firm consolidation waiver* and it is applying the *IRB approach* or the *AMA*, the *waiver* will explain how the *investment firm consolidation waiver* applies for the purpose of this section.

- TP 3 Pre CRD capital requirements applying on a solo basis during 2007
- Application
- 3.1 R This section applies to a *BIPRU firm*.
- Purpose
- 3.2 G This section (together with *BIPRU TP 4 - BIPRU TP 10*) implements Articles 152(8) – (14) of the *Banking Consolidation Directive* and Article 50(1) of the *Capital Adequacy Directive*.
- Duration of transitional
- 3.3 R This section applies until 1 January 2008.
- Continued use of IPRU
- 3.4 R Unless a *firm* notifies the *FSA* to the contrary, a *firm* must use on a solo basis the credit risk *rules* in whichever part of *IPRU* applies to it under *BIPRU TP 1.4* rather than the ones in *BIPRU*.
- 3.5 R *BIPRU TP 3.8R* sets out, for all types of *firm*, which parts of *GENPRU* and *BIPRU* do and do not apply when *BIPRU TP 3.4R* applies.
- 3.6 G *BIPRU TP 4 - BIPRU TP 9* set out, for each category of *BIPRU firm*, which sections of the part of *IPRU* that applies to it do and do not apply during 2007 as follows:
- (1) *BIPRU TP 4* applies to a *bank*;
- (2) *BIPRU TP 5* applies to a *building society*;
- (3) *BIPRU TP 6* applies to an *investment management firm*;
- (4) *BIPRU TP 7* applies to a *UCITS investment firm*;
- (5) *BIPRU TP 8* applies to a *securities and futures firm*; and
- (6) *BIPRU TP 9* applies to a *personal investment firm*.
- 3.7 G *BIPRU TP 10* explains how this section is applied on a consolidated basis.
- Disapplication of GENPRU and BIPRU
- 3.8 R Table: Parts of *GENPRU* and *BIPRU* that apply in 2007
This table belongs to *BIPRU TP 3.5R*

GENPRU and BIPRU provisions		A Y denotes that the provision does apply An N denotes that it does not apply
GENPRU TP (Transitional provisions)		Y
GENPRU 1.1 (Application and scope)		Y
GENPRU 1.2 (Adequacy of financial resources)	The <i>overall financial adequacy rule</i>	Y
	GENPRU 1.2 so far as it applies to liquidity risk	Y
	The rest of GENPRU 1.2 for purposes other than liquidity risk	N
GENPRU 1.3 (Valuation)		Y
GENPRU 1.4 (Actions for damages)		Y
GENPRU 1.5 (Application of GENPRU 1 to Lloyd's)		Not applicable as does not apply to <i>BIPRU firms</i>
GENPRU 2.1 (Calculation of capital resources requirements)		Y
GENPRU 2.2 (Capital resources)		Y
GENPRU 2.3 (Application of GENPRU 2 to Lloyd's)		Not applicable as does not apply to <i>BIPRU firms</i>
GENPRU 3.1 (Cross sector groups)		Y
GENPRU 3.2 (Third-country groups)		Y
BIPRU TP (Transitional provisions)		Y
BIPRU 1.1 (Application and scope)		Y

GENPRU and BIPRU provisions		A Y denotes that the provision does apply An N denotes that it does not apply
<i>BIPRU</i> 1.2 (Definition of the trading book)		Y
<i>BIPRU</i> 1.3 (Application for advanced approaches)		Y
<i>BIPRU</i> 1.4 (Actions for damages)		Y
<i>BIPRU</i> 2.1 (Solo consolidation)		Y
<i>BIPRU</i> 2.2 (Adequacy of financial resources)		N
<i>BIPRU</i> 2.3 (Interest rate risk in the non-trading book);		N
<i>BIPRU</i> 3 (Standardised approach to credit risk)		N
<i>BIPRU</i> 4 (The IRB approach)		N
<i>BIPRU</i> 5 (Credit risk mitigation)		N
<i>BIPRU</i> 6 (Operational risk)		N
<i>BIPRU</i> 7 (Market risk)	<i>BIPRU</i> 7.2.43R to <i>BIPRU</i> 7.2.49R (Interest rate specific risk calculation)	N (<i>BIPRU</i> TP 4 - <i>BIPRU</i> TP 9 set out what applies in place of these <i>rules</i>)
	<i>BIPRU</i> 7.11.18R to <i>BIPRU</i> 7.11.58R (Special treatment of credit default swaps)	N
	Rest of <i>BIPRU</i> 7	Y
<i>BIPRU</i> 8 (Group risk – consolidation)		Y
<i>BIPRU</i> 9 (Securitisation)		N
<i>BIPRU</i> 10 (Concentration risk)	<i>BIPRU</i> 10.5.2R to <i>BIPRU</i> 10.5.5R (Capital resources)	Y

GENPRU and BIPRU provisions		A Y denotes that the provision does apply An N denotes that it does not apply
	<i>BIPRU</i> 10.5.14R (Notification of trading book excesses)	Y Only applies if <i>BIPRU</i> TP 4 to <i>BIPRU</i> TP 10 allow excess exposures in the trading book.
	The rest of <i>BIPRU</i> 10	N
<i>BIPRU</i> 11 (Disclosure)		N
<i>BIPRU</i> 12		Chapter does not yet exist
<i>BIPRU</i> 13 (Financial derivatives, SFTs and long settlement transactions)		N
<i>BIPRU</i> 14 (Capital requirements for settlement and counterparty risk)		N
This table is subject to the adjustments set out in <i>BIPRU</i> TP 3.15R to <i>BIPRU</i> TP 3.21R when a firm also uses the <i>IRB</i> approach.		

Application of BIPRU concentration risk rules for underwriting

- 3.9 G Even though *BIPRU* 10 (Concentration risk) does not apply, the provisions in *BIPRU* 7.8 (Securities underwriting) about the calculation of the *net underwriting exposures* still apply.

How to interpret cross-references

- 3.10 R If a provision in *BIPRU* or *GENPRU* that applies under this section refers to a provision of *BIPRU* or *GENPRU* that does not apply that reference must be read as referring to the *IPRU* provision that applies instead under this section (if any). If a provision in *IPRU* that applies under this section refers to a provision of *IPRU* that does not apply that reference must be read as referring to the corresponding provision in *BIPRU* or *GENPRU* that applies under this section.
- 3.11 G *BIPRU* TP 4 - *BIPRU* TP 9 set out, for each category of *BIPRU* firm, some of the main examples of the sort of cross-references referred to in *BIPRU* TP 3.10R.
- 3.12 G *GENPRU* 2.2.187R and *GENPRU* 2.2.188R (Upper tier two capital: General/collective provisions) still applies to a firm that uses *BIPRU* TP 3.4R. The reference to the sum of *risk-weighted* assets under the *standardised approach* for credit risk should be read as being to the sum of risk-weighted assets under the provisions of *IPRU* that apply under this section.

Combination of IPRU with the standardised approach to credit risk

- 3.13 R A firm may not combine the *standardised approach* to credit risk with the use of *IPRU* under *BIPRU* TP 3.4R.

Effect of switching off GENPRU 1.2

- 3.14 G If *GENPRU* 1.2 (Adequacy of financial resources) does not apply to a firm, stress and scenario testing obligations in other parts of the *Handbook* still apply. In particular these include stress and scenario tests required under the *IRB approach* (see in particular *BIPRU* 4.3.39R to *BIPRU* 4.3.42G (Stress tests used in assessment of capital adequacy) and *BIPRU* 2.2.41R to *BIPRU* 2.2.45G), under the *VaR model approach* and under *BIPRU* 10.6.22R to *BIPRU* 10.6.27G (Stress testing of credit risk concentrations).

Continued use of IPRU combined with the IRB approach

- 3.15 R *BIPRU* TP 3.16R to *BIPRU* TP 3.21R only apply to a firm that is applying the *IRB approach* as well as using *IPRU*.
- 3.16 R If a firm's *IRB permission* allows it to do this, a firm may combine the *IRB approach* with the use of *IPRU* under *BIPRU* TP 3.4R.

- 3.17 G If an *exposure* comes within the scope of a *firm's IRB permission* the *firm* should use the *IRB approach* to calculate the *credit risk capital component* and the *counterparty risk capital component* with respect to that *exposure* in accordance with *BIPRU* rather than *IPRU*. In particular *BIPRU 4* (The *IRB approach*), *BIPRU 5* (Credit risk mitigation), *BIPRU 9* (Securitisation), *BIPRU 13* (Financial derivatives, SFTs and long settlement transactions) and *BIPRU 14* (Capital requirements for settlement and counterparty risk) apply.
- 3.18 R If a *firm* combines the *IRB approach* with the use of *IPRU* under *BIPRU TP 3.14R*, the disapplication of *BIPRU 10* (Concentration risk) still applies. However in the case of *exposures* to which the *firm* applies the *IRB approach*:
- (1) *BIPRU 10.6.14R* to *BIPRU 10.6.26* (Exemptions for firms using the financial collateral comprehensive approach, Exemptions for firms using own estimates of LGDs and conversion factors under the *IRB approach* and Stress testing of credit risk concentrations) apply;
 - (2) a *firm* may not recognise *credit risk mitigation* if it does not comply with *BIPRU 5* and *BIPRU 4.10* (Credit risk mitigation) to the extent they apply to *BIPRU 10*; and
 - (3) *BIPRU 5* and *BIPRU 4.10* apply for the purpose of calculating the amount of *credit risk mitigation* to the extent that they apply to *BIPRU 10*.
- 3.19 R *BIPRU 11* (Disclosure) applies to *exposures* to which the *firm* applies the *IRB approach*. The rest of *BIPRU 11* also applies except to the extent that it relates to parts of *BIPRU* and *GENPRU* that do not apply under this section.
- 3.20 R *BIPRU 7.11.18R* to *BIPRU 7.11.58R* (Special treatment of credit default swaps) apply to *exposures* subject to the *IRB approach*.
- Reduced operational risk capital requirement
- 3.21 R Where *BIPRU TP 3.4R* applies, the *operational risk capital requirement* is reduced by the percentage representing the ratio of the value of the *firm's exposures* for which capital requirements are calculated in accordance with *BIPRU TP 3.4R* to the total value of its *exposures*.

- TP 4 Pre CRD capital requirements applying on a solo basis during 2007: Banks Application
- 4.1 R *BIPRU* TP 4 applies to a *BIPRU firm* that is:
- (1) a *bank*; and
 - (2) applying *BIPRU* TP 3.4R (Pre CRD capital requirements applying on a solo basis during 2007).
- Purpose of this section
- 4.2 G *BIPRU* TP 3 (Pre CRD capital requirements applying on a solo basis during 2007) says that during 2007 a *firm* may apply the credit risk requirements of *IPRU* instead of the ones in *BIPRU*. For a *bank* this involves applying the credit risk requirements in *IPRU(BANK)*. This section explains how this is done. In particular *BIPRU* TP 4 explains:
- (1) which parts of *IPRU(BANK)* should be treated as credit risk requirements for this purpose;
 - (2) what parts of *IPRU(BANK)* apply during 2007 and what changes are made to *IPRU(BANK)* for that purpose; and
 - (3) what changes are made to *GENPRU* and *BIPRU* to reflect the fact that *IPRU(BANK)* applies in place of parts of *GENRU* and *BIPRU*.
- Duration of transitional
- 4.3 R This section applies until 1 January 2008.
- Drafting approach in this section
- 4.4 G The purpose of *BIPRU* TP 3 (Pre CRD capital requirements applying on a solo basis during 2007) is that the basic provisions of *BIPRU* and *GENPRU* should be in force from 1 January 2007. However a *firm* should be able to calculate the capital requirements for credit risk under *IPRU* and use the large exposures requirements in *IPRU*. This means that a *bank* should slot the credit risk requirements of *IPRU(BANK)* into the general requirements of *GENPRU* and *BIPRU*.
- 4.5 G The capital calculation for credit risk under *BIPRU* is made up of three elements, which are set out in *GENPRU* 2.1.51R (Calculation of the credit risk capital requirement). These are the *credit risk capital component*, the *counterparty risk capital component* and the *concentration risk capital component*. So the approach in *BIPRU* TP 4.4G involves finding equivalents for these three elements in *IPRU(BANK)*.

- 4.6 G *BIPRU* TP 3.8R (Parts of *GENPRU* and *BIPRU* that apply in 2007) provides that *GENPRU* 2.2 (Capital resources) applies during 2007. So a *bank* using *BIPRU* TP 3.4R (Pre CRD capital requirements applying on a solo basis during 2007) should calculate its *capital resources* under *GENPRU* 2.2, instead of calculating its capital under *IPRU(BANK)*.

Parts of *IPRU(BANK)* that apply in 2007: Chapter GN

- 4.7 R The parts of Chapter GN of *IPRU(BANK)* that do and do not apply during the period that *BIPRU* TP 3.4R applies are as set out in *BIPRU* TP 4.8R.
- 4.8 R Table: Parts of Chapter GN of *IPRU(BANK)* that apply in 2007
This table belongs to *BIPRU* TP 4.7R

Provisions of Chapter GN of <i>IPRU(BANK)</i>	A Y denotes that the provision does apply An N denotes that it does not apply	Remarks
GN 3.3.19R to GN 3.3.20G (requirement to have adequate systems and controls for monitoring, controlling and calculating LE)	Y	
GN 3.3.21R to GN 3.3.22G (requirement to notify FSA if breach or propose to breach the 25% limit)	Y	Solo consolidation is dealt with by <i>BIPRU</i> 2.1 (Solo consolidation)
GN 3.4.1R to GN 3.4.2G (requirement to have written policy statement for LE)	Y	
GN 3.4.5R to GN 3.4.6G (requirement to have written provisioning policy statement)	Y	The reference to <i>rule</i> 3.3.17 is replaced by a reference to the requirements in <i>GENPRU</i> 1.3.4R (General requirements: Accounting principles to be applied)

Provisions of Chapter GN of <i>IPRU(BANK)</i>	A Y denotes that the provision does apply An N denotes that it does not apply	Remarks
GN 3.4.9E to GN 3.4.12R (Policy statement procedures)	Y	Applies in relation to large exposures and provisioning policy statements
GN 3.5.1R (Definitions)	Y	Applies for the purpose of the provisions that continue in force under this table
GN 3.6.1 R (Transitional rule for policy statements)	Y	Applies in relation to large exposures and provisioning policy statements
The parts of Chapter GN that remain in force even if the <i>bank</i> is not applying <i>BIPRU</i> TP 3.4R (Pre CRD capital requirements applying on a solo basis during 2007)	Y	See in particular <i>rules</i> 3.4.3 and 3.4.9 (Liquidity policy statement)
Rest of Chapter GN	N	
A <i>bank</i> must calculate its capital for the purposes of the <i>rules</i> in this table about large exposures in accordance with <i>BIPRU</i> 10.5.2R to <i>BIPRU</i> 10.5.5R (Capital resources for concentration risk purposes).		

Parts of *IPRU(BANK)* that apply in 2007

- 4.9 G The parts of *IPRU(BANK)* that do and do not apply during the period that *BIPRU* TP 3.4R applies are as set out in *BIPRU* TP 4.11G. This section does not explain what parts of *IPRU(BANK)* do and do not apply to an overseas *bank* as this section only applies to a *bank* that is a *BIPRU firm*.
- 4.10 G The table in *BIPRU* TP 4.11G assumes that the *firm* is not applying the *IRB approach*. *BIPRU* TP 4.40G to *BIPRU* TP 4.43G deal with a *firm* that does apply the *IRB approach*.

4.11 G Table: Parts of IPRU(BANK) that apply in 2007
This table belongs to *BIPRU* TP 4.9G

Provisions of <i>IPRU(BANK)</i>	A Y denotes that the provision does apply An N denotes that it does not apply		Remarks
GN (General)	See the table in <i>BIPRU</i> TP 4.8R		
CO (Capital Adequacy Overview)	Sections 1-3	Y	
	Section 4	N	
CB (Trading Book/Banking Book Division)	N		
CA (Definition of Capital)	N		
BC (Credit Risk in the Banking Book)	Y		
BO (Proxies for Market Risk in Banking Book)	Y		
FX (Foreign Exchange Risk)	N		
CM (Commodities Risk)	N		
DU (Common Treatments for Counterparty Risk)	Y		
TI (Interest Rate Position Risk)	N		
TE (Equity Position Risk)	N		
TC (Counterparty Risk in the Trading Book)	Y		
TL (Incremental Capital for Large Exposures)	Y		
TU (Underwriting in Capital Adequacy Framework)	N		

Provisions of <i>IPRU(BANK)</i>	A Y denotes that the provision does apply An N denotes that it does not apply	Remarks
TS (CAD 1 Models)	N	
TV (The Use of Internal Models)	N	
LE (Large Exposures)	Y	
CD (Credit Derivatives)	Y	<p>(1) Applies for the purpose of credit risk (the calculation of the <i>credit risk capital requirement</i>)</p> <p>(2) Applies for the purpose of large exposures to the extent set out in the chapter.</p> <p>(3) Does not apply for the purpose <i>position risk</i> (calculation of the <i>market risk capital requirement</i>).</p>
SE (Securitisation and Asset Transfers)	Y	See <i>BIPRU TP 4.17G</i> to <i>BIPRU TP 4.19G</i>
LM (Mismatch Liquidity)	Y	Subject to the other provisions of this section, applies in the same way as it does for a <i>bank</i> that does not use <i>BIPRU TP 3.4R</i> (Pre CRD capital requirements applying on a solo basis during 2007).

Provisions of <i>IPRU(BANK)</i>	A Y denotes that the provision does apply An N denotes that it does not apply		Remarks
LS (Sterling Stock Liquidity)	Y		Subject to the other provisions of this section, applies in the same way as it does for a <i>bank</i> that does not use <i>BIPRU</i> TP 3.4R (Pre CRD capital requirements applying on a solo basis during 2007).
AR (Accounting and Other Records and Internal Control Systems)	N		
ST (Foreign Exchange -Risk-Based Supervision)	N		
FR (Fraud)	N		
CL (Comfort letters)	N		
VA (Valuation)	Section 4	Y	(1) Applies for the purpose of credit risk (the calculation of the <i>credit risk capital requirement</i>) (2) Applies for the purpose of large exposures to the extent set out in the chapter.
	Rest	N	

Provisions of <i>IPRU(BANK)</i>	A Y denotes that the provision does apply An N denotes that it does not apply	Remarks
NE (Collateral and Netting)	Y	(1) Applies for the purpose of credit risk (the calculation of the <i>credit risk capital requirement</i>) (2) Applies for the purpose of large exposures to the extent set out in the chapter.
CS (Consolidated Supervision)	Paragraph 2b) of Section 3	Y (1) Applies to the extent it provides for zero risk weighting for intra-group exposures on a solo basis. (2) Applies for the purpose of the exemption for certain intra-group exposures for large exposure purposes on a solo basis (see paragraph 7 of section 9.2.2 of chapter LE of <i>IPRU(BANK)</i>). (3) Otherwise does not apply.

Provisions of <i>IPRU(BANK)</i>	A Y denotes that the provision does apply An N denotes that it does not apply		Remarks
	Appendices C and D (equivalent third country prudential regimes)	Y	Only has effect to extent that these apply on a solo basis for the purposes of the parts of <i>IPRU(BANK)</i> that apply under this table. In particular applies for the purposes of <i>IPRU(BANK)</i> BC Section 3 paragraph 6 (f) a) regarding equivalent CAD regimes.
	Rest	N	
OS (Outsourcing)	N		
PN (Provisioning Policy Statement)	Y		

General material about the parts of *IPRU(BANK)* that apply in 2007

- 4.12 G Many of the chapters of *IPRU(BANK)* that apply under the table in *BIPRU* TP 4.11G (particularly the application sections) deal with the application of the material on a consolidated basis. However this does not apply for the purpose of this section as consolidation is dealt with under *BIPRU* TP 10 (Pre CRD capital requirements applying on a consolidated basis during 2007). Likewise those provisions also deal with solo consolidation but this material does not apply either as the provisions about solo consolidation in *IPRU(BANK)* do not apply for the purpose of this section. Nevertheless it is possible to combine the use of this section with solo consolidation under *BIPRU* 2.1 (Solo consolidation).

Status of material on credit risk charges

- 4.13 G The credit risk provisions of *IPRU(BANK)* are mostly *guidance* on rule 3.3.13 of Chapter GN of *IPRU(BANK)*. That *rule* does not apply in 2007. When the credit risk provisions of *IPRU(BANK)* are applied under this section they are *guidance* on the *overall financial adequacy rule*. In turn the *overall financial adequacy rule* is the *rule* on which the calculation of the capital requirements for credit risk under *GENPRU* and *BIPRU* is based for a *bank* under this section.

How to calculate credit risk charges

- 4.14 G A *bank* should calculate the *BIPRU* credit risk charge for *non-trading book* items, called the *credit risk capital component*, by adding together the following:
- (1) the capital charge calculated under Chapter BC (taking into account the revised risk weights in Chapter BO);
 - (2) the capital charge for OTC derivatives in the banking book under section 3 of Chapter DU
 - (3) the capital charge for free deliveries for banking book items in section 4 of Chapter DU; and
- 4.15 G A *bank* should calculate the *BIPRU* credit risk charge for *trading book* items, called the *counterparty risk capital component*, by adding together the following:
- (1) the capital charge calculated under Chapter TU;
 - (2) the capital charge for OTC derivatives in the trading book under section 3 of Chapter DU;
 - (3) the capital charge for unsettled transactions and free deliveries for trading book items in section 4 of Chapter DU; and
 - (4) the capital charge for unsettled transactions in the banking book calculated under Chapter TU (the calculation of the *counterparty risk capital component* includes a capital charge for unsettled transactions in the *non-trading book* as an exception to the principle that the *counterparty risk capital component* relates to the *trading book*).
- 4.16 G *BIPRU* TP 4.28G deals with how to calculate the *concentration risk capital component*.

Adjustments to securitisation requirements

- 4.17 G Under Chapter SE a *bank* should deduct certain credit enhancements from capital. A *bank* should deduct these credit enhancements at stage M of the calculation in the *capital resources table* (Deductions from the totals of tier one and two).
- 4.18 G Paragraph 6 of section 10.4 of Chapter SE of *IPRU(BANK)* says that if a *bank* does not meet the policy on liquidity facilities provided by sponsors or repackagers it should fully consolidate the scheme. This does not apply under this section. Instead a *bank* should treat the scheme assets as being on its balance sheet.
- 4.19 G The definition of investment grade for the purposes of Chapter SE (see in particular sections 3.2.2, 9.3 and 11.1) remains based on Chapter TI of *IPRU(BANK)*.

Adjustments to counterparty credit risk: General

- 4.20 G Broadly speaking the Directive transitional provisions that allow pre-2007 credit risk rules to be used in 2007 cover all credit risk rules. However the transitional provisions for *trading book* credit risk (Annex II of the *Capital Adequacy Directive*, which is implemented in *BIPRU 14* (Capital requirements for settlement and counterparty risk)) is not quite as straightforward as that. In some cases pre-2007 requirements can be used. In others they cannot. One of the purposes of *BIPRU TP 4.21G* to *BIPRU TP 4.25G* is to reflect those cases in which the Directive requires the new requirements to apply from 1 January 2007.

Adjustments to counterparty credit risk: Free deliveries

- 4.21 G A *bank* should include *foreign currency* and *commodity* transactions in the calculations under *IPRU(BANK)* Chapter DU section 4.2 (Free deliveries).
- 4.22 G A *bank* should apply the capital treatment in the table in *BIPRU 14.4.3R* and *BIPRU 14.4.4R* (Capital treatment for free deliveries). But when the capital treatment in that table is that the *firm* must treat the transaction as an *exposure*, the *bank* should apply the treatment in *IPRU(BANK)* Chapter BC for *non-trading book exposures* or TC for *trading book exposures* rather than *BIPRU 14* (Capital requirements for settlement and counterparty risk).

Adjustments to counterparty credit risk: Derivative transactions

- 4.23 G A *bank* should treat a credit derivative in the *trading book* as a derivative to which section 3 of *IPRU(BANK)* Chapter TC (OTC derivatives) applies. However the capital treatment for credit derivatives as set out in *BIPRU 14.2.5R* - *BIPRU 14.2.8R* (Capital treatment for credit derivatives) does not apply; a *bank* should continue to use the treatment in *IPRU(BANK)* as adjusted by this section.

Adjustments to counterparty credit risk: Unsettled transactions

- 4.24 G The alternative treatment set out in *IPRU(BANK)* DU 4.1.3 does not apply.
- 4.25 G A *bank* should include *foreign exchange* and *commodity* transactions in the calculations under *IPRU(BANK)* Chapter DU section 4.1 (Unsettled transactions).
- OTC derivatives
- 4.26 G The treatment in section 3 of Chapter DU applies to the derivatives mentioned there whether or not they are off-balance sheet.
- How to use the *IPRU(BANK)* large exposure rules
- 4.27 G *IPRU(BANK)* Chapter LE (Large exposures) applies in place of *BIPRU* 10 (Concentration risk).
- 4.28 G A *bank* should calculate the *concentration risk capital component* as being equal to the capital charge under *IPRU(BANK)* Chapter TL.
- 4.29 G *BIPRU* 10.5.2R to *BIPRU* 10.5.5R (Capital resources for concentration risk purposes) apply in place of the corresponding provisions of *IPRU(BANK)*. The provisions in *IPRU(BANK)* about the calculation of the large exposures capital base (LECB) do not apply.
- 4.30 G Generally a *bank* should use the specific risk weights that apply under *BIPRU* 7 (Market risk) for the purposes of the incremental capital calculation under section 2.2 of Chapter TL and the net trading book position under paragraph 2(b) of section 7 of Chapter LE. However *BIPRU* TP 4.33G also applies for these purposes.
- 4.31 G References in paragraph 4(d) of section 9.2.1 and paragraph 7 of section 9.2.2 of Chapter LE to the requirements in Chapter CS about zero-risk weighting intra-group exposures still apply.
- 4.32 G When Chapter LE of *IPRU(BANK)* is applied under this section it is *guidance* on the *overall financial adequacy rule* as well as on the relevant provisions of Chapter GN of *IPRU(BANK)*.
- Interest rate PRR
- 4.33 G A *bank* should use *IPRU(BANK)* as it applies under *BIPRU* TP 3 (Pre CRD capital requirements applying on a solo basis during 2007) and *BIPRU* TP 4 to calculate the *specific risk* portion of the *interest rate PRR* under *BIPRU* 7.2 (Interest rate PRR) to the extent that the relevant *rules* in *BIPRU* 7.2 require the use of the *standardised approach* to credit risk.

- 4.34 G The reason for *BIPRU* TP 4.33G is that the calculation of the *specific risk* portion of the *interest rate PRR* under *BIPRU* 7 (Market risk) involves the use of the *standardised approach* to credit risk. The *specific risk rules* therefore need to be adjusted for a *firm* that is not using the *standardised approach* to credit risk in 2007 so as to apply the pre-2007 method of calculating *specific risk*.

Valuation

- 4.35 G *BIPRU* TP 3.8R (Parts of *GENPRU* and *BIPRU* that apply in 2007) says that *GENPRU* 1.3 (Valuation) applies during 2007, so the values of assets and off balance sheet items used in the calculation of credit risk charges should be in accordance with *GENPRU* 1.3.

Definitions

- 4.36 G Any reference to a *qualifying debt security* or *qualifying equity* in a part of *BIPRU* that applies during 2007 should be interpreted in accordance with *IPRU(BANK)*. However *BIPRU* 7.2.50R (Must not apply *qualifying debt security* treatment to risky assets) also applies.

- 4.37 G The reason for *BIPRU* TP 4.36G is that the *BIPRU* definitions rely in part on the *standardised approach* to credit risk. The definitions therefore need to be adjusted for a *bank* that is not using the *standardised approach* to credit risk in 2007.

Mapping *GENPRU* and *BIPRU* concepts onto *IPRU*

- 4.38 G Some of the parts of *IPRU(BANK)* that apply in 2007 refer to parts of *IPRU* that do not apply. *BIPRU* TP 3.10R explains that where this happens a *firm* should interpret that cross-reference in accordance with the provision in *BIPRU* or *GENPRU* that corresponds to the *IPRU* provision that does not apply in 2007. A *firm* should refer to *IPRU* in the case of cross-references in *GENPRU* and *BIPRU* to provisions in *GENPRU* and *BIPRU* that do not apply in 2007. *BIPRU* TP 4.39G sets out how certain concepts in *IPRU(BANK)* correspond to ones in *GENPRU* and *BIPRU*. The purpose of the table is to help *firms* to interpret such cross-references.

- 4.39 G Table: Mapping *GENPRU* and *BIPRU* concepts onto ones in *IPRU(BANK)*
This table belongs to *BIPRU* TP 4.38G

<i>GENPRU</i> and <i>BIPRU</i>	<i>IPRU(BANK)</i>
<i>BIPRU</i> 1.2	Chapter CB
<i>GENPRU</i> 2.2	Chapter CA
<i>BIPRU</i> 7.2	Chapter TI

<i>GENPRU and BIPRU</i>	<i>IPRU(BANK)</i>
<i>BIPRU 7.3</i>	Chapter TE
<i>BIPRU 7.8</i>	Chapter TU
<i>BIPRU 7.4</i>	Chapter CM
<i>BIPRU 7.5</i>	Chapter FX
<i>BIPRU 7.10</i>	Chapter TV
<i>BIPRU 8</i>	Chapter CS
<i>GENPRU 1.3</i>	Chapter VA
<i>Market risk capital component (excluding charges arising from FX and commodity banking book business) and the counterparty risk capital component, excluding unsettled transactions arising from the banking book.</i>	Trading book capital requirements
<i>Non-trading book</i>	Banking book
<i>Trading book</i>	Trading book
<i>Capital resources calculated under BIPRU 10.5.2R to BIPRU 10.5.5R</i>	Large exposures capital base (LECB)
<i>Concentration risk capital component or the capital resources used to meet it</i>	Incremental capital under Chapter TL
<i>Financial derivative instruments and trading book credit derivatives</i>	OTC derivatives
<i>the overall financial adequacy rule</i>	<i>Rule GN 3.3.13R (Adequate capital)</i>
<i>individual capital guidance</i>	Individual capital ratio
<i>Bank that calculates its capital requirements under BIPRU 1.2.17R (Firm with small trading book using non-trading book treatments for certain trading book items)</i>	<i>Bank to which the Capital Adequacy Directive does not apply</i>
<i>trading book concentration risk excess</i>	Exposures over the 25% in the trading book under Chapter TL

Firms using the IRB approach during 2007: General

- 4.40 G *BIPRU* TP 4.41G to *BIPRU* TP 4.43G only apply to a *firm* that is applying the *IRB approach* under *BIPRU* TP 3 (Pre CRD capital requirements applying on a solo basis during 2007) as well as using *IPRU*.
- 4.41 G The effect of *BIPRU* TP 3.17G (Pre CRD capital requirements applying on a solo basis during 2007 for *firms* also using the *IRB approach*) is that neither credit risk or counterparty risk requirements of *IPRU(BANK)* apply to an *exposure* to which the *firm* applies the *IRB approach*. The *IRB approach* requirements in *BIPRU* apply instead. The main requirements are listed in *BIPRU* TP 3.17G.
- 4.42 G A *firm* should apply *BIPRU* 7.2.45R - *BIPRU* 7.2.47R (Using internal ratings to calculate *specific risk* and treatment of *securitisations*) to calculate the *specific risk* portion of the *interest rate PRR* to the extent that the obligor or *exposure* in question comes within the scope of its *IRB permission*.
- 4.43 G The definitions of *qualifying debt security* and *qualifying equity* in the *Glossary* apply if the security or obligor in question comes within the scope of a *firm's IRB permission*.

- TP 5 Pre CRD capital requirements applying on a solo basis during 2007:
Building societies
- Application
- 5.1 R This section applies to a *building society* that is applying *BIPRU* TP 3.4R (Use of *IPRU* on a solo basis during 2007).
- Purpose of this chapter
- 5.2 G *BIPRU* TP 3 (Pre CRD capital requirements applying on a solo basis during 2007) says that during 2007 a *firm* may apply the credit risk requirements of *IPRU* instead of the ones in *BIPRU*. For a *building society* this involves applying the credit risk requirements in *IPRU(BSOC)*. This section explains how this is done. In particular this section explains what parts of *IPRU(BSOC)* apply during 2007 and what changes are made to *IPRU(BSOC)* for that purpose.
- Duration of transitional
- 5.3 R This section applies until 1 January 2008.
- Drafting approach in this chapter
- 5.4 G The purpose of *BIPRU* TP 3 (Pre CRD capital requirements applying on a solo basis during 2007) is that the basic provisions of *BIPRU* and *GENPRU* should be in force from 1 January 2007. However a *firm* should be able to calculate the capital requirement for credit risk under *IPRU* and use the large exposures requirements in *IPRU*. This means that a *building society* should slot the credit risk requirements of *IPRU(BSOC)* into the general requirements of *GENPRU* and *BIPRU*.
- 5.5 G The capital calculation for credit risk under *BIPRU* is made up of three elements, which are set out in *GENPRU* 2.1.51R (Calculation of the credit risk capital requirement). These are the *credit risk capital component*, the *counterparty risk capital component* and the *concentration risk capital component*. So the approach in *BIPRU* TP 5.4G involves determining which of these three elements apply, and then finding their equivalents (if any) in *IPRU(BSOC)*.
- 5.6 G The general approach to calculating the capital requirements for credit risk in *GENPRU* and *BIPRU* is to calculate the overall *credit risk capital requirement* (which is the sum of the three components listed in *BIPRU* TP 5.5G) – a monetary amount - and to compare it with *capital resources*, also a monetary amount.

- 5.7 G The general approach in *IPRU(BSOC)* is different. A *building society* calculates the total of its own funds (after making the relevant deductions) and the total of its risk weighted assets and off balance sheet items (in the latter case, after applying credit conversion factors). The own funds total is divided by the risk weighted assets total and the quotient expressed as a percentage: this is the pre-CRD solvency ratio.
- 5.8 G To enable a *building society* to use *BIPRU* TP 3.4R (Pre CRD capital requirements applying on a solo basis during 2007), the calculation method set out in *IPRU(BSOC)*, which is designed to produce the solvency ratio, needs adjustment so that it produces the *credit risk capital component* instead.
- 5.9 G *BIPRU* TP 3.8R (Parts of *GENPRU* and *BIPRU* that apply in 2007) provides that *GENPRU* 2.2 (Capital resources) applies during 2007. So a *building society* using *BIPRU* TP 3.4R (Pre CRD capital requirements applying on a solo basis during 2007) will calculate its *capital resources* under *GENPRU* 2.2, instead of calculating its own funds under *IPRU(BSOC)*.
- Rules in *IPRU(BSOC)* that apply in 2007
- 5.10 R The *rules* in Chapter 7 of Volume 1 of *IPRU(BSOC)* (Large Exposures) apply during the period that *BIPRU* TP 3.4R applies. None of the other *rules* in *IPRU(BSOC)* apply except the *rules* in chapters 4 and 5 which apply to *building societies* generally whether or not they apply the treatment in this section.
- Parts of Volume 1 of *IPRU(BSOC)* that apply in 2007
- 5.11 G The parts of Volume 1 of *IPRU(BSOC)* that do and do not apply during the period that *BIPRU* TP 3.4R applies are set out in *BIPRU* TP 5.13G.
- 5.12 G The table in *BIPRU* TP 5.13G assumes that the *firm* is not applying the *IRB approach*. *BIPRU* TP 5.36R to *BIPRU* TP 5.38R deal with a *firm* that does apply the *IRB approach*.

5.13 G Table: Parts of Volume 1 of IPRU(BSOC) that apply in 2007
This table belongs to *BIPRU* TP 5.11G

<i>IPRU(BSOC) rule</i>	A Y denotes that the provision does apply An N denotes that it does not apply	Remarks
Chapter X (Introduction)	<i>Rule</i> X.2.1 (Application)	N <i>BIPRU</i> TP 5.1R applies in its place for the purposes of <i>BIPRU</i> TP 5. However see <i>BIPRU</i> TP 5.15G.
	Definition of the BCD in X.7.1G	Y
	Other definitions in X.7	Y Apply to the extent used in the parts of <i>IPRU(BSOC)</i> that have effect under this section.
	The rest of chapter X	N
Chapter 1 (Solvency)		
Section 1.1 (Introduction)	N	
Section 1.2 (Solvency rules)	N	
Section 1.3 (Purpose of Capital)	N	
Section 1.4 (EU Directives)	N	
Section 1.5 (Threshold Ratios)	Y	See <i>BIPRU</i> TP 5.25G to <i>BIPRU</i> TP 5.26G
Section 1.6 (Own Funds)	N	
Section 1.7 (Minority Interests)	N	

<i>IPRU(BSOC) rule</i>	A Y denotes that the provision does apply An N denotes that it does not apply	Remarks
Section 1.8 (Deductions)	N	
Section 1.9 (Limits on Tier 2 capital)	N	
Section 1.10 (Solvency Ratio)	Y	(1) Applies on a solo basis except to the extent <i>BIPRU</i> 2.1 (Solo consolidation) applies. (2) Application on a consolidated basis is covered by <i>BIPRU</i> TP 10 (Pre CRD capital requirements applying on a consolidated basis during 2007). (3) Requirement that the solvency ratio should be calculated on a consolidated basis where a <i>building society</i> has <i>subsidiary undertakings</i> does not otherwise apply. (4) See <i>BIPRU</i> TP 5.20G to <i>BIPRU</i> TP 5.24G.
Section 1.11 (Solo consolidation)	N	
Section 1.12 (Mortgage Subsidiaries)	N	
Section 1.13 (Exclusions from consolidation)	N	
Section 1.14 (Mortgage Indemnity Captives)	N	

<i>IPRU(BSOC) rule</i>	A Y denotes that the provision does apply An N denotes that it does not apply	Remarks
Section 1.15 (Securitisation)	Y	See <i>BIPRU</i> TP 5.33G to <i>BIPRU</i> TP5.35G
Section 1.16 (Deductions of holdings)	N	
Section 1.17 (capital cost and pricing)	N	
Section 1.18 (CAD)	Y	Only applies to the extent that the relevant provisions of <i>IPRU(BANK)</i> apply to a <i>building society</i> under <i>BIPRU</i> TP 3. See <i>BIPRU</i> TP 5.16R to <i>BIPRU</i> TP 5.19G.
Section 1.19 (Credit derivatives)	Y	
Annex 1A (Calculation of Own Funds)	N	
Annex 1B (Risk Asset Weights)	Y	See <i>BIPRU</i> TP 5.32G
Annex 1C (Off Balance Sheet Items)	Y	The treatment of items under section 1C.5 (The treatment of off-balance sheet items using the "mark to market" approach) applies to the types of item listed in section 1C.7 whether they are on or off balance sheet.
Annex 1D (Deductions from own funds)	N	

<i>IPRU(BSOC) rule</i>	A Y denotes that the provision does apply An N denotes that it does not apply	Remarks
Annex 1E (Verification of Interim Profits)	N	
Annex 1F (Definition of Relevant Authority)	N	
Annex 1G (Definition of Zones A and B)	Y	
Annex 1H – Society Only Definitions	Y	
Annex 1J – Threshold Appraisal Sheet	Y	
Other chapters		
Chapter 2 (Issued Capital)	N	
Chapter 3 (Boards and Management)	N	
Chapter 4 (Financial Risk Management)	Annex 4B (Credit derivatives)	Y The provisions in <i>BIPRU</i> TP 4 (Pre CRD capital requirements applying on a solo basis during 2007: Banks) about Chapter CD of <i>IPRU(BANK)</i> (Credit derivatives) apply.

<i>IPRU(BSOC) rule</i>	A Y denotes that the provision does apply An N denotes that it does not apply	Remarks
	The rest of Chapter 4	Y Subject to the other provisions of this section, applies in the same way as it does for a <i>building society</i> that does not use <i>BIPRU</i> TP 3.4R (Pre CRD capital requirements applying on a solo basis during 2007). See <i>BIPRU</i> TP 5.15G.
Chapter 5 (Liquidity) (including Annexes 5A to 5C)	Y	Subject to the other provisions of this section, applies in the same way as it does for a <i>building society</i> that does not use <i>BIPRU</i> TP 3.4R (Pre CRD capital requirements applying on a solo basis during 2007). See <i>BIPRU</i> TP 5.15G
Chapter 6 (Lending)	N	

<i>IPRU(BSOC) rule</i>	A Y denotes that the provision does apply An N denotes that it does not apply	Remarks
Chapter 7 (Large Exposures)	Y	<p>(1) Applies on a solo basis except to the extent <i>BIPRU</i> 2.1 (Solo consolidation) applies.</p> <p>(2) Application on a consolidated basis is covered by <i>BIPRU</i> TP 10 (Pre CRD capital requirements applying on a consolidated basis during 2007).</p> <p>(3) Requirement that large exposures of a <i>building society</i> with <i>subsidiary undertakings</i> should, in general, be monitored on a fully consolidated basis does not otherwise apply.</p> <p>(4) <i>IPRU(BSOC)</i> 7.7 (Systems) applies.</p> <p>(5) See <i>BIPRU</i> TP 5.27R to <i>BIPRU</i> TP 5.30G.</p>
Chapter 8 (Mortgage Indemnity Insurance)	N	
Chapter 9 (Systems)	N	

<i>IPRU(BSOC) rule</i>	A Y denotes that the provision does apply An N denotes that it does not apply	Remarks
Chapter 10 (Securitisation)	Y	The provisions in <i>BIPRU</i> TP 4 (Pre CRD capital requirements applying on a solo basis during 2007: Banks) about Chapter SE of <i>IPRU(BANK)</i> (Securitisation) apply. See <i>BIPRU</i> TP 5.33G to <i>BIPRU</i> TP 5.35G
Chapter 11 (Outsourcing)	N	

Volume 2 of *IPRU(BSOC)*

- 5.14 G Volume 2 of *IPRU(BSOC)* does not apply to a *building society* that applies *BIPRU* TP 3.4R (Use of *IPRU* on a solo basis during 2007). It has been replaced by the Building Societies Regulatory Guide, which applies to all *building societies*, not just ones that apply *BIPRU* TP 3.4R.

Chapters 4 and 5 of Volume 1 of *IPRU(BSOC)*

- 5.15 G (1) Chapters 4 and 5 of Volume 1 of *IPRU(BSOC)* apply to all *building societies*, not just ones that apply *BIPRU* TP 3.4R (Use of *IPRU* on a solo basis during 2007). The version that applies to a *building society* that applies *BIPRU* TP 3.4R is the one in force at the relevant time, not the version in force on 31 December 2006. However there are some exceptions to this, as explained in (2) and (3).
- (2) As *BIPRU* 2.3 (Interest rate risk in the non-trading book) does not apply to a *firm* applying *BIPRU* TP 3.4R, references in Chapter 4 to *BIPRU* 2.3 should be disregarded (see in particular paragraphs 4.1.3G, 4.7.1G and 4.7.7G of chapter 4 of Volume 1 of *IPRU(BSOC)*).
- (3) As shown in the table in *BIPRU* TP 5.12G, Annex 4B (Credit derivatives) applies to a *building society* that applies *BIPRU* TP 3.4R.

- (4) *Rule X.2.1* of Chapter X of Volume 1 of *IPRU(BSOC)* (Application) applies to all *building societies*, not just ones that apply *BIPRU TP 3.4R*. However *BIPRU TP 5.1R* is the relevant application *rule* for the purpose of *BIPRU TP 5*.

The trading book

- 5.16 R *BIPRU TP 4* (Pre CRD capital requirements applying on a solo basis during 2007: Banks) applies for the purpose of calculating the *counterparty credit risk component* and the *market risk capital requirement*.
- 5.17 G The reason for *BIPRU TP 5.16R* is explained in *BIPRU TP 5.18G* to *BIPRU TP 5.19G*.
- 5.18 G (1) Only exceptionally will a *building society* have a *trading book*. If a *building society* does not have a *trading book*, the calculations that a *building society* should carry out under *BIPRU TP 3* (Use of *IPRU* on a solo basis during 2007) and this section are simplified as described in this paragraph.
- (2) A *building society* does not have to calculate a *counterparty risk capital component* (the capital charge for counterparty risk in the *trading book*) or a *concentration risk capital component* (the capital charge for exceeding concentration risk limits in the *trading book*).
- (3) *BIPRU 7* (Market risk) does not apply for the most part. This is because most of it only applies to the *trading book*.
- (4) *BIPRU 7.5* (Foreign currency PRR) will apply if a *building society* has *foreign currency* exposure even if the *building society* does not have a *trading book*.
- (5) *BIPRU 7.6* (Option PRR) will apply if a *building society* has *foreign currency option positions*.
- (6) *BIPRU 7.4* (Commodity PRR) and *BIPRU 7.6* (Option PRR) apply to a *firm's commodity positions* in its *non-trading book* as well as its *trading book*. However a *building society* will not generally have *commodity positions*.
- 5.19 G Paragraph 1.18.1G of Volume 1 of *IPRU(BSOC)* (CAD) says that a *building society* on the "Trading" approach to financial risk management (described in chapter 4 of Volume 1 of *IPRU(BSOC)* (Financial Risk Management)), under which it can trade securities and maintain unhedged foreign exchange positions within defined limits, should calculate the capital requirements for its trading book and foreign exchange positions separately in accordance with *IPRU(BANK)*. Therefore if a *building society* does have a *trading book* and applies *BIPRU TP 3.4R* (Use of *IPRU* on a solo basis during 2007):

- (1) it should calculate its credit risk charge for items in the *trading book* using *IPRU(BANK)* as adjusted under *BIPRU TP 4* (Pre CRD capital requirements applying on a solo basis during 2007: Banks);
- (2) it should calculate its capital requirements for *foreign currency positions* under *BIPRU 7* (Market risk), particularly *BIPRU 7.5* (Foreign currency PRR) as adjusted under *BIPRU TP 4*;
- (3) it should calculate its capital requirements for other market risks under *BIPRU 7* as adjusted under *BIPRU TP 4*; and
- (4) even if a *building society* does have a *trading book* it still does not have to calculate a *concentration risk capital component* as *IPRU(BSOC)* does not allow a *building society* to exceed the limits in Chapter 7 of *IPRU(BSOC)* (Large exposures).

How to calculate a credit risk capital component under IPRU

- 5.20 G A *building society* should calculate its *credit risk capital component* (under paragraph 1.10 of Volume 1 of chapter 1 of *IPRU(BSOC)* (Solvency)) by taking the total of its risk weighted assets and off balance sheet items (using the risk weights in Annex 1B and the credit conversion factors in Annex 1C) and multiplying this by 8%.
- 5.21 G *BIPRU TP 5.18G* to *BIPRU TP 5.19G* explain why the *counterparty risk capital component* and the *concentration risk capital component* (which together with the *credit risk capital component* make up the *credit risk capital requirement*) are unlikely to apply to a *building society*.
- 5.22 G *BIPRU TP 3.8R* (Parts of *GENPRU* and *BIPRU* that apply in 2007) says that *GENPRU 1.3* (Valuation) applies during 2007, so the values of assets and off balance sheet items used in the calculation under *BIPRU TP 5.20G* should be in accordance with *GENPRU 1.3*.
- 5.23 G In the light of *BIPRU TP 5.9G*, *BIPRU TP 5.20G* and *BIPRU TP 5.22G*, the first two sentences and the fourth sentence of paragraph 1.10 of Volume 1 of *IPRU(BSOC)* should be disregarded. The remainder of paragraph 1.10 gives useful detail on the credit risk calculations.
- 5.24 G The solvency ratio provisions of *IPRU(BSOC)* are mostly *guidance on rules 1.2.1* and *1.2.2* of Chapter 1 of Volume 1 of *IPRU(BSOC)*. These *rules* do not apply in 2007. When the solvency ratio provisions of Volume 1 of *IPRU(BSOC)* are applied under this section they are *guidance on the overall financial adequacy rule*. In turn the *overall financial adequacy rule* is the *rule* on which the calculation of the capital requirements for credit risk under *GENPRU* and *BIPRU* is based for a *building society* under this section.

How to maintain the threshold ratio

- 5.25 G A *building society* should maintain the amount of *capital resources* (calculated under *GENPRU* 2.2 (Capital resources)) that corresponds to the result of multiplying the total of its risk weighted assets and off balance sheet items (as calculated for the purposes of *BIPRU* TP 5.20G) by its threshold ratio. Further transitional provisions about the threshold ratio can be found in *GENPRU* TP 9 (Individual capital guidance for *BIPRU* firms).
- 5.26 G Complying with *BIPRU* TP 5.25G is treated as satisfying the expectation set out in section 1.5 of chapter 1 of Volume 1 of *IPRU(BSOC)* (Solvency) that a *building society* will maintain the threshold ratio. Maintaining the threshold ratio is in turn treated as satisfying the *overall Pillar 2 rule* so far as that *rule* requires a *firm* to maintain adequate capital resources.

Large exposures

- 5.27 G Chapter 7 of Volume 1 of *IPRU(BSOC)* (Large exposures) applies in place of *BIPRU* 10 (Concentration risk).
- 5.28 G *BIPRU* 10.5.2R to *BIPRU* 10.5.3R and *BIPRU* 10.5.5R (Capital resources for concentration risk) apply for the purpose in *BIPRU* TP 5.27R. Although the table in *BIPRU* TP 3.8R (Parts of *GENPRU* and *BIPRU* that apply in 2007) says that *BIPRU* 10.5.14R (Notification of trading book excesses) also applies, this is irrelevant to a *building society* as it relates to the regime for excess *exposures* in the *trading book*, which does not apply to a *building society*.
- 5.29 G The effect of *BIPRU* TP 5.28R is that a *building society* should treat all references to own funds in chapter 7 of Volume 1 of *IPRU(BSOC)* (Large exposures) as references to *capital resources* under *BIPRU* 10.5.2R to *BIPRU* 10.5.3R and *BIPRU* 10.5.5R (Capital resources for concentration risk). The last sentence of paragraph 7.3.1 of Volume 1 of *IPRU(BSOC)* should be disregarded.
- 5.30 G Chapter 7 of *IPRU(BSOC)* is mostly *guidance* on *rules* 1.2.1 and 1.2.2 of Chapter 1 of Volume 1 of *IPRU(BSOC)*. These *rules* do not apply in 2007. When the large exposures provisions of Volume 1 of *IPRU(BSOC)* are applied under this section they are *guidance* on the *overall financial adequacy rule*.

Operational risk

- 5.31 G *BIPRU* TP 3.21R provides that the *operational risk capital requirement* is reduced where a *firm* uses *BIPRU* TP 3.4R (Capital floors for a firm using the IRB or AMA approaches). A *building society* (unless, exceptionally, it has a *trading book*) will apply *BIPRU* 3.4R to all its *exposures*. So the effect of *BIPRU* TP 3.21R in those cases will be to reduce the *operational risk capital requirement* to zero while *BIPRU* TP 3.4 applies.

Miscellaneous modifications of *IPRU(BSOC)*

- 5.32 G When using Annex 1B of Chapter 1 of Volume 1 of *IPRU(BSOC)* (Risk Asset Weights) for the purposes of *BIPRU* TP 5.20G, the definition of "relevant authority" will be found in Annex 5A of Chapter 5 of Volume 1 of *IPRU(BSOC)* (Prudential Liquidity) instead.
- 5.33 G *BIPRU* TP 5.12R says that chapter 10 of Volume 1 of *IPRU(BSOC)* (Securitisation) applies. Under that chapter a *firm* should deduct certain credit enhancements from capital. A *building society* should deduct these credit enhancements at stage M of the calculation in the *capital resources table* (Deductions from the totals of tier one and two).
- 5.34 G Paragraph 6 of section 10.4 of Chapter SE of *IPRU(BANK)*, which is applied to a *building society* by chapter 10 of Volume 1 of *IPRU(BSOC)* (Securitisation), says that if a *firm* does not meet the policy on liquidity facilities provided by sponsors or repackers it should fully consolidate the scheme. This does not apply under this section. Instead a *building society* should treat the scheme assets as being on its balance sheet.
- 5.35 G The definition of investment grade for the purposes of Chapter SE (see in particular sections 3.2.2, 9.3 and 11.1) remains based on Chapter TI of *IPRU(BANK)*.
- Firms using the IRB approach during 2007: General
- 5.36 R *BIPRU* TP 5.37G to *BIPRU* TP 5.38R only apply to a *firm* that is applying the *IRB approach* under *BIPRU* TP 3 (Pre CRD capital requirements applying on a solo basis during 2007) as well as using *IPRU*.
- 5.37 G The effect of *BIPRU* TP 3.17G (Pre CRD capital requirements applying on a solo basis during 2007 for *firms* also using the *IRB approach*) is that Section 1.10 of Volume 1 of *IPRU(BSOC)* (Solvency Ratio) does not apply to an *exposure* to which the *firm* applies the *IRB approach*. The *IRB approach* requirements in *BIPRU* apply instead. The main requirements are listed in *BIPRU* TP 3.17G.
- 5.38 R A *building society* that has a *trading book* must apply the parts of *BIPRU* TP 4 (Pre CRD capital requirements applying on a solo basis during 2007: Banks) that deal with capital charges for items in the *trading book* for a *bank* that applies the *IRB approach* under *BIPRU* TP 3 (Pre CRD capital requirements applying on a solo basis during 2007) as well as using *IPRU*.

- TP 6 Pre CRD capital requirements applying on a solo basis during 2007:
Investment management firms
- Application
- 6.1 R This section applies to a *BIPRU firm* that:
- (1) is an *investment management firm*; and
 - (2) is applying *BIPRU* TP 3.4R (Use of IPRU on a solo basis during 2007).
- Purpose of this section
- 6.2 G *BIPRU* TP 3 (Pre CRD capital requirements applying on a solo basis during 2007) says that during 2007 a *firm* may apply the credit risk requirements of *IPRU* instead of the ones in *BIPRU*. For an *investment management firm* this involves applying the credit risk requirements in chapter 5 of *IPRU(INV)*. This section explains how this is done. In particular this section explains:
- (1) which parts of chapter 5 should be treated as credit risk requirements for this purpose;
 - (2) what parts of chapter 5 apply during 2007 and what changes are made to chapter 5 for that purpose; and
 - (3) what changes are made to *GENPRU* and *BIPRU* to reflect the fact that chapter 5 applies in place of parts of *GENPRU* and *BIPRU*.
- Duration of transitional
- 6.3 R This section applies until 1 January 2008.
- Drafting approach in this section
- 6.4 G The purpose of *BIPRU* TP 3 (Pre CRD capital requirements applying on a solo basis during 2007) is that the basic provisions of *BIPRU* and *GENPRU* should be in force from 1 January 2007. However a *firm* should be able to calculate the capital requirements for credit risk under *IPRU* and use the large exposures requirements in *IPRU*. This means that an *investment management firm* should slot the credit risk requirements of chapter 5 of *IPRU(INV)* into the general requirements of *GENPRU* and *BIPRU*.
- 6.5 G The capital calculation for credit risk under *BIPRU* is made up of three elements, which are set out in *GENPRU* 2.1.51R (Calculation of the credit risk capital requirement). These are the *credit risk capital component*, the *counterparty risk capital component* and the *concentration risk capital component*. So the approach in *BIPRU* TP 6.4G involves finding equivalents for these three elements in chapter 5 where this is possible.

- 6.6 G Under *GENPRU* and *BIPRU* a *firm* calculating its capital resources may usually choose between deducting *illiquid assets* and *material holdings*. Only if it has a *waiver* from consolidated supervision need it deduct both. However under chapter 5, both illiquid assets and material holdings in credit and financial institutions are deducted.
- 6.7 G The chapter 5 *rules* can still be made to work if a *firm* is allowed to choose between deducting *illiquid assets* and *material holdings* as any *exposure* that is not deducted is covered by the chapter 5 other assets requirement.
- 6.8 G (1) To make the *GENPRU* and *BIPRU* requirements compatible with chapter 5 for the purpose of *BIPRU* TP 3 (Pre CRD capital requirements applying on a solo basis during 2007), this section takes the approach in this paragraph.
- (2) The *illiquid assets* and *material holdings* provisions of *GENPRU* 2.2 (Capital resources) apply.
- (3) The chapter 5 counterparty risk requirement and the other assets requirement are used to calculate the *BIPRU* credit risk charge for *non-trading book* items (called the *credit risk capital component*) and the *BIPRU* credit risk charge for *trading book* items (called the *counterparty risk capital component*).
- (4) *BIPRU* 10 (Concentration risk) allows a *firm* to exceed the large exposure limits in the *trading book*. A *firm* that takes up that option is subject to an additional capital requirement, called the *concentration risk capital component*. Chapter 5 does not give a *firm* that option. Therefore the *concentration risk capital component* does not apply to a *firm* under this section.

Parts of chapter 5 of *IPRU(INV)* that apply in 2007

- 6.9 R The parts of chapter 5 of *IPRU(INV)* that do and do not apply during the period that *BIPRU* TP 3.4R applies are set out in *BIPRU* TP 6.11R.
- 6.10 G The table in *BIPRU* TP 6.11R assumes that the *firm* is not applying the *IRB approach*. *BIPRU* TP 6.31R to *BIPRU* TP 6.34R deal with a *firm* that does apply the *IRB approach*.

6.11 R Table: Parts of chapter 5 of IPRU(INV) that apply in 2007
This table belongs to *BIPRU* TP 6.9R

Chapter 5 rule	A Y denotes that the provision does apply An N denotes that it does not apply		Remarks
5.1.1(1)(a) and (b) (Application)	N		<i>BIPRU</i> TP 6.1R applies instead
Table 5.1.1(1)(a) (What parts of chapter 5 apply to what <i>firm</i>)	N		<i>BIPRU</i> TP 6.1R applies instead
5.1.1(1)(c) (Interpretation)	Y		See <i>BIPRU</i> TP 6.26R to <i>BIPRU</i> TP 6.28G
5.2.1 (General requirement)	N		
5.2.2 (Financial resources)	N		<i>GENPRU</i> 2.2 (Capital resources) applies instead
5.2.3(1) (Determination of requirement)	N		
5.2.3(2) (Exceptions from the liquid capital requirement)	N		
5.2.3(3) (Own funds requirement)	N		
5.2.3(4) (Liquid capital requirement)	N		
5.2.3(5) (Total capital requirement)	Expenditure based requirement	N	
	Position risk requirement	N	
	Counterparty risk requirement	Y	

Chapter 5 rule	A Y denotes that the provision does apply An N denotes that it does not apply	Remarks
	Foreign exchange requirement	N
	Other assets requirement	Y
5.2.4 (Annual audited expenditure)	N	
5.2.5 (Qualifying subordinated loans)	N	
5.2.6 (Qualifying property and qualifying undertakings)	N	
5.2.7 (Large exposures)	Y	See <i>BIPRU</i> TP 6.21R to <i>BIPRU</i> TP 6.22R
Table 5.2.2(1) (Calculation of own funds and liquid capital)	N	
Table 5.2.3(3)(b) (Own funds requirement)	N	
Table 5.2.3(5)(a) (Expenditure based requirement)	N	
Table 5.2.3(5)(b) (Position risk requirement)	N	See <i>BIPRU</i> TP 6.254
Table 5.2.3(5)(c) (Counterparty risk requirement)	Y	See <i>BIPRU</i> TP 6.13R to <i>BIPRU</i> TP 6.19G
Table 5.2.3(5)(c)(i) (Counterparty risk factor –cash settlements)	Y	

Chapter 5 rule	A Y denotes that the provision does apply An N denotes that it does not apply	Remarks
Table 5.2.3(5)(c)(ii) (Counterparty risk requirement)	Y	
Table 5.2.3(5)(c)(iii) (OTC derivatives calculation of credit equivalent amount)	Y	See <i>BIPRU</i> TP 6.15G and <i>BIPRU</i> TP 6.18R to <i>BIPRU</i> TP 6.19G
Table 5.2.3(5)(d) (Foreign exchange requirement)	N	
Table 5.2.3(5)(e) (Other assets requirement)	Y	See <i>BIPRU</i> TP 6.20R
5.3.1 (Records)	N	Applied in part under <i>BIPRU</i> TP 23 (Record keeping transitionals)
5.5.1 (Financial notification)	N	
5.7 (Consolidated supervision)	N	
Glossary	Y	See <i>BIPRU</i> TP 6.26R to <i>BIPRU</i> TP 6.28G

Categorisation

- 6.12 R Each *firm* is an ISD firm for the purposes of chapter 5 of *IPRU(INV)* as applied by *BIPRU* TP 3 (Pre CRD capital requirements applying on a solo basis during 2007) and this section.

How to use the chapter 5 Counterparty Risk Requirement and the Other Assets Requirement

- 6.13 R A *firm* must calculate the sum of the *credit risk capital component* and the *counterparty risk capital component* as being equal to the sum of the counterparty risk requirement under chapter 5 of *IPRU(INV)* and of the other assets requirement under chapter 5 of *IPRU(INV)*.

- 6.14 R If it is necessary to distinguish between the *credit risk capital component* and the *counterparty risk capital component* a *firm* must allocate:
- (1) any amount calculated for an *exposure* in the *non-trading book* to the *credit risk capital component*; and
 - (2) any amount calculated for an *exposure* in the *trading book* to the *counterparty risk capital component*;

- 6.15 G A *firm* may still apply the netting provisions for OTC derivatives in chapter 5 even though the OTC derivative calculation is split between the *credit risk capital component* and the *counterparty risk capital component* under *BIPRU* TP 6.14R. The net amount should be allocated to the *credit risk capital component* if the gross value of the *non-trading book* derivatives is bigger and to the *counterparty risk capital component* if the gross value of the *trading book* derivatives is bigger.

Adjustments to the Counterparty Risk Requirement calculations: General

- 6.16 G Broadly speaking the Directive transitional provisions that allow pre-2007 credit risk rules to be used in 2007 cover all credit risk rules. However the transitional provisions for *trading book* credit risk (Annex II of the *Capital Adequacy Directive*, which is implemented in *BIPRU* 14 (Capital requirements for settlement and counterparty risk)) is not quite as straightforward as that. In some cases pre-2007 requirements can be used. In others they cannot. The purpose of *BIPRU* TP 6.17R to *BIPRU* TP 6.19G is to reflect those cases in which the Directive requires the new requirements to apply from 1 January 2007.

Adjustments to the Counterparty Risk Requirement calculations: Free deliveries

- 6.17 R
- (1) The calculation of the part of the counterparty risk requirement set out in section 3 of Table 5.2.3(5)(c) of chapter 5 of *IPRU(INV)* (Free deliveries) is amended in accordance with this *rule* for the purposes of *trading book* calculations.
 - (2) A *firm* must include *foreign currency* and *commodity* transactions.
 - (3) The capital treatment in the table in *BIPRU* 14.4.3R (Capital treatment for free deliveries) applies. But when the capital treatment in that table is that the *firm* must treat the transaction as an *exposure*, the *firm* must apply the treatment in chapter 5 of *IPRU(INV)* rather than *BIPRU* 14 (Capital requirements for settlement and counterparty risk).

Adjustments to the Counterparty Risk Adjustments calculations: Credit derivative transactions

- 6.18 R A *firm* must treat a credit derivative in the *trading book* as a derivative to which section 6 of Table 5.2.3(5)(c) of chapter 5 of *IPRU(INV)* (OTC derivatives) and table 5.2.3(5)(c)(iii) (OTC derivatives calculation of credit equivalent amount) apply.
- 6.19 G The capital treatment for credit derivatives set out in *BIPRU* 14.2.5R - *BIPRU* 14.2.8R (Capital treatment for credit derivatives) does not apply.

Adjustments to the Other Assets Requirement calculations

- 6.20 R A *firm* must include the items listed in section 4 of Chapter BC of *IPRU(BANK)* that are in the *firm's non-trading book* as off-balance sheet items in table 5.2.3(5)(e) (Other assets requirement) whether they are on or off balance sheet. A *firm* must include a credit derivative as a full risk item.

How to use the chapter 5 large exposure rules

- 6.21 R Section 5.2.7 of chapter 5 of *IPRU(INV)* (Large exposures) applies in place of *BIPRU* 10 (Concentration risk).
- 6.22 R *BIPRU* 10.5.2R to *BIPRU* 10.5.5R (Capital resources for concentration risk purposes) apply in place of the definition of own funds that applies under section 5.2.7 of chapter 5 of *IPRU(INV)*.

Specific risk calculations

- 6.23 R A *firm* must calculate the *specific risk* portion of the *interest rate PRR* in accordance with *BIPRU* TP 8.28R (Pre CRD interest rate *PRR* for *securities and futures firms*).
- 6.24 R Any reference to a *qualifying debt security* in a part of *BIPRU* that applies during 2007 must be interpreted in accordance with the meaning it has when used in section A of Table 5.2.3(5)(b) of chapter 5 of *IPRU(INV)* (Position risk requirement for qualifying debt securities). However *BIPRU* 7.2.50R (Must not apply *qualifying debt security* treatment to risky assets) also applies. Any reference to a *qualifying equity* in a part of *BIPRU* that applies during 2007 must be interpreted in accordance with the definition in the Glossary to chapter 10 of *IPRU(INV)*.
- 6.25 G The reason for *BIPRU* TP 6.23R and *BIPRU* TP 6.24R is that the calculation of the *specific risk* portion of the *interest rate PRR* under *BIPRU* 7 (Market risk) involves the use of the *standardised approach* to credit risk. The *specific risk rules* therefore need to be adjusted for a *firm* that is not using the *standardised approach* to credit risk in 2007 so as to apply the pre-2007 method of calculating *specific risk*. However chapter 5 does not use the concept of *specific risk*. The nearest equivalent is in chapter 10 of *IPRU(INV)* (*Securities and futures firms*). The definition of *qualifying equity* also depends in part on the *standardised approach* to credit risk.

Definitions

- 6.26 R The definition of trading book is replaced with the definition in the *Glossary*.
- 6.27 R A *firm* may treat a reference in the Glossary to Chapter 5 of *IPRU(INV)* to a financial supervision regime at least equivalent to the Second Consolidated Supervision Directive and the Capital Adequacy Directive (No. 93/6/EEC) as including one to a regime equivalent to the *Banking Consolidation Directive* and Directive 2006/49 (the new version of the Capital Adequacy Directive).
- 6.28 G *GENPRU* 1.3 (Valuation) applies. The definition of exposure in the Glossary to chapter 5 should be read accordingly.

Mapping GENPRU and BIPRU concepts onto IPRU

- 6.29 G Some of the parts of chapter 5 of *IPRU(INV)* that apply in 2007 refer to parts of chapter 5 that do not apply. *BIPRU* TP 3.10R explains that where this happens a *firm* should interpret that cross-reference in accordance with the provision in *BIPRU* or *GENPRU* that corresponds to the chapter 5 provision that does not apply in 2007. A *firm* should refer to *IPRU* in the case of cross-references in *GENPRU* and *BIPRU* to provisions in *GENPRU* and *BIPRU* that do not apply in 2007. *BIPRU* TP 6.30G sets out how certain concepts in chapter 5 of *IPRU(INV)* correspond to ones in *GENPRU* and *BIPRU*. The purpose of the table is to help *firms* to interpret such cross-references.
- 6.30 G Table: Mapping GENPRU and BIPRU concepts onto ones in chapter 5 of *IPRU(INV)*
This table belongs to *BIPRU* TP 6.29G

<i>GENPRU</i> and <i>BIPRU</i>	Chapter 5 of <i>IPRU(INV)</i>
<i>Illiquid asset</i>	Illiquid asset
<i>Material holding</i>	Material holdings in credit and financial institutions (item 8 in Table 5.2.2(1) (Calculation of own funds and liquid capital))
Unsettled transaction under <i>BIPRU</i> 14.3	Delivery of cash against documents and settlements outstanding for 30 days or more (part of counterparty risk requirement)
<i>Free deliveries</i> under <i>BIPRU</i> 14.4	Free deliveries (part of counterparty risk requirement)

<i>GENPRU and BIPRU</i>	Chapter 5 of <i>IPRU(INV)</i>
See <i>BIPRU</i> TP 6.8G	Counterparty risk requirement
See <i>BIPRU</i> TP 6.8G	Other assets requirement
<i>Market risk capital requirement</i>	The position risk requirement and the foreign exchange requirement
<i>Trading book concentration risk excess</i>	This concept does not apply in Chapter 5
<i>Risk weight</i>	Risk weights in Table 5.2.3(5)(c)(ii) (Counterparty risk requirement). In general where Table 5.2.3(5)(e) (Other assets requirement) applies a risk factor of 8% that is equivalent to applying a <i>risk weight</i> of 100%. Applying the 1.6% adjustment under that table is equivalent to applying a 20% <i>risk weight</i> under <i>BIPRU</i> together with the standard 8% <i>BIPRU</i> credit risk charge. The "NIL" adjustment under that table is equivalent to applying a 0% <i>risk weight</i> .

Firms using the IRB approach during 2007: General

- 6.31 R *BIPRU* TP 6.31R to *BIPRU* TP 6.34R only apply to a *firm* that is applying the *IRB approach* under *BIPRU* TP 3 (Pre CRD capital requirements applying on a solo basis during 2007) as well as using *IPRU*.
- 6.32 G The effect of *BIPRU* TP 3.17G (Pre CRD capital requirements applying on a solo basis during 2007 for *firms* also using the *IRB approach*) is that the counterparty risk requirement and the other assets requirement do not apply to an *exposure* to which the *firm* applies the *IRB approach*. The *IRB approach* requirements in *BIPRU* apply instead. The main requirements are listed in *BIPRU* TP 3.17G.
- 6.33 R A *firm* must apply *BIPRU* 7.2.45R - *BIPRU* 7.2.47R (Using internal ratings to calculate *specific risk* and treatment of *securitisations*) to calculate the *specific risk* portion of the *interest rate PRR* to the extent that the obligor or *exposure* in question comes within the scope of its *IRB permission*.
- 6.34 R The definition of *qualifying debt security* and *qualifying equity* in the *Glossary* apply if the security or obligor in question comes within the scope of a *firm's IRB permission*.

- TP 7 Pre CRD capital requirements applying on a solo basis during 2007: UCITS investment firms
- Application
- 7.1 R This section applies to a *BIPRU firm* that:
- (1) is a *UCITS investment firm*; and
- (2) is applying *BIPRU TP 3.4R* (Use of IPRU on a solo basis during 2007).
- Purpose of this section
- 7.2 G *BIPRU TP 3* (Pre CRD capital requirements applying on a solo basis during 2007) says that during 2007 a *firm* may apply the credit risk requirements of *IPRU* instead of the ones in *BIPRU*. For a *UCITS investment firm* this involves applying the credit risk requirements in chapter 7 of *IPRU(INV)*. This section explains how this is done.
- Duration of transitional
- 7.3 R This section applies until 1 January 2008.
- Drafting approach
- 7.4 G Chapter 7 of *IPRU(INV)* does not contain any credit risk *rules*. Instead it cross refers to the ones in chapter 5 (Interim prudential requirements for former IMRO firms). Therefore this section applies *BIPRU TP 6* (Pre CRD capital requirements applying on a solo basis during 2007: Investment management firms).
- Parts of chapter 7 of *IPRU(INV)* that apply in 2007
- 7.5 R The parts of chapter 7 of *IPRU(INV)* that do and do not apply during the period that *BIPRU TP 3.4R* applies are set out in *BIPRU TP 7.7R*.
- 7.6 G The table in *BIPRU TP 7.7R* assumes that the *firm* is not applying the *IRB approach*. *BIPRU TP 6.31R* to *BIPRU TP 6.34R* (which are applied to a *UCITS investment firm* by *BIPRU TP 7.8R*) deal with a *firm* that does apply the *IRB approach*.

7.7

R Table: Parts of chapter 7 of IPRU(INV) that apply in 2007
This table belongs to *BIPRU* TP 7.5R

Chapter 7 rule	A Y denotes that the provision does apply An N denotes that it does not apply	Remarks
7.1.1 (Application)	N	<i>BIPRU</i> TP 7.1R applies instead
7.1.2 and 7.1.3 (<i>Guidance</i> on types of <i>UCITS</i> management companies etc)	Y	
7.2.1 (General rule about financial resources and financial resources requirements)	N	
7.2.2 (Financial resources requirement)	N	
7.2.3 (Liquid capital resource requirement)	13/52 annual audited fixed expenditure requirement	N
	Provision of paragraph (2) that says that requirements apply in respect of <i>designated investment business</i> other than when undertaking <i>scheme management activity</i>	Y
	Position risk requirement	N
	Counterparty risk requirement	Y
	Foreign exchange requirement	N

Chapter 7 rule	A Y denotes that the provision does apply An N denotes that it does not apply		Remarks
	Other assets requirement	Y	
7.2.4 to 7.2.5 (Calculation of annual expenditure)	N		
7.3 (Method of calculation of financial resources)	N		<i>GENPRU 2.2</i> (Capital resources) applies instead
7.4.1 (Application of <i>rules</i> in chapter 5 of <i>IPRU(INV)</i> about qualifying subordinated loans etc)	N		The record keeping <i>rules</i> referred to in <i>rule 7.4.1(1)(c)</i> are applied under <i>BIPRU TP 23</i> (Record keeping transitionals)
7.4.2 (Application of <i>rules</i> in chapter 5 of <i>IPRU(INV)</i> about large exposures)	Y		
7.5 (Financial notification)	N		
7.6 (Records)	N		Applied under <i>BIPRU TP 23</i> (Record keeping transitionals)

Application of BIPRU TP 6

- 7.8 R *BIPRU TP 6* (Pre CRD capital requirements applying on a solo basis during 2007: Investment management firms) applies for the purposes of this section.

- TP 8 Pre CRD capital requirements applying on a solo basis during 2007:
Securities and futures firms
- Application
- 8.1 R This section applies to a *BIPRU firm* that is:
- (1) a *securities and futures firm*; and
 - (2) is applying *BIPRU TP 3.4R* (Pre CRD capital requirements applying on a solo basis during 2007).
- Purpose of this section
- 8.2 G *BIPRU TP 3* (Pre CRD capital requirements applying on a solo basis during 2007) says that during 2007 a *firm* may apply the credit risk requirements of *IPRU* instead of the ones in *BIPRU*. For a *securities and futures firm* this involves applying the credit risk requirements in chapter 10 of *IPRU(INV)*. *BIPRU TP 8* explains how this is done. In particular this section explains:
- (1) which parts of chapter 10 should be treated as credit risk requirements for this purpose;
 - (2) what parts of chapter 10 apply during 2007 and what changes are made to chapter 10 for that purpose; and
 - (3) what changes are made to *GENPRU* and *BIPRU* to reflect the fact that chapter 10 applies in place of parts of *GENPRU* and *BIPRU*.
- Duration of transitional
- 8.3 R *BIPRU TP 8* applies until 1 January 2008.
- Drafting approach in this section
- 8.4 G The purpose of *BIPRU TP 3* (Pre CRD capital requirements applying on a solo basis during 2007) is that the basic provisions of *BIPRU* and *GENPRU* should be in force from 1 January 2007. However a *firm* should be able to calculate the capital requirements for credit risk under *IPRU* and use the large exposures requirements in *IPRU*. This means that a *securities and futures firm* should slot the credit risk requirements of chapter 10 of *IPRU(INV)* into the general requirements of *GENPRU* and *BIPRU*. A *firm* that applies *BIPRU TP 3.4R* should not use chapter 3 as the source of its pre-2007 credit risk requirements even if it was subject to chapter 3 before becoming a *BIPRU investment firm*.

- 8.5 G The capital calculation for credit risk under *BIPRU* is made up of three elements, which are set out in *GENPRU* 2.1.51R (Calculation of the credit risk capital requirement). These are the *credit risk capital component*, the *counterparty risk capital component* and the *concentration risk capital component*. So the approach in *BIPRU* TP 8.4G involves finding equivalents for these three elements in chapter 10 where possible.
- 8.6 G Under *GENPRU* and *BIPRU* a *firm* calculating its capital resources may usually choose between deducting *illiquid assets* and *material holdings*. Only if it has a *waiver* from consolidated supervision need it deduct both. This broadly corresponds to the approach in calculating financial resources under Tables 10-62(2)A to 10-62(2)C.
- 8.7 G The financial resources requirements calculations under chapter 10 depend in part on which of the financial resources calculations in Tables 10-62(2)A to 10-62(2)C a *firm* uses. Where this is the case the *firm* should use the requirements calculation associated with the version of the tables in 10-62(2) that corresponds to the *capital resources* calculation the *firm* uses under *GENPRU* 2.2 (Capital resources). *BIPRU* TP 8.33G explains how the *capital resources* calculations in *GENPRU* 2.2 map onto Tables 10-62(2)A to 10-62(2)C.
- 8.8 G
- (1) To make the *GENPRU* and *BIPRU* requirements compatible with chapter 10 for the purpose of *BIPRU* TP 3 (Pre CRD capital requirements applying on a solo basis during 2007), this section takes the approach in this paragraph.
 - (2) The *illiquid assets* and *material holdings* provisions of *GENPRU* 2.2 (Capital resources) apply.
 - (3) The 8% illiquid asset adjustment under *IPRU(INV)* 10-65 applies to a *firm* calculating its financial resources under Table 10-62(2)A. It is equivalent to a capital charge for credit risk under *BIPRU*. Therefore a *firm* using the *capital resources* calculation in *GENPRU* that corresponds to Table 10-62(2)A (*GENPRU* 2 Ann 4R (Capital resources table for a *BIPRU investment firm* deducting *material holdings*)) should continue to apply that adjustment. It should be included as part of the *non-trading book* credit risk charge in *BIPRU*, which is called the *credit risk capital component*.
 - (4) A 100% illiquid asset adjustment under *IPRU(INV)* 10-65 is equivalent to a deduction of *illiquid assets* under *GENPRU* 2.2 (Capital resources). Therefore a *firm* should not use this adjustment. This is because, as explained in (2), the *illiquid assets* provisions in *GENPRU* 2.2 apply. Any item that would have been caught by *IPRU(INV)* 10-65 but is not caught by the *illiquid asset* deduction under *GENPRU* 2.2 should be dealt with under *IPRU(INV)* 10-66.

- (5) The *IPRU(INV)* 10-66 liquidity adjustment covers any asset that has not been subject to a liquidity adjustment for illiquid assets under *IPRU(INV)* 10-65. Therefore (subject to (3)) a *firm* should calculate the *credit risk capital component* (the *non-trading book* credit charge in *BIPRU*) by applying *IPRU(INV)* 10-66 to any asset not deducted as an *illiquid asset* under *GENPRU* 2.2 (Capital resources).
- (6) The chapter 10 counterparty risk requirement is used to calculate the *BIPRU* credit risk charge for *trading book* items, called the *counterparty risk capital component*.
- (7) The chapter 10 LER calculation is used to calculate the *concentration risk capital component*.

Parts of chapter 10 of *IPRU(INV)* that apply in 2007

- 8.9 R The parts of chapter 10 of *IPRU(INV)* that do and do not apply during the period that *BIPRU* TP 3.4R applies are as set out in *BIPRU* TP 8.11R.
- 8.10 G The table in *BIPRU* TP 8.11R assumes that the *firm* is not applying the *IRB approach*. *BIPRU* TP 8.35R to *BIPRU* TP 8.38R deal with a *firm* that does apply the *IRB approach*.
- 8.11 R Table: Parts of chapter 10 of *IPRU(INV)* that apply in 2007
This table belongs to *BIPRU* TP 8.9R

Chapter 10 rule	A Y denotes that the provision does apply An N denotes that it does not apply	Remarks
10-A (Application of Chapter 10 Glossary)	Y	See <i>BIPRU</i> TP 8.32R
10-B (Application)	N	<i>BIPRU</i> TP 8.1R applies instead
10.10 to 10.12 (Record keeping and Reconciliations)	N	Applied in part under <i>BIPRU</i> TP 23 (Record keeping transitionals)
10-32 (Defaulting repo counterparty and LE Notification Requirements)	N	
10-41 (Repo and Valuation)	N	

Chapter 10 <i>rule</i>	A Y denotes that the provision does apply An N denotes that it does not apply		Remarks
10-60 to 10-63 (Initial Capital and Financial Resources)	N		
10-64 to 10-68 (Liquidity Adjustments, Charged Assets and Contingent Liabilities)	10-64(2) (Intangible assets)	N	<i>GENPRU</i> 2.2 (Capital resources) applies instead
	10-65(12) (Material holdings)	N	<i>GENPRU</i> 2.2 applies instead
	The rest	Y	See <i>BIPRU</i> TP 8.13R to <i>BIPRU</i> TP 8.19G. The requirement in 10-64(1)(c) for an illiquid asset adjustment for commodities to be calculated under appendix 6 (the <i>PRR</i> charge for <i>commodities</i>) does not apply
10-69 (Deficiencies in subsidiaries)	N		
10-70 (Calculation of financial resources requirement)	N		
10-71 (Primary requirement)	N		
10-72 (Base requirement)	N		
10-73 (Expenditure requirement)	N		
10-74 (Secondary requirement)	Y		<i>BIPRU</i> TP 3.10R and the table in <i>BIPRU</i> TP 8.34G explain how the terms used in <i>rule</i> 10-74 are to be interpreted

Chapter 10 <i>rule</i>	A Y denotes that the provision does apply An N denotes that it does not apply		Remarks
10-80 to 10-120 (PRR)	N		But see <i>BIPRU</i> TP 8.29R to <i>BIPRU</i> TP 8.31G
10-170 to 10-176 (CRR)	10-170(3) and (9) (Valuation) and 10-173(8) (Daily valuation)	N	
	The rest	Y	See <i>BIPRU</i> TP 8.20R to <i>BIPRU</i> TP 8.25R
10-190 to 10-196 (Large exposures)	10-190(1) (Application)	N	<i>BIPRU</i> TP 10 (Pre CRD capital requirements applying on a consolidated basis during 2007) deals with consolidation
	The rest	Y	See <i>BIPRU</i> TP 8.26R to <i>BIPRU</i> TP 8.28R
10-200 to 10-204 (Consolidated supervision)	N		
10-300 (ACMPs)	Y		Applies to the extent relevant to the parts of chapter 10 that apply under <i>BIPRU</i> TP 8
Appendix 1 (Glossary of Terms for <i>IPRU(INV)</i> 10)	Y		See <i>BIPRU</i> TP 8.32R
Appendices 4 to 11 (PRR)	Appendix 4 43R to 47R (Specific risk portion of the interest rate PRR)	Y	

Chapter 10 <i>rule</i>	A Y denotes that the provision does apply An N denotes that it does not apply		Remarks
	The rest of Appendices 4 to 11	N	
Appendix 20 (Guidance notes on reconciliation of firm's balances with a counterparty which is a member of an exchange (rule 10-11(4)))	N		
Appendix 21 (Note on the valuation of positions)	N		
Appendix 43 (Guidance note on the financial resources and accounting treatment of soft commission agreements (rule 10-73 and 10-175))	Y		Applies so far as relevant to CRR
Appendix 47 (Counterparty weights to be applied in calculating liquidity adjustment and CRR (rules 10-64 to 10-68, and 10-172 to 10-176))	Y		
Appendix 48 (Securities and Futures firms: Guidance notes on the secondary requirement)	Y		
Appendix 55 (Guidance notes on the application of adequate collateral or acceptable collateral to reduce counterparty exposures)	Y		

Chapter 10 <i>rule</i>	A Y denotes that the provision does apply An N denotes that it does not apply	Remarks
Appendix 56 (Guide to Adequate Credit Management Policy (ACMP) (rules 10-172 to 10-175, 10-300 and "ACMP"))	Y	See remarks for 10-300
Appendix 57 (List of exchanges and clearing houses recognised for the purposes of IPRU(INV))	Y	
Appendix 58 (Verification of interim profits by external auditors)	N	
Appendix 59 (List of regulators for the purposes of the definition of recognised third country investment firms)	Y	
Appendix 62 (Netting)	Y	
Appendix 63 (Guidance on Credit derivatives)	Y	(1) Applies so far as relevant to CRR. (2) Applies so far as relevant to liquidity adjustments. (3) Does not apply so far as relevant to the PRR. (4) If the <i>firm</i> is the protection seller in relation to a credit derivative in the <i>non-trading book</i> it must apply the treatment in <i>IPRU(BANK)</i> .

Categorisation

- 8.12 R Each *firm* is a Category A firm for the purposes of chapter 10 of *IPRU(INV)* as applied by *BIPRU* TP 3 (Pre CRD capital requirements applying on a solo basis during 2007) and this section.

How to use the chapter 10 liquidity adjustment rules

- 8.13 R A *firm* must calculate the *credit risk capital component* by adding together the deductions under the liquidity adjustment *rules* that apply under *BIPRU* TP 8.11R.
- 8.14 R The 100% liquidity adjustment in *IPRU(INV)* 10-65 (Liquidity adjustment on illiquid assets) does not apply.
- 8.15 G The reason for *BIPRU* TP 8.14R is explained in *BIPRU* TP 8.8G.
- 8.16 R *IPRU(INV)* 10-65 (Illiquid assets) only applies to a *firm* calculating *capital resources* under *GENPRU* 2 Annex 4R (Capital resources table for a *BIPRU* investment firm deducting material holdings).
- 8.17 G The reason for *BIPRU* TP 8.16R is explained in *BIPRU* TP 8.8G.
- 8.18 R A *firm* must calculate the credit risk charge for *commodities* in the *non-trading book* as a liquidity adjustment under *IPRU(INV)* 10-64(1)(c) in accordance with the *CRR rules* in Chapter 10. A *firm* must include that amount in the calculation of the *credit risk capital component*.
- 8.19 G A *firm* may still apply the *CRR* netting provisions for *commodities* in chapter 10 even though the calculation is split between the *credit risk capital component* and the *counterparty risk capital component* under *BIPRU* TP 8.18R and *BIPRU* TP 8.20R. The net amount should be allocated to the *credit risk capital component* if the gross value of the *non-trading book commodities* is bigger and to the *counterparty risk capital component* if the gross value of the *trading book commodities* is bigger.

How to use the chapter 10 CRR rules

- 8.20 R Subject to *BIPRU* TP 8.18R, a *firm* must calculate the *counterparty risk capital component* as being equal to the capital charge under the *CRR rules* that apply under *BIPRU* TP 8.11R.

Adjustments to the CRR calculations: General

- 8.21 G Broadly speaking the Directive transitional provisions that allow pre-2007 credit risk rules to be used in 2007 cover all credit risk rules. However the transitional provisions for *trading book* credit risk (Annex II of the *Capital Adequacy Directive*, which is implemented in *BIPRU* 14 (Capital requirements for settlement and counterparty risk)) is not quite as straightforward as that. In some cases pre-2007 requirements can be used. In others they cannot. The purpose of *BIPRU* TP 8.22R to *BIPRU* TP 8.25R is to reflect those cases in which the Directive requires the new requirements to apply from 1 January 2007.

Adjustments to the CRR calculations: Free deliveries

- 8.22 R (1) The calculations under *rule* 10-172 of *IPRU(INV)* (Free deliveries) are amended in accordance with this *rule*.
- (2) A *firm* must include *foreign currency* transactions.
- (3) The capital treatment in the table in *BIPRU* 14.4.3R (Capital treatment for free deliveries) applies. But when the capital treatment in that table is that the *firm* must treat the transaction as an *exposure*, the *firm* must apply the treatment in *rule* 10-172 rather than *BIPRU* 14 (Capital requirements for settlement and counterparty risk).

Adjustments to the CRR calculations: Derivative transactions

- 8.23 R A *firm* must treat a credit derivative in the *trading book* as a derivative to which *rule* 10-174 of *IPRU(INV)* (Derivative transactions) applies.
- 8.24 G The capital treatment for credit derivatives set out in *BIPRU* 14.2.5R - *BIPRU* 14.2.8R (Capital treatment for credit derivatives) does not apply.

Adjustments to the CRR calculations: Cash against documents

- 8.25 R A *firm* must include *foreign currency* transactions in the calculations under 10-171 of chapter 10 of *IPRU(INV)* (Cash against documents transactions).

How to use the chapter 10 large exposure rules

- 8.26 R 10-190 to 10-196 of chapter 10 of *IPRU(INV)* (Large exposures requirement) apply in place of *BIPRU* 10 (Concentration risk).
- 8.27 R A *firm* must calculate the *concentration risk capital component* as being equal to the capital charge under the LER *rules* that apply under *BIPRU* TP 8.11R.
- 8.28 R *BIPRU* 10.5.2R to *BIPRU* 10.5.5R (Capital resources for concentration risk purposes) apply in place of the corresponding provisions of chapter 10.

Specific risk calculations

- 8.29 R A *firm* must use chapter 10 of *IPRU(INV)* as it applies under *BIPRU* TP 3 (Pre CRD capital requirements applying on a solo basis during 2007) and this section to calculate the *specific risk* portion of the *interest rate PRR* under *BIPRU* 7.2 (Interest rate PRR) to the extent that the relevant *rules* in *BIPRU* 7.2 require the use of the *standardised approach* to credit risk.
- 8.30 R Any reference to a *qualifying debt security* or *qualifying equity* in a part of *BIPRU* that applies during 2007 must be interpreted in accordance with the definition in the Glossary to chapter 10 of *IPRU(INV)*. However *BIPRU* 7.2.50R (Must not apply *qualifying debt security* treatment to risky assets) also applies.
- 8.31 G The effect of *BIPRU* TP 8.29R and *BIPRU* TP 8.30R is that a *firm* should apply *rules* 43R to 47R of Appendix 4 of Chapter 10 of *IPRU(INV)* (Specific risk portion of interest rate PRR) instead of *BIPRU* 7.2.43R to *BIPRU* 7.2.49R (Specific risk portion of interest rate PRR). The reason for this is that the calculation of the *specific risk* portion of the *interest rate PRR* under *BIPRU* 7 (Market risk) involves the use of the *standardised approach* to credit risk. The *specific risk rules* therefore need to be adjusted for a *firm* that is not using the *standardised approach* to credit risk in 2007 so as to apply the pre-2007 method of calculating *specific risk*. The definition of *qualifying equity* also depends in part on the *standardised approach* to credit risk.

Definitions

- 8.32 R The definitions of trading book, non-trading book, commodity, financial institution, illiquid asset and material holding in the Glossary to chapter 10 of *IPRU(INV)* are replaced by the corresponding definitions in the *Glossary*.

Mapping GENPRU and BIPRU concepts onto IPRU

- 8.33 G Some of the parts of chapter 10 of *IPRU(INV)* that apply in 2007 refer to parts of *IPRU* that do not apply. *BIPRU* TP 3.10R explains that where this happens a *firm* should interpret that cross-reference in accordance with the provision in *BIPRU* or *GENPRU* that corresponds to the *IPRU* provision that does not apply in 2007. A *firm* should refer to *IPRU* in the case of cross-references in *GENPRU* and *BIPRU* to provisions in *GENPRU* and *BIPRU* that do not apply in 2007. *BIPRU* TP 8.34G sets out how certain concepts in chapter 10 of *IPRU(INV)* correspond to ones in *GENPRU* and *BIPRU*. The purpose of the table is to help *firms* to interpret such cross-references.
- 8.34 G Table: Mapping GENPRU and BIPRU concepts onto ones in chapter 10 of *IPRU(INV)*
This table belongs to *BIPRU* TP 8.33G

<i>GENPRU</i> and <i>BIPRU</i>	Chapter 10 of <i>IPRU(INV)</i>
Calculations of <i>counterparty risk capital component</i> and calculations under <i>BIPRU</i> 14 (Capital requirements for settlement and counterparty risk)	Calculation of CRR
<i>Illiquid asset</i>	Illiquid asset
Deduction from <i>capital resources</i> as an <i>illiquid asset</i>	100% liquidity adjustment
Calculation of the <i>credit risk capital component</i>	8% liquidity adjustment
<i>Concentration risk capital component</i>	LER
Unsettled transaction under <i>BIPRU</i> 14.3	Cash against documents (<i>IPRU(INV)</i> 10-171)
<i>Free deliveries</i> under <i>BIPRU</i> 14.4	Free deliveries (<i>IPRU(INV)</i> 10-172)
Calculation of <i>PRR</i> or of the <i>market risk capital requirement</i>	Calculation of <i>PRR</i> and the foreign exchange requirement
<i>Capital resources</i> calculations under <i>GENPRU</i> 2 Ann 4R	Financial resources calculation under table 10-62(2)A
<i>Capital resources</i> calculations under <i>GENPRU</i> 2 Ann 6R	Financial resources calculation under table 10-62(2)B
<i>Capital resources</i> calculations under <i>GENPRU</i> 2 Ann 5R respectively	Financial resources calculation under table 10-62(2)C
<i>Investment firm consolidation waiver</i>	Exemption from consolidated supervision
<i>Commodity extended maturity ladder approach</i>	Modified maturity ladder approach (relevant to the CRR calculation – see 10-174)
The table in <i>BIPRU</i> 7.8.28R (Net underwriting position reduction factors)	Table 27R of Appendix 7 (Net underwriting position reduction factors)
Consolidated supervision in accordance with <i>rules</i> 10-200 to 10-203 (see for example the reference in <i>rule</i> 10-192(1)(g))	Consolidated supervision under <i>BIPRU</i> 8 (Group risk – consolidation)

<i>GENPRU and BIPRU</i>	Chapter 10 of <i>IPRU(INV)</i>
<i>Initial capital</i>	Initial capital
<i>Tier one capital resources plus tier two capital resources after deductions (stage N of the capital resources table)</i>	Own funds
<i>Capital resources</i>	Financial resources (as referred to for example in <i>rule 10-74</i>)
Externally verified interim net profits and losses and partners' capital as referred to in <i>GENPRU 2.2.102R</i>	Interim profit and loss account (as referred to in <i>rule 10-74</i>)
<i>trading book concentration risk excess</i>	Excess D under <i>rule 10-194(3)</i>
<i>Risk weight</i>	Counterparty weight.

Firms using the IRB approach during 2007: General

- 8.35 R *BIPRU* TP 8.36G to *BIPRU* TP 8.38R only apply to a *firm* that is applying the *IRB approach* under *BIPRU* TP 3 (Pre CRD capital requirements applying on a solo basis during 2007) as well as using *IPRU*.
- 8.36 G The effect of *BIPRU* TP 3.17G (Pre CRD capital requirements applying on a solo basis during 2007 for *firms* also using the *IRB approach*) is that neither the illiquid asset adjustment nor the CRR requirements of chapter 10 apply to an *exposure* to which the *firm* applies the *IRB approach*. The *IRB approach* requirements in *BIPRU* apply instead. The main requirements are listed in *BIPRU* TP 3.17G.
- 8.37 R A *firm* must apply *BIPRU* 7.2.45R - *BIPRU* 7.2.47R (Using internal ratings to calculate *specific risk* and treatment of *securitisations*) to calculate the *specific risk* portion of the *interest rate PRR* to the extent that the obligor or *exposure* in question comes within the scope of its *IRB permission*.
- 8.38 R The definitions of *qualifying debt security* and *qualifying equity* in the *Glossary* apply if the security or obligor in question comes within the scope of a *firm's IRB permission*.

- TP 9 Pre CRD capital requirements applying on a solo basis during 2007 and capital floors: Personal investment firms
- Application
- 9.1 R This section (except *BIPRU* TP 9.45R) applies to a *BIPRU* firm that:
- (1) is a *personal investment firm*; and
 - (2) is applying *BIPRU* TP 3.4R (Use of IPRU on a solo basis during 2007).
- 9.2 G *BIPRU* TP 9.45R applies to a *BIPRU* firm that:
- (1) is a *personal investment firm*; and
 - (2) applies *BIPRU* TP 2 (Capital floors for a firm using the IRB or AMA approaches).
- Purpose of this section
- 9.3 G *BIPRU* TP 3 (Pre CRD capital requirements applying on a solo basis during 2007) says that during 2007 a *firm* may apply the credit risk requirements of *IPRU* instead of the ones in *BIPRU*. For a *personal investment firm* this involves applying the credit risk requirements in chapter 13 of *IPRU(INV)*. This section explains how this is done. In particular this section explains:
- (1) which parts of chapter 13 should be treated as credit risk requirements for this purpose;
 - (2) what parts of chapter 13 apply during 2007 and what changes are made to chapter 13 for that purpose; and
 - (3) what changes are made to *GENPRU* and *BIPRU* to reflect the fact that chapter 13 applies in place of parts of *GENPRU* and *BIPRU*.
- 9.4 G This section also explains how the obligation in *BIPRU* TP 2 (Capital floors for a firm using the IRB or AMA approaches) is applied to a *personal investment firm*.
- Duration of transitional
- 9.5 R This section applies until 1 January 2008.
- Drafting approach in this section

- 9.6 G The purpose of *BIPRU* TP 3 (Pre CRD capital requirements applying on a solo basis during 2007) is that the basic provisions of *BIPRU* and *GENPRU* should be in force from 1 January 2007. However a *firm* should be able to calculate the capital requirements for credit risk under *IPRU* and use the large exposures requirements in *IPRU*. This means that a *firm* should slot the credit risk requirements of chapter 13 of *IPRU(INV)* into the general requirements of *GENPRU* and *BIPRU*.
- 9.7 G The capital calculation for credit risk under *BIPRU* is made up of three elements, which are set out in *GENPRU* 2.1.51R (Calculation of the credit risk capital requirement). These are the *credit risk capital component*, the *counterparty risk capital component* and the *concentration risk capital component*. So the approach in *BIPRU* TP 9.6G involves finding equivalents for these three elements in chapter 13 where possible.
- 9.8 G The general approach to calculating the capital requirements for credit risk in *GENPRU* and *BIPRU* is to calculate the overall *credit risk capital requirement* (which is the sum of the three components listed in *BIPRU* TP 9.7G) – a monetary amount - and to compare it with *capital resources*, also a monetary amount. A *firm* calculating its *capital resources* may usually choose between deducting *illiquid assets* and *material holdings*. Only if it has a *waiver* from consolidated supervision need it deduct both.
- 9.9 G The drafting approach of chapter 13 to calculating the capital requirement for credit risk is different from the one in *GENPRU* and *BIPRU*. A *firm* calculates financial resources by adjusting the assets in the balance sheet, taking into account liabilities. Financial resources are then used to test compliance with an own funds test, an expenditure based requirement test and a net asset test. The equivalent of a credit risk charge in Chapter 13 is the deduction of an asset as an Illiquid Adjustment or the deduction of a portion of an asset calculated using the Counterparty Risk Adjustment. Both illiquid assets and material holdings in *credit institutions*, *investment firms* and *insurers* are deducted under Chapter 13.
- 9.10 G To make the *GENPRU* and *BIPRU* requirements compatible with chapter 13 for the purpose of *BIPRU* TP 3 (Pre CRD capital requirements applying on a solo basis during 2007), this section takes the approach in *BIPRU* TP 9.11G to *BIPRU* TP 9.18G.
- 9.11 G The *illiquid assets* and *material holdings* provisions of *GENPRU* 2.2 (Capital resources) apply.
- 9.12 G The chapter 13 Illiquid Adjustment and the chapter 13 Counterparty Risk Adjustment are used to calculate the *BIPRU* credit risk charge for *non-trading book* items (called the *credit risk capital component*) and the *BIPRU* credit risk charge for *trading book* items (called the *counterparty risk capital component*).

- 9.13 G When this section requires a *firm* to apply an Illiquid Adjustment to an asset a *firm* should apply a credit risk charge to that asset equal to the amount of the Illiquid Adjustment under Chapter 13 and include that charge in the calculation of the total credit risk charge. The amount of that credit risk charge will generally be equal to the amount of that asset. This is equivalent to a deduction from capital. A *firm* should not apply an Illiquid Adjustment to the extent that the asset has already been included as an *illiquid asset* or *material holding* and deducted from *capital resources* under *GENPRU 2.2*.
- 9.14 G The Chapter 13 Position Risk Adjustment no longer applies. If a *firm* has a *trading book*, an item in the *trading book* that would have received a Position Risk Adjustment is subject to a capital charge under *BIPRU 7* (Market risk). An item in a *firm's non-trading book* that would have received a Position Risk Adjustment is subject under this section to an Illiquid Adjustment. A *firm* should approach its usual supervisory contact at the *FSA* if it believes that this treatment is disproportionate.
- 9.15 G When this section requires a *firm* to apply a Counterparty Risk Adjustment to an asset a *firm* should apply a credit risk charge to that asset equal to the amount of the Counterparty Risk Adjustment under Chapter 13 and include that charge in the calculation of the total credit risk charge. The amount of that credit risk charge will generally be equal to the amount of that asset multiplied by the percentage in Table 13.5.4B or 13.5.4C. A *firm* should not apply a Counterparty Risk Adjustment to the extent that the asset has already been included as an *illiquid asset* or *material holding* and deducted from *capital resources* under *GENPRU 2.2*.
- 9.16 G All *non-trading book* items are excluded under *IPRU(INV) 13.8*. This exclusion is incorporated in the calculations under this section as a credit risk charge of 100%. *IPRU(INV) 13.8* does not apply if the *firm* does not have a *trading book*.
- 9.17 G The calculation of the capital requirements for credit risk in *GENPRU* and *BIPRU* is based on applying a capital charge to the *firm's* assets. The credit risk charge in *GENPRU* and *BIPRU* in broad terms reflects the risk to a *firm* that it will suffer loss because its counterparties do not pay what they owe to the *firm*. Thus generally it is not necessary to continue the requirement in Table 13.5.4 to deduct liabilities. However it is still necessary to include other liabilities deducted as part of the calculation of financial resources under Chapter 13 if they are of the type listed in section 4 of Chapter BC of *IPRU(BANK)*. This is because the Directive provisions that allow pre-2007 credit risk requirements to be used during 2007 require a capital charge for this type of item. In practice it is unlikely that these items will be relevant to a *personal investment firm* except for guarantees.
- 9.18 G The chapter 13 Large exposure Adjustment is used to calculate the *concentration risk capital component*. This is only relevant to a *firm* with a *trading book*.

Parts of chapter 13 of IPRU(INV) that apply in 2007

- 9.19 R The parts of chapter 13 of *IPRU(INV)* that do and do not apply during the period that *BIPRU* TP 3.4R applies are set out in *BIPRU* TP 9.21R.
- 9.20 G The table in *BIPRU* TP 9.21R assumes that the *firm* is not applying the *IRB* approach. *BIPRU* TP 9.41R to *BIPRU* TP 9.44R deal with a *firm* that does apply the *IRB* approach.
- 9.21 R Table: Parts of chapter 13 of IPRU(INV) that apply in 2007
This table belongs to *BIPRU* TP 9.19R

Chapter 13 rule	A Y denotes that the provision does apply An N denotes that it does not apply	Remarks
13.1 (Application)	N	<i>BIPRU</i> TP 9.1R and <i>BIPRU</i> TP 9.2R apply instead
13.1.2 (General requirements)	N	
13.1.3 to 13.1.6 (Professional Indemnity insurance)	N	
13.1.7 to 13.1.9 (Notification)	N	
13.1.10 to 13.1.17 (Record keeping)	N	Applied in part under <i>BIPRU</i> TP 23 (Record keeping transitionals)
13.2 (Financial Resources Tests)	N	
13.3 (Financial Resources Test 1 – Own funds)	N	
13.4 (Financial resources Test 1A – Adjusted net current assets)	N	

Chapter 13 <i>rule</i>	A Y denotes that the provision does apply An N denotes that it does not apply		Remarks
13.5.1R to 13.5.3AG (Expenditure-based Requirement)	N		
13.5.4 (Calculation of financial resources to meet Tests 1, 1A or 2)	Y		Only applies for the purpose of deciding whether Table 13.5.4(1) or Table 13.5.4(2) applies
13.5.4A (Obligation to identify trading book items and special adjustments)	Y		Does not apply to special adjustments that do not apply under this section
Part I of Tables 13.5.4(1) and (2) (Net assets requirement for firms in Category A): (Assets calculation)	Illiquid Adjustment	Y	See <i>BIPRU</i> TP 9.23R to <i>BIPRU</i> TP 9.26G
	Counterparty Risk Adjustment	Y	See <i>BIPRU</i> TP 9.23R to <i>BIPRU</i> TP 9.31G
	Position Risk Adjustment	N	If an <i>exposure</i> in the <i>non-trading book</i> would have been subject to a Position Risk Adjustment a <i>firm</i> must apply an Illiquid Adjustment to it.
	Large exposure Adjustment	Y	See <i>BIPRU</i> TP 9.34R

Chapter 13 <i>rule</i>	A Y denotes that the provision does apply An N denotes that it does not apply	Remarks
Part II of Tables 13.5.4(1) and (2) (Net assets requirement for firms in Category A): (Liabilities calculation)	Counterparty Risk Adjustments	Y See <i>BIPRU</i> TP 9.23R to <i>BIPRU</i> TP 9.31G
	Liabilities if they are listed in section 4 of Chapter BC of <i>IPRU(BANK)</i> and are in the <i>firm's non-trading book</i>	Y (1) This applies whether they are on or off balance sheet. (2) A <i>firm</i> must include liabilities under a credit derivative. (3) See <i>BIPRU</i> TP 9.23R
	Position Risk Adjustment	N If an <i>exposure</i> in the <i>non-trading book</i> would have been subject to a Position Risk Adjustment a <i>firm</i> must apply an Illiquid Adjustment to it.
	The rest	N
Table 13.5.4A (Position risk)	N	
Table 13.5.4B (Unsettled securities transactions)	N	See <i>BIPRU</i> TP 9.28R
Table 13.5.4C (Counterparty risk)	Y	See <i>BIPRU</i> TP 9.23R to <i>BIPRU</i> TP 9.31G
Table 13.5.4D (Over the counter derivatives)	Y	See <i>BIPRU</i> TP 9.26G and <i>BIPRU</i> TP 9.30R to <i>BIPRU</i> TP 9.31G
Table 13.5.4E (Foreign exchange risk)	N	

Chapter 13 <i>rule</i>	A Y denotes that the provision does apply An N denotes that it does not apply	Remarks
13.5.5 to 13.5.5C (Subordinated debt)	N	
13.6 (Large exposures)	Y	See <i>BIPRU</i> TP 9.32R to <i>BIPRU</i> TP 9.34R
13.7 (Consolidated Supervision of Group Companies)	N	
13.8 (Trading book)	Table 13.8(1) (Definition of trading book)	N
	The rest	Y See <i>BIPRU</i> TP 9.23R and <i>BIPRU</i> TP 9.38R
13.9 to 13.9.12 (Financial resources tests for Category B firms)	N	
Glossary for chapter 13	Y	See <i>BIPRU</i> TP 9.38R

Categorisation

- 9.22 R Each *firm* is a Category A firm for the purposes of chapter 13 of *IPRU(INV)* as applied by *BIPRU* TP 3 (Pre CRD capital requirements applying on a solo basis during 2007) and this section.

How to use the chapter 13 Illiquid Adjustment and the Counterparty Risk Adjustment

- 9.23 R A *firm* must calculate the sum of the *credit risk capital component* and the *counterparty risk capital component* as being equal to the sum of the following:

- (1) the amount of the Illiquid Adjustments under chapter 13 of *IPRU(INV)* so far as they are in force under *BIPRU* TP 9.21R;

- (2) the amount of any *non-trading book* assets that would be excluded under *rule* 13.8.2 of chapter 13 of *IPRU(INV)* (exclusion of *non-trading book* items from financial resources calculations);
 - (3) the amount in relation to unsettled securities transactions (Cash against documents) specified in *BIPRU* TP 9.28R;
 - (4) the amount in relation to unsettled securities transactions (Free deliveries) specified in *BIPRU* TP 9.29R;
 - (5) the amount of the Counterparty Risk Adjustments under whichever is applicable of point 22 of Part II of Table 13.5.4(1) and point 22 of Part II of Table 13.5.4(2) of chapter 13 of *IPRU(INV)* (Liabilities adjustments relating to OTC derivatives for calculating financial resources);
 - (6) the amount of the other Counterparty Risk Adjustments under whichever is applicable of Part I of Table 13.5.4(1) and Part I of Table 13.5.4(2) of chapter 13 of *IPRU(INV)* (Assets adjustments for calculating financial resources); and
 - (7) the amount of any other liabilities under whichever is applicable of Part II of Table 13.5.4(1) and Part II of Table 13.5.4(2) of chapter 13 of *IPRU(INV)* but only to the extent provided by *BIPRU* TP 9.21R.
- 9.24 R A *firm* must not apply a credit risk charge to an *exposure* under *BIPRU* TP 9.23R to the extent that it has already been deducted as an *illiquid asset* or a *material holding* under *GENPRU* 2.2 (Capital resources).
- 9.25 R If it is necessary to distinguish between the *credit risk capital component* and the *counterparty risk capital component* a *firm* must allocate:
- (1) any amount calculated for an *exposure* in the *non-trading book* to the *credit risk capital component*; and
 - (2) any amount calculated for an *exposure* in the *trading book* to the *counterparty risk capital component*.
- 9.26 G A *firm* may still apply the netting provisions for OTC derivatives in chapter 13 even though the OTC derivative calculation is split between the *credit risk capital component* and the *counterparty risk capital component* under *BIPRU* TP 9.25R. The net amount should be allocated to the *credit risk capital component* if the gross value of the *non-trading book* derivatives is bigger and to the *counterparty risk capital component* if the gross value of the *trading book* derivatives is bigger.

Adjustments to the Counterparty Risk Adjustments calculations: General

- 9.27 G Broadly speaking the Directive transitional provisions that allow pre-2007 credit risk rules to be used in 2007 cover all credit risk rules. However the transitional provisions for *trading book* credit risk (Annex II of the *Capital Adequacy Directive*, which is implemented in *BIPRU* 14 (Capital requirements for settlement and counterparty risk)) is not quite as straightforward as that. In some cases pre-2007 requirements can be used. In others they cannot. The purpose of *BIPRU* TP 9.28R to *BIPRU* TP 9.31G is to reflect those cases in which the Directive requires the new requirements to apply from 1 January 2007.

Adjustments to the Counterparty Risk Adjustments calculations: Unsettled Securities Transactions

- 9.28 R (1) The calculation of the credit risk charge for unsettled securities transactions is based on the Counterparty Risk Adjustment for such transactions adjusted in accordance with this *rule*.
- (2) Subject to the rest of this *rule*, the amount of the credit risk charge is equal to the Counterparty Risk Adjustment under paragraphs (a) and (b) in the unsettled securities transactions sections of Table 13.5.4(1) or (2).
- (3) The credit risk charge applies where the *firm* is exposed to loss if the counterparty does not perform.
- (4) A *firm* must calculate the Counterparty Risk Adjustment for an unsettled securities transaction in the *trading book* under *BIPRU* 14.3 (Unsettled transactions) rather than under chapter 13 of *IPRU(INV)*.

Adjustments to the Counterparty Risk Adjustments calculations: Free deliveries

- 9.29 R (1) The calculation of the credit risk charge for a free delivery is based on the Counterparty Risk Adjustment for such transactions adjusted in accordance with this *rule*.
- (2) Subject to the rest of this *rule*, the amount of the credit risk charge is equal to the Counterparty Risk Adjustment under paragraphs (a) and (b) in the free delivery sections of Table 13.5.4(1) or (2).
- (3) A *firm* must include *foreign currency* and *commodity* for the purpose of *trading book* calculations.
- (4) The capital treatment in the table in *BIPRU* 14.4.3R (Capital treatment for free deliveries) applies for the purpose of *trading book* calculations. But when the capital treatment in that table is that the *firm* must treat the transaction as an *exposure*, the *firm* must calculate a credit risk charge equal to the amount in (2).

Adjustments to the Counterparty Risk Adjustments calculations: Derivative transactions

9.30 R A *firm* must treat a credit derivative in the *trading book* as a derivative to which paragraph 22 of Part II of Table 13.5.4(1), paragraph 22 of Part II of Table 13.5.4(2) and table 13.5.4D of chapter 13 of *IPRU(INV)* (Over the counter derivatives) apply.

9.31 G The capital treatment for a credit derivative set out in *BIPRU* 14.2.5R - *BIPRU* 14.2.8R (Capital treatment for credit derivatives) does not apply.

How to use the chapter 13 large exposure rules

9.32 R Section 13.6 of chapter 13 of *IPRU(INV)* (Large exposures) applies in place of *BIPRU* 10 (Concentration risk).

9.33 R The following adjustments are made to section 13.6 of chapter 13 of *IPRU(INV)* (Large exposures):

- (1) *BIPRU* 10.5.2R to *BIPRU* 10.5.5R (Capital resources for concentration risk purposes) apply in place of the definition of own funds that applies under section 13.6 of chapter 13 of *IPRU(INV)*;
- (2) *rule* 13.6.2B (Excess over EBR should not be excluded) does not apply; and
- (3) *BIPRU* 10.5.14R (Notification) applies instead of the notification requirement in 13.6.

9.34 R A *firm* must calculate its *concentration risk capital component* as being equal to the sum of the Large exposure Adjustments under whichever is applicable of Part I of Table 13.5.4(1) and Part I of Table 13.5.4(2) of chapter 13 of *IPRU(INV)* (Assets adjustments for calculating financial resources).

Specific risk calculations

9.35 R A *firm* must calculate the *specific risk* portion of the *interest rate PRR* in accordance with *BIPRU* TP 8.29R (Pre CRD interest rate *PRR* for *securities and futures firms*).

9.36 R Any reference to a *qualifying debt security* in a part of *BIPRU* that applies during 2007 must be interpreted in accordance with the definition in the Glossary to chapter 13 of *IPRU(INV)*. However *BIPRU* 7.2.50R (Must not apply *qualifying debt security* treatment to risky assets) also applies. Any reference to a *qualifying equity* in a part of *BIPRU* that applies during 2007 must be interpreted in accordance with the definition in the Glossary to chapter 10 of *IPRU(INV)*.

9.37 R The reason for *BIPRU* TP 9.35R and *BIPRU* TP 9.36R is that the calculation of the *specific risk* portion of the *interest rate PRR* under *BIPRU* 7 (Market risk) involves the use of the *standardised approach* to credit risk. The *specific risk rules* therefore need to be adjusted for a *firm* that is not using the *standardised approach* to credit risk in 2007 so as to apply the pre-2007 method of calculating *specific risk*. However chapter 13 does not distinguish between *specific risk* and *general market risk*. The nearest equivalent is in chapter 10 of *IPRU(INV)* (*Securities and futures firms*). The definition of *qualifying equity* also depends in part on the *standardised approach* to credit risk.

Definitions

9.38 R The definition of trading book is replaced with the definition in the *Glossary*. Section 13.8 of chapter 13 of *IPRU(INV)* (Trading book) and the definition in the *Glossary* to chapter 13 are amended accordingly.

Mapping GENPRU and BIPRU concepts onto IPRU

9.39 G Some of the parts of chapter 13 of *IPRU(INV)* that apply in 2007 refer to parts of chapter 13 that do not apply. *BIPRU* TP 3.10R explains that where this happens a *firm* should interpret that cross-reference in accordance with the provision in *BIPRU* or *GENPRU* that corresponds to the chapter 13 provision that does not apply in 2007. A *firm* should refer to *IPRU* in the case of cross-references in *GENPRU* and *BIPRU* to provisions in *GENPRU* and *BIPRU* that do not apply in 2007. *BIPRU* TP 9.40G sets out how certain concepts in chapter 13 of *IPRU(INV)* correspond to ones in *GENPRU* and *BIPRU*. The purpose of the table is to help *firms* to interpret such cross-references.

9.40 G Table: Mapping GENPRU and BIPRU concepts onto ones in chapter 13 of *IPRU(INV)*
This table belongs to *BIPRU* TP 9.39G

<i>GENPRU</i> and <i>BIPRU</i>	Chapter 13 of <i>IPRU(INV)</i>
See <i>BIPRU</i> TP 9.10G to <i>BIPRU</i> TP 9.17G	Illiquid Adjustment
See <i>BIPRU</i> TP 9.10G to <i>BIPRU</i> TP 9.17G	Counterparty Risk Adjustment
See <i>BIPRU</i> TP 9. 18G	Large exposure Adjustment
<i>Material holding</i>	The nearest equivalent is point 13 of Part I of Table 13.5.4(1) and (2) (All other assets)

<i>GENPRU</i> and <i>BIPRU</i>	Chapter 13 of <i>IPRU(INV)</i>
Unsettled transaction under <i>BIPRU</i> 14.3	Cash against documents
<i>Free deliveries</i> under <i>BIPRU</i> 14.4	Free deliveries
<i>Market risk capital requirement</i>	The Position Risk Adjustment and the Foreign Exchange Risk Adjustment
<i>Trading book concentration risk excess</i>	Excess X in Table 13.6.2(2)
A <i>firm</i> should use the <i>specific risk</i> portion of the relevant <i>PRR charge</i> under <i>BIPRU</i> 7 (Market risk) (subject to the other provisions of this section about specific risk) where Chapter 13 as applied by this section requires the <i>firm</i> to apply position risk discounts.	Position risk discounts (particularly relevant for the purposes of Table 13.6.2(2))
<i>Risk weight</i>	Where Chapter 13 requires an asset to be deducted from capital that is equivalent to applying a <i>risk weight</i> of 1250%. Applying the 1.6% adjustment under Table 13.5.4C is equivalent to applying a 20% <i>risk weight</i> under <i>BIPRU</i> together with the standard 8% <i>BIPRU</i> credit risk charge. The "NIL" adjustment under that table is equivalent to applying a 0% <i>risk weight</i> .

Firms using the IRB approach during 2007: General

- 9.41 R *BIPRU* TP 9.42G to *BIPRU* TP 9.44R only apply to a *firm* that is applying the *IRB approach* under *BIPRU* TP 3 (Pre CRD capital requirements applying on a solo basis during 2007) as well as using *IPRU*.

- 9.42 G The effect of *BIPRU* TP 3.17G (Pre CRD capital requirements applying on a solo basis during 2007 for *firms* also using the *IRB approach*) is that the Counterparty Risk Adjustments do not apply to an *exposure* to which the *firm* applies the *IRB approach*. The *IRB approach* requirements in *BIPRU* apply instead. The main requirements are listed in *BIPRU* TP 3.17G. The same applies to the Illiquid Adjustments although *illiquid assets* or *material holdings* will still have to be deducted under *GENPRU* 2.2 (Capital resources).
- 9.43 R A *firm* must apply *BIPRU* 7.2.45R - *BIPRU* 7.2.47R (Using internal ratings to calculate *specific risk* and treatment of *securitisations*) to calculate the *specific risk* portion of the *interest rate PRR* to the extent that the obligor or *exposure* in question comes within the scope of its *IRB permission*.
- 9.44 R The definition of *qualifying debt security* and *qualifying equity* in the *Glossary* apply if the security or obligor in question comes within the scope of a *firm's IRB permission*.

Calculation of capital floors under *BIPRU* TP 2

- 9.45 R (1) This paragraph sets out how the obligation in *BIPRU* TP 2 (Capital floors for a firm using the *IRB* or *AMA* approaches) is applied to a *personal investment firm*.
- (2) A *firm* must apply Financial Resources Test 2 (Expenditure-based Requirement) for the periods specified in *BIPRU* TP 2 by multiplying the Expenditure-based Requirement by the percentage figure in *BIPRU* TP 2.8R or *BIPRU* TP 2.9R.
- (3) *BIPRU* TP 2 does not apply to Financial Resources Test 1 (Own funds) or Financial Resources Test 1A (Adjusted net current assets).

- TP 10 Pre CRD capital requirements applying on a consolidated basis during 2007
Application
- 10.1 R This section applies to a *firm* to which *BIPRU* 8 (Consolidation) applies.
Purpose
- 10.2 G This section sets out how *BIPRU* TP 3 - *BIPRU* TP 9 (Use of *IPRU* during 2007) are applied on a consolidated basis.
Duration of transitional
- 10.3 R *BIPRU* TP 10 applies until 1 January 2008.
Main rule
- 10.4 R A *firm* may apply *BIPRU* TP 3 to *BIPRU* TP 9 (Use of *IPRU* during 2007 on a solo basis) on a consolidated basis. Applying them on a consolidated basis means that *BIPRU* 8 (Group risk - Consolidation) is modified by applying the relevant parts of *BIPRU* TP 3 to *BIPRU* TP 9 (as defined in *BIPRU* TP 10.5R) in place of the corresponding *BIPRU* credit risk and other rules.
- 10.5 R (1) This rule sets out what the relevant parts of *BIPRU* TP 3 to *BIPRU* TP 9 (Use of *IPRU* during 2007 on a solo basis) are for the purposes of *BIPRU* TP 10.4R. The answer depends on the kind of *UK consolidation group* or *non-EEA sub-group* ("group") to which consolidated requirements are being applied.
- (2) If the group is a building society group as defined in *BIPRU* TP 1.7R, the relevant parts of *BIPRU* TP 3 to *BIPRU* TP 9 are those applicable to a *building society*.
- (3) If the group is a banking group as defined in *BIPRU* TP 1.7R, the relevant parts of *BIPRU* TP 3 to *BIPRU* TP 9 are those applicable to a *bank*.
- (4) If the group is an investment services group as defined in *BIPRU* TP 1.7R, the relevant parts of *BIPRU* TP 3 to *BIPRU* TP 9 are those applicable to the main *BIPRU investment firm* in that group. For these purposes the main *BIPRU investment firm* is identified in the same way as the "main *firm*" is identified under rule 14.4.2R(1) of chapter 14 *IPRU(INV)*.

- 10.6 G The application of *BIPRU* TP 3 (Pre CRD capital requirements applying on a solo basis during 2007) on a consolidated basis is not done by applying the relevant consolidation provisions in *IPRU*. *BIPRU* 8 (Group risk - Consolidation) still applies, as modified by this section. *BIPRU* TP 10.7G to *BIPRU* TP 10.12G summarise how *BIPRU* TP 3 works on a consolidated basis under this section assuming that the *firm* does not use the *IRB approach*.
- 10.7 G The consolidated credit risk charge (called the *consolidated credit risk requirement*) is normally calculated under *BIPRU* 8 by applying the solo *BIPRU* credit risk charges on a consolidated basis. Under this section the *IPRU* credit risk charges are applied instead, as modified by *BIPRU* TP 3 to *BIPRU* TP 9 (Use of *IPRU* during 2007 on a solo basis).
- 10.8 G Under this section the applicable *IPRU* large exposure requirements, as modified by *BIPRU* TP 3 to *BIPRU* TP 9, apply instead of the ones in *BIPRU* 10 (Concentration risk requirements). *BIPRU* TP 10.15R disapplies most of *BIPRU* 8.9 (Consolidated concentration risk requirements).
- 10.9 G A *firm* should calculate the *consolidated credit risk requirement* so far as it relates to the *concentration risk capital component* using the relevant *IPRU rules*. In particular a *firm* should not use the capital requirements of a regulator other than the *FSA* for this purpose.
- 10.10 G A *firm* should still base its capital resources calculation for consolidation purposes on *BIPRU* 8.6 (Consolidated capital resources) rather than using the *IPRU* capital resources calculations. In turn, *BIPRU* 8.6 is based on *GENPRU* 2.2 (Capital resources). This applies for consolidated concentration risk purposes as well.
- 10.11 G *BIPRU* 8.4 (CAD Article 22 groups and investment firm consolidation waiver) still applies.
- 10.12 G The calculation of consolidated capital requirements under *BIPRU* 8.7 (Consolidated capital resources requirements) depends in part on whether the group contains *banks*, *BIPRU limited activity firms* or *BIPRU limited license firms*. This continues to apply for the purpose of this section in addition to *BIPRU* TP 10.5R. So for instance, if a group contains only *BIPRU limited license firms* the consolidated capital requirements for the group are based on the capital requirements for *BIPRU limited license firms*. However in addition if, for example, the main *firm* (as defined in *BIPRU* TP 10.5R) is a *personal investment firm* the requirements for *BIPRU limited license firms* are modified in accordance with *BIPRU* TP 9 (Pre CRD capital requirements applying on a solo basis during 2007 and capital floors: Personal investment firms). The calculation of notional capital resources requirements under *BIPRU* 8.4.13R (Capital adequacy obligations relating to a CAD Article 22 group: Capital resources requirement) works in a similar way.

Consolidated capital resources requirement: Use of home state requirements for EEA firms

- 10.13 R A *firm* may, for the purposes of *BIPRU* TP 10.4R, use the solo financial resources requirement to which an *EEA firm* is subject in accordance with *BIPRU* 8.7.34R (Use of the solo requirements of another EEA competent authority) or the consolidated financial resources requirements of an *EEA competent authority* under *BIPRU* 8.7.37R (Use of the consolidated requirements of another EEA competent authority). However those requirements must be ones that apply under the *CRD implementation measures* for Articles 152(8) – (14) of the *Banking Consolidation Directive* and Article 50(1) of the *Capital Adequacy Directive* for the relevant *EEA State* (Pre CRD capital requirements applying during 2007).

Consolidated capital resources requirement: Use of home state requirements for third country undertakings

- 10.14 R (1) A *firm* may, for the purposes of *BIPRU* TP 10.4R, use the solo financial resources requirement of a *third country competent authority* in accordance with *BIPRU* 8.7.35R (Use of the solo requirements of a regulator outside the EEA) or the consolidated financial resources requirements of a *third country competent authority* under *BIPRU* 8.7.38R (Use of the consolidated requirements of a regulator outside the EEA) in accordance with the adjustments in this *rule*.
- (2) The list in *BIPRU* 8 Ann 6R (List of equivalent third country regulators) does not apply and instead:
- (a) if the *UK consolidation group* or *non-EEA sub-group* is a banking group or building society group as defined in *BIPRU* TP 1.7R (Classification of groups for certain consolidation rules), the list in Appendix D of chapter CS of *IPRU(BANK)* applies; and
 - (b) if the *UK consolidation group* or *non-EEA sub-group* is an investment firm group as defined in *BIPRU* TP 1.7R, the list in Appendix 57 of chapter 10 of *IPRU(INV)* applies.
- (3) The *firm* must apply the version of those requirements in force on 31 December 2006 or any later version that remains consistent with *EEA prudential sectoral legislation* for the *banking sector* or *investment services sector* in the form it was in on 31 December 2006.
- (4) The requirement in *BIPRU* 8.7.35R(2) and the last sentence of *BIPRU* 8.7.38R(2) (Requirement for calculation not to produce a lower figure than the *FSA's rules*) still applies.

Consolidated large exposures

- 10.15 R *A firm must apply the concentration risk requirements under BIPRU TP 3 to BIPRU TP 9 (Use of IPRU during 2007 on a solo basis) applicable to its UK consolidation group or non-EEA sub-group under BIPRU TP 10.4R as if it were a single undertaking. BIPRU 8.9.2R (Definition of consolidated capital resources for concentration risk purposes) applies for the purpose of this rule. BIPRU 8.9 (Consolidated concentration risk requirements) does not otherwise apply.*

- TP 11 IRB transitionals
- Application
- 11.1 R *BIPRU* TP 11 applies to a *BIPRU* firm that uses the *IRB* approach.
- Purpose
- 11.2 G *BIPRU* TP 11 implements Articles 154(2), (3) and (5) of the *Banking Consolidation Directive* and (in part) Article 17 of the *Capital Adequacy Directive*.
- Use requirement
- 11.3 R In accordance with Article 154(2) of the *Banking Consolidation Directive*, for a firm applying for the use of the *IRB* approach before 2010, the three years' use requirement prescribed in *BIPRU* 4.2.11R (Requirements concerning the experience requirement) is reduced to a period of one year until 31 December 2009.
- 11.4 R In accordance with Article 154(3) of the *Banking Consolidation Directive*, for a firm applying for the use of own estimates of *LGDs* and/or *conversion factors*, the three year use requirement prescribed in *BIPRU* 4.2.13R (Requirements concerning the experience requirement) is reduced to two years until 31 December 2008.
- 11.5 G The transitional period in *BIPRU* TP 11.3R rather than that in *BIPRU* TP 11.4R applies to *retail exposures*.
- Residential properties
- 11.6 R In accordance with Article 154(5) of the *Banking Consolidation Directive*, until 31 December 2010, the *exposure*-weighted average *LGD* for all *retail exposures* secured by residential properties and not benefiting from guarantees from central governments must not be lower than 10%.
- Expected loss
- 11.7 R *BIPRU* TP 11.3R to *BIPRU* TP 11.6R also apply for the purpose of *BIPRU* 14.2.18R and *BIPRU* 14.2.19R (Treatment of expected loss amounts under the *IRB* approach) and *GENPRU* 2.2.193R (Upper tier two capital: Surplus provisions).

- TP 12 Operational risk transitionals: small trading book
- Application
- 12.1 R Subject to *BIPRU* TP 12.2R, *BIPRU* TP 12 applies to a *BIPRU investment firm* that satisfies the following conditions:
- (1) it is a *full scope BIPRU investment firm*;
 - (2) it does not fall within the definition of *limited licence firm* or *limited activity firm* in *BIPRU* 1.1.11R to *BIPRU* 1.1.12R (Definitions of *limited licence firm* or *limited activity firm*);
 - (3) its total *trading book positions* never exceed 50 million Euro;
 - (4) the average number of its relevant employees during the financial year does not exceed 100; and
 - (5) the *firm* has a *waiver* that modifies *BIPRU* 6 (Operational risk) so as to require the *firm* to calculate its *ORCR* in accordance with *BIPRU* TP 12.
- 12.2 R *BIPRU* TP 12.12R to *BIPRU* TP 12.14G apply to any *firm* to which *BIPRU* 8 (Group risk – consolidation) applies.
- Purpose
- 12.3 G *BIPRU* TP 12 implements Article 46 of the *Capital Adequacy Directive*.
- Duration of transitional
- 12.4 R *BIPRU* TP 12 applies until 31 December 2011.
- Calculation of number of employees
- 12.5 R In calculating the average number of its relevant employees a *firm* must:
- (1) include all its *directors*, officers having executive responsibilities and *senior managers*;
 - (2) include all staff whose responsibilities include front office responsibilities in relation to activities that give rise to *positions* in the *trading book*;
 - (3) include all staff whose responsibilities include back office, compliance or risk management responsibilities in relation to activities that give rise to *positions* in the *trading book*;

- (4) include contractors of or *persons* seconded to the *firm* or carrying out functions for the *firm* who would be relevant employees if they were employed by the *firm*; and
- (5) take into account the methodology for calculating an average number of employees referred to in section 247(6) of the Companies Act 1985.

12.6 R A *firm* must have a written policy for identifying *persons* who are relevant employees for the purpose of *BIPRU* TP 12.5R.

Purpose of *BIPRU* TP 12.1R(2)

12.7 G The purpose of *BIPRU* TP 12.1R(2) is to exclude a *firm* that falls into the definition of *full scope BIPRU investment firm* because it has obtained a *waiver* or has a *Part IV permission* that enables it to calculate an *ORCR* instead of the *fixed overheads requirement* (see *BIPRU* 6.1.2G).

Reduction of the *ORCR*

12.8 R The *ORCR* of a *firm* to which this *rule* applies is the lower of:

- (1) the *ORCR* that would have applied but for this *rule*; and
- (2) 12/88 of the higher of the following:
 - (a) the sum of *credit risk capital requirement* and the *market risk capital requirement*; and
 - (b) the *fixed overheads requirement*, notwithstanding that the *fixed overheads requirement* does not apply.

12.9 R The fraction 12/88 in *BIPRU* TP 12.8R(2) increases in accordance with the table in *BIPRU* TP 12.10R.

12.10 R Table: Increase in 12/88 fraction
This table belongs to *BIPRU* TP 12.9R

Date on which increase takes effect	Fraction
1 January 2008	27/88
1 January 2009	42/88
1 January 2010	57/88
1 January 2011	72/88

Minimum capital requirement

- 12.11 R (1) A *firm* must have capital resources at least equal to the capital resources requirement that applies to it under whichever part of *IPRU* applies to the *firm* under *BIPRU* TP 1.4R.
- (2) A *firm* must calculate its capital resources for the purposes of this *rule* in accordance with the same part of *IPRU*.
- (3) The following provisions of *BIPRU* TP 2 (Capital floors for a firm using the IRB or AMA approaches) apply for the purposes of this *rule*:
- (a) *BIPRU* TP 2.14R to *BIPRU* TP 2.15G (Adjustments to the calculation of capital resources);
 - (b) *BIPRU* TP 2.18R to *BIPRU* TP 2.19G (CAD 1 model and VaR model);
 - (c) *BIPRU* TP 2.20R to *BIPRU* TP 2.21G (Individual capital guidance);
 - (d) *BIPRU* TP 2.22R to *BIPRU* TP 2.27G (How to apply *IPRU* for the purposes of the capital floor calculations); and
 - (e) *BIPRU* TP 2.29R (Solo consolidation and the capital floor calculations).

Consolidation

- 12.12 R A *firm* may only calculate the *consolidated operational risk requirement* with respect to its *UK consolidation group* or *non-EEA sub-group* in accordance with *BIPRU* TP 12 if the group in question satisfies the following conditions:
- (1) there is no *credit institution* in the group;
 - (2) the *consolidated capital resources requirement* of the group is calculated in accordance with stage 2 in *BIPRU* 8 Annex 5R (Consolidation requirements for a group containing a *CAD full scope firm*);
 - (3) the group meets the conditions in *BIPRU* TP 12.1R(3) and (4) applied on a consolidated basis; and
 - (4) the *firm* has a *waiver* that modifies *BIPRU* 8 (Group risk – consolidation) so as to require the *firm* to calculate its *consolidated operational risk requirement* in accordance with *BIPRU* TP 12.

Minimum consolidated capital requirement

- 12.13 R If a *firm* applies *BIPRU* TP 12.12R to its *UK consolidation group* or *non-EEA sub-group* it must apply *BIPRU* TP 12.11R to that group in accordance with *BIPRU* TP 2.31R to *BIPRU* TP 2.33G (Consolidated capital floors for a *firm* using the *IRB approach* or *AMA approach*).

Changes in a firm's business

- 12.14 G The *Capital Adequacy Directive* says that a *competent authority* may agree to reduce the capital floor implemented by *BIPRU* TP 12.11R and *BIPRU* TP 12.13R if such a reduction is prudentially justified by a reduction in the size of the *firm's* business. Those *rules* implement that option by requiring a *firm* to apply the *IPRU* requirements to its business as it changes over time.

- TP 13 Other operational risk transitionals
- Application
- 13.1 R *BIPRU* TP 13 applies to a *BIPRU* firm.
- Purpose
- 13.2 G *BIPRU* TP 13.3R implements Articles 155 of the *Banking Consolidation Directive* and Article 44 of the *Capital Adequacy Directive*.
- Relevant indicator
- 13.3 R Until 31 December 2012, a percentage of 15% applies to the business line "Trading and Sales" of a *firm* whose relevant indicator (as referred to in *BIPRU* 6.4.6R) for the business line "Trading and Sales" represents at least 50% of the total of the relevant indicators for all of the *firm's* business lines in accordance with *BIPRU* 6.4.6R to *BIPRU* 6.4.16R (Calculating the *ORCR* under the *standardised approach to operational risk*).
- Reduced operational risk charge in 2007
- 13.4 G *BIPRU* TP 3.21R (Reduced *ORCR* for a *firm* applying pre-CRD capital requirements in 2007) also contains a transitional rule about *operational risk*.
- Systems and controls in 2007
- 13.5 R A reference in *BIPRU* 6 (Operational risk) to *SYSC* 4 to 10 (referred to in this *rule* as the "common platform requirements") or a part of those requirements must be read as being to the corresponding provisions of *SYSC* 3. This *rule* ceases to have effect on 1 November 2007 or on any earlier date on which the *firm* elects to comply with the common platform requirements in accordance with *SYSC*.

TP 14 Market risk: VaR models

Application

14.1 R *BIPRU* TP 14 applies to a *BIPRU* firm that:

- (1) has had a *VaR model permission* since 1 January 2007; and
- (2) on 31 December 2006 calculated its capital requirements under *IPRU* using the *VaR model approach* (as then in force) under a *waiver* or (in the case of a firm to which *IPRU(BANK)* or *IPRU(BSOC)* applied) written *guidance* (a "written concession").

Purpose

14.2 G *BIPRU* TP 14 implements Article 47 of the *Capital Adequacy Directive*.

Duration of transitional

14.3 R *BIPRU* TP 14 applies until 31 December 2009 or any earlier date specified in the firm's *VaR model permission*.

Specific risk calculations for VaR models

14.4 R A firm may treat:

- (1) the *VaR specific risk minimum requirements* and the provisions about backtesting in relation to *specific risk* as being replaced by the provisions of the written concession referred to in *BIPRU* TP 14.1 relating to *specific risk*; and
- (2) the *incremental default risk charge* as being replaced by the provisions of that written concession relating to the calculation of capital requirements for *specific risk*.

- TP 15 Commodities firm transitionals: Exemption from capital requirements
- Application
- 15.1 R Subject to *BIPRU* TP 15.2R, *BIPRU* TP 15 applies to a *BIPRU investment firm*:
- (1) whose main business consists exclusively of the provision of investment services or investment activities in relation to the financial instruments set out in points 5, 6, 7, 9 and 10 of Section C of Annex I to the *MIFID*; and
- (2) to whom the *ISD* would not have applied if it had remained in force in the form it was in on 31 December 2006.
- 15.2 R *BIPRU* TP 15.13R to *BIPRU* TP 15.14G apply to any *firm* to which *BIPRU* 8 (Group risk – consolidation) applies.
- Purpose
- 15.3 G *BIPRU* TP 15 implements Article 48(1) of the *Capital Adequacy Directive*.
- Duration of exemption
- 15.4 R *BIPRU* TP 15 applies until 31 December 2010.
- 15.5 G If there are any modifications pursuant to paragraphs 2 and 3 of Article 48 of the *Capital Adequacy Directive* (European Commission review of prudential regime for exempt commodity firms), the *FSA* will revoke *BIPRU* TP 15 if the date of coming into force of the implementing measures in relation to those changes is before the date in *BIPRU* TP 15.4R.
- Exemption
- 15.6 R The provisions of *GENPRU* and *BIPRU* on capital requirements and *GENPRU* 1.2 (Adequacy of financial resources) do not apply to a *firm* to which *BIPRU* TP 15 applies. However *BIPRU* 10 (Concentration risk) continues to apply, including the *CNCOM*.
- 15.7 G If a *firm* meets the conditions in *BIPRU* TP 16 (Commodities firm transitionals: large exposures) it will be exempt from *BIPRU* 10 as well.
- 15.8 G An *exempt BIPRU commodities firm* (which is the name in the *Glossary* given to a *firm* with the benefit of the exemption in *BIPRU* TP 15.6R) may be subject to the requirements of Chapter 3 of *IPRU(INV)*. Details of which *exempt BIPRU commodities firm* are subject to those requirements can be found in Chapter 3 of *IPRU(INV)*.

15.9 G The table in *BIPRU* TP 15.10G provides an indication of which parts of *GENPRU* and *BIPRU* generally apply to an *exempt BIPRU commodities firm* and which parts in general do not apply. If a section is shown as not in general applying the table also identifies any significant aspects of that section that do apply.

15.10 G Table: Parts of *GENPRU* and *BIPRU* that apply to exempt *BIPRU* commodities firms
This table belongs to *BIPRU* TP 15.9G

<i>GENPRU</i> and <i>BIPRU</i> provisions	A Y denotes that the provision generally does apply An N denotes that generally it does not apply	Remarks
<i>GENPRU</i> TP (Transitional provisions)	Y	
<i>GENPRU</i> 1.1 (Application and scope)	Y	
<i>GENPRU</i> 1.2 (Adequacy of financial resources)	N	
<i>GENPRU</i> 1.3 (Valuation)	Y	
<i>GENPRU</i> 1.4 (Actions for damages)	Y	
<i>GENPRU</i> 1.5 (Application of <i>GENPRU</i> 1 to Lloyd's)	Not applicable as does not apply to <i>BIPRU firms</i>	
<i>GENPRU</i> 2.1 (Calculation of capital resources requirements)	N	

<i>GENPRU</i> and <i>BIPRU</i> provisions	A Y denotes that the provision generally does apply An N denotes that generally it does not apply	Remarks
<i>GENPRU</i> 2.2 (Capital resources)	Y	This applies for the purposes of <i>BIPRU</i> 10. If <i>BIPRU</i> 10 does not apply this does not apply either.
<i>GENPRU</i> 2.3 (Application of <i>GENPRU</i> 2 to Lloyd's)	Not applicable as does not apply to <i>BIPRU firms</i>	
<i>GENPRU</i> 3.1 (Cross sector groups)	Y	Only applies if the <i>firm</i> is a member of a <i>financial conglomerate</i>
<i>GENPRU</i> 3.2 (Third-country groups)	Y	Provisions about <i>financial conglomerate</i> only apply if the <i>firm</i> is a member of a <i>financial conglomerate</i> See remarks on <i>BIPRU</i> 8 for provisions about a <i>third country banking and investment group</i>
<i>BIPRU</i> TP (Transitional provisions)	Y	
<i>BIPRU</i> 1.1 (Application and scope)	Y	
<i>BIPRU</i> 1.2 (Definition of the trading book)	Y	
<i>BIPRU</i> 1.3 (Application for advanced approaches)	N	Provisions about <i>BIPRU</i> 2.1 and <i>BIPRU</i> 8 apply to the extent those parts of <i>BIPRU</i> apply. Otherwise does not apply.

<i>GENPRU</i> and <i>BIPRU</i> provisions	A Y denotes that the provision generally does apply An N denotes that generally it does not apply	Remarks
<i>BIPRU</i> 1.4 (Actions for damages)	Y	
<i>BIPRU</i> 2.1 (Solo consolidation)	Y	Applies for the purposes of <i>BIPRU</i> 10.
<i>BIPRU</i> 2.2 (Adequacy of financial resources)	N	
<i>BIPRU</i> 2.3 (Interest rate risk in the non-trading book)	N	
<i>BIPRU</i> 3 (Standardised approach to credit risk)	N	
<i>BIPRU</i> 4 (The IRB approach)	N	
<i>BIPRU</i> 5 (Credit risk mitigation)	N	
<i>BIPRU</i> 6 (Operational risk)	N	
<i>BIPRU</i> 7 (Market risk)	N	<i>BIPRU</i> 7.8.38R and <i>BIPRU</i> 7.3.39G (Risk management systems and controls) apply in theory although it is unlikely that a <i>firm</i> will be able to carry out these activities without losing the exemption in <i>BIPRU</i> TP 15.
<i>BIPRU</i> 8 (Group risk – consolidation)	Y	See <i>BIPRU</i> TP 15.13R to <i>BIPRU</i> TP 15.14G

<i>GENPRU</i> and <i>BIPRU</i> provisions	A Y denotes that the provision generally does apply An N denotes that generally it does not apply	Remarks
<i>BIPRU</i> 9 (Securitisation)	N	<i>BIPRU</i> 9.1.6R to <i>BIPRU</i> 9.1.8G (Risk systems) apply
<i>BIPRU</i> 10 (Concentration risk)	Y	If <i>firm</i> also qualifies for exemption under <i>BIPRU</i> TP 16 (Commodities firm transitionals: large exposures) <i>BIPRU</i> 10 does not apply except as described in <i>BIPRU</i> TP 16.7G
<i>BIPRU</i> 11 (Disclosure)	Y	
<i>BIPRU</i> 12	Chapter does not yet exist	
<i>BIPRU</i> 13 (Financial derivatives, SFTs and long settlement transactions)	N	
<i>BIPRU</i> 14 (Capital requirements for settlement and counterparty risk)	N	

15.11 G *SYSC* applies to an *exempt BIPRU commodities firm*.

Definitions

15.12 R The terms financial instrument, investment services and investment activities have the same meaning as they do in the *MIFID*.

Consolidation

- 15.13 R *BIPRU* TP 15 does not apply for the purposes of *BIPRU* 8 with respect to a firm's UK consolidation group or, as the case may be, non-EEA sub-group unless the following conditions are satisfied:
- (1) there is no *credit institution* in that group;
 - (2) each *investment firm* in the group meets the conditions in *BIPRU* TP 15.1R(1);
 - (3) each *investment firm* whose head office is in an *EEA State* satisfies the conditions in *BIPRU* TP 15.1R(2); and
 - (4) any *investment firm* whose head office is outside the *EEA* would have fallen into *BIPRU* TP 15.1R(2) if:
 - (a) its head office had been in an *EEA State*; and
 - (b) it had carried on all its business in the *EEA* and had obtained whatever authorisations for doing so were required under the *ISD* in the form that Directive was in on 31 December 2006.
- 15.14 G If an *exempt BIPRU commodities firm* is a member of a group that meets the conditions in *BIPRU* TP 15.13R, *BIPRU* 8 will not apply to the group. Chapter 14 of IPRU(INV) (Consolidation) applies instead.

- TP 16 Commodities firm transitionals: large exposures
- Application
- 16.1 R Subject to *BIPRU* TP 16.2R, *BIPRU* TP 16 applies to a *BIPRU investment firm* that satisfies the following conditions:
- (1) it satisfies the requirements in *BIPRU* TP 15.1R and it remains eligible to apply the treatment in *BIPRU* TP 15 (Commodities firm transitionals: Exemption from capital requirements);
 - (2) the *firm* provides investment services or investment activities related to the financial instruments listed in points 5, 6, 7, 9 and 10 of Section C of Annex I of the *MIFID*;
 - (3) the *firm* does not provide such investment services or undertake such investment activities for, or on behalf of, retail clients;
 - (4) breaches of the limits referred to in *BIPRU* TP 16.6R arise in connection with *exposures* resulting from contracts that are financial instruments as listed in (2) and relate to commodities or underlyings within the meaning of point 10 of Section C of Annex I of the *MIFID* and are calculated in accordance with *BIPRU* 13 (Financial derivatives, SFTs and long settlement transactions) or in connection with *exposures* resulting from contracts concerning the delivery of *commodities* or emission allowances; and
 - (5) it satisfies the requirements in *BIPRU* TP 16.8R.
- 16.2 R *BIPRU* TP 16.11R applies to any *firm* to which *BIPRU* 8 (Group risk – consolidation) applies.
- Purpose
- 16.3 G *BIPRU* TP 16 implements Article 45 of the *Capital Adequacy Directive*. The condition in *BIPRU* TP 16.1R(1) is in addition to the Directive conditions.
- Duration of transitional
- 16.4 R The treatment in *BIPRU* TP 16 is available until 31 December 2010.
- 16.5 G If there are any modifications consequent on the treatment of *large exposures*, pursuant to Article 119 of the *Banking Consolidation Directive*, the *FSA* will revoke *BIPRU* TP 16 if the date of coming into force of the implementing measures in relation to those changes is before the date in *BIPRU* TP 16.4R. If the *FSA* revokes *BIPRU* TP 15 it will also revoke *BIPRU* TP 16 at the same time.

Exemption

- 16.6 R (1) A *firm* may exceed the limits concerning *large exposures* in *BIPRU* 10.5.6R (25% limit), *BIPRU* 10.5.8R (800% limit), *BIPRU* 10.5.12R (500% limit) and *BIPRU* 10.5.13R (600% limit).
- (2) The *CNCOM* does not apply.
- 16.7 G Broadly speaking the effect of *BIPRU* TP 16.6R is that *BIPRU* 10 (Concentration risk) does not apply to a *firm* that meets the conditions in *BIPRU* TP 16.1R. However *BIPRU* 10.12 (Systems and controls and general) continues to apply.

Documented strategy

- 16.8 R A *firm* must have a documented strategy for managing and, in particular, for controlling and limiting risks arising from the concentration of *exposures*. The *firm* must notify the *FSA* of this strategy and all material changes to this strategy without delay. The *firm* must make appropriate arrangements to ensure a continuous monitoring of the creditworthiness of borrowers, according to their impact on concentration risk. These arrangements must enable the *firm* to react adequately and sufficiently promptly to any deterioration in that creditworthiness.
- 16.9 R Where a *firm* exceeds the internal limits set according to the strategy referred to in *BIPRU* TP 16.8R, it must notify the *FSA* without delay of the size and nature of the excess and of the *counterparty*.

Definitions

- 16.10 R The terms financial instrument, investment services and investment activities have the same meaning as they do in the *MIFID*.

Consolidation

- 16.11 R *BIPRU* TP 16 does not apply for the purposes of *BIPRU* 8 (Group risk – consolidation) with respect to a *firm's UK consolidation group* or, as the case may be, *non-EEA sub-group* unless the following conditions are satisfied:
- (1) the group satisfies the requirements in *BIPRU* TP 15.13 (Application of *BIPRU* TP 15 on a consolidated basis) and the *firm* remains eligible to apply the treatment in *BIPRU* TP 15.13 with respect to that *UK consolidation group* or, as the case may be, *non-EEA sub-group*;
 - (2) there is no *credit institution* in that group;
 - (3) each *investment firm* in the group meets the conditions in *BIPRU* TP 16.1R(2) and (3); and

- (4) the group meets the conditions in *BIPRU* TP 16.1R(4) to (5) applied on a consolidated basis.

- 17 Large exposures: Exemptions for intra-group exposures for banks and investment firms
- Application
- 17.1 R This section applies to a *BIPRU firm* other than a *building society*.
- Purpose
- 17.2 G This section deals with the exemption or partial exemption of intra-group *exposures* from large exposure limits. It exempts some intra-group *exposures*. It allows a *firm* to use certain of the intra-group exemptions in *IPRU* for others. In some cases those *IPRU* exemptions apply in a modified form.
- 17.3 G This section only applies to *exposures to concentration risk group counterparties*. This term broadly covers group members if they and the *firm* are subject to consolidated supervision by the *FSA*, another *EEA competent authority* or certain non-*EEA* regulators. The full definition can be found in the *Glossary*.
- Duration of transitional
- 17.4 R This section applies until 31 December 2009.
- General rule
- 17.5 R A *firm* may, to the extent permitted by this section, treat an *exposure* to a *concentration risk group counterparty* as exempt or partially exempt for the purposes of *BIPRU 10* (Concentration risk) or, if the *firm* applies *BIPRU TP 3* (Pre CRD capital requirements applying on a solo basis during 2007), the relevant part of *IPRU*.
- Effect of this section on intra-group concentration risk exemptions in *BIPRU 10*
- 17.6 R If a *firm* applies this section, *BIPRU 10.8* to *BIPRU 10.10* (Integrated groups) do not apply.
- 17.7 G The effect of *BIPRU TP 17.6R* is that a *firm* should not apply *BIPRU 10.8* to *BIPRU 10.10* (Integrated groups) to some *exposures to concentration risk group counterparties* and this section to others. The purpose of *BIPRU TP 17.6R* is that a *firm* should choose between treating intra-group *exposures* under the *BIPRU 10* integrated group regime and treating them under the *IPRU rules* but that it should not mix the two approaches.

- 17.8 G If a *firm* applies this section, *BIPRU* 10.7 (Treasury concession and intra-group securities financing transactions) continues to apply. However *BIPRU* 10.7 will not apply if the *firm* applies *BIPRU* TP 3 (Pre CRD capital requirements applying on a solo basis during 2007).

Treatment of intra-group exposures

- 17.9 R If a *firm* applies this section it must allocate each *exposure* to its *concentration risk group counterparties* to one of the categories in the table in *BIPRU* TP 17.10R and apply the applicable treatment in that table to it.

- 17.10 R Table: Treatment for types of group counterparty
This table belongs to *BIPRU* TP 17.9R

Type of counterparty	Treatment
(1) <i>Exposure</i> to an <i>undertaking</i> that is a member of the <i>firm's UK integrated group</i>	Exempt
(2) <i>Exposure</i> to a domestic <i>concentration risk group counterparty</i> that is not a member of its <i>UK integrated group</i>	Not exempt or partially exempt unless an exemption outside this section is available
(3) An <i>exposure</i> to a foreign <i>concentration risk group counterparty</i>	Apply the treatment in the applicable part of the table in <i>BIPRU</i> TP 17.11R. If it does not qualify as exempt or partially exempt under that table then it is not exempt or partially exempt unless an exemption outside this section is available
A domestic <i>concentration risk group counterparty</i> means a <i>concentration risk group counterparty</i> that meets the condition in <i>BIPRU</i> 10.8.4R(4) (Establishment in the <i>United Kingdom</i>)	
A foreign <i>concentration risk group counterparty</i> means a <i>concentration risk group counterparty</i> that does not meet the condition in <i>BIPRU</i> 10.8.4R(4)	

17.11 R Table: Treatment of exposures to non-UK undertakings
This table belongs to *BIPRU* TP 17.10R

Category of <i>firm</i>	Treatment	Adjustments
<i>Bank</i>	Apply the treatment in <i>BIPRU</i> TP 17.15R	
<i>Investment management firm</i>	Treat <i>exposure</i> as exempt if it falls within paragraph (g) or (h) of the definition of exempt exposure in the Glossary to chapter 5 of <i>IPRU(INV)</i> Treat <i>exposure</i> as partially exempt if it falls within paragraph (c) of the definition of partially exempt exposure in the Glossary to chapter 5 of <i>IPRU(INV)</i>	Paragraph (g) of the definition of exempt exposure is adjusted by replacing the reference to the Second Consolidated Supervision Directive and Directive 93/6 (the old version of the <i>Capital Adequacy Directive</i>) with a reference to the <i>Banking Consolidation Directive</i> and the <i>Capital Adequacy Directive</i> .
<i>UCITS investment firm</i>	Same as for <i>investment management firm</i>	
<i>Securities and futures firm</i>	Treat <i>exposure</i> as exempt if it falls within <i>rules</i> 10-192(1)(g) or 10-192(1)(n) of chapter 10 of <i>IPRU(INV)</i> Treat <i>exposure</i> as partially exempt if it falls within <i>rule</i> 10-192(2)(c) of chapter 10 of <i>IPRU(INV)</i>	<i>Rule</i> 10-192(1)(g) of chapter 10 of <i>IPRU(INV)</i> is adjusted by replacing the reference to <i>rules</i> 10-200 to 10-203 of chapter 10 of <i>IPRU(INV)</i> with a reference to <i>BIPRU</i> 8 and the consolidation provisions of <i>BIPRU</i> TP.

Category of <i>firm</i>	Treatment	Adjustments
<i>Personal investment firm</i>	Treat <i>exposure</i> as exempt if it falls within item 11 in Table 13.6.2(1) of Chapter 13 of <i>IPRU(INV)</i> Treat <i>exposure</i> as exempt or partially exempt if it falls within item 15 in Table 13.6.2(1) of Chapter 13 of <i>IPRU(INV)</i>	
Note: A <i>firm</i> must apply any exemption or partial exemption in <i>IPRU</i> in accordance with the applicable <i>IPRU rule</i> .		

- 17.12 G The effect of *BIPRU* TP 17.9R to *BIPRU* TP 17.11R is that a *firm* may only apply the *IPRU* and other treatments in the table in *BIPRU* TP 17.11R to non-UK undertakings. An *exposure* to a UK undertaking is exempt if it is a member of the *firm's* UK integrated group. If the UK undertaking is not a member of the *firm's* UK integrated group no exemption is available even if an exemption would have been available under *IPRU*.
- 17.13 G If an *exposure* to a concentration risk group counterparty is not exempt or partially exempt under the table in *BIPRU* TP 17.10R or *BIPRU* TP 17.11R the exemptions in *BIPRU* 10.5 (Excess exposures in the trading book), *BIPRU* 10.6 (General exemptions) and *BIPRU* 10.7 (Treasury concession and intra-group securities financing transactions) may be available. *BIPRU* 10.8 to *BIPRU* 10.10 (Integrated groups) do not apply. However none of the exemptions in *BIPRU* 10 will apply if the *firm* applies *BIPRU* TP 3 (Pre CRD capital requirements applying on a solo basis during 2007).
- 17.14 G *BIPRU* TP 1.3R explains whether a *BIPRU investment firm* is a securities and futures firm, an investment management firm or a personal investment firm.
- Exemption for banks
- 17.15 R An *exposure* of a bank coming within column 1 of row (3) of the table in *BIPRU* TP 17.10R is exempt if:
- (1) both the counterparty and the bank are in the same integrated banking group as defined in *BIPRU* TP 17.16R;
 - (2) both the counterparty and the bank are included within the scope of consolidation on a full basis with respect to the same UK consolidation group;
 - (3) the counterparty is not a member of that UK consolidation group in which no more than a participation is held;

- (4) *BIPRU* 8.2.1R (Main consolidation rule for UK consolidation groups) applies to the *firm* with respect to that *UK consolidation group*; and
- (5) *capital resources* are freely transferable between the *counterparty* and the *UK bank* referred to in *BIPRU* TP 17.16R(1).
- 17.16 R An integrated banking group means, in relation to a *firm*, a group of *undertakings* (the "potential integrated banking group") that satisfy the following conditions:
- (1) the potential integrated banking group is managed as an integrated banking business by a *UK bank*; and
- (2) the *UK bank* in (1) is the principal *bank* in the potential integrated banking group.
- 17.17 G An *undertaking* is included within the scope of consolidation of a group on a full basis as referred to in *BIPRU* TP 17.15R(2) if it is at the head of the group or if its assets and liabilities are taken into account in full as referred to in *BIPRU* 8.5.4R (Basis of inclusion of undertakings in consolidation).
- Notification
- 17.18 R A *firm* may not apply this section unless it has given one *Month's* prior notice to the *FSA* that it intends do so. That notice must specify which category of *firm* listed in the table in *BIPRU* TP 17.11R it belongs to.
- 17.19 R A *firm* need only give the *FSA* the notice required in *BIPRU* TP 17.18R once rather than with respect to each *exposure*.
- 17.20 R A *firm* may stop applying this section if it has given one *Month's* prior notice to the *FSA* that it intends to do so.
- 17.21 R If a *firm* stops applying this section it may start to apply it again if it notifies the *FSA* under *BIPRU* TP 17.18R that it intends to do so.
- 17.22 R A *firm* must notify the *FSA* if it becomes aware that any *exposure* that it has treated as exempt or partially exempt under this section has ceased to meet the conditions for that treatment.
- Combination of this section with *BIPRU* TP 3
- 17.23 R A *firm* may apply this section even if it also applies *BIPRU* TP 3 (Pre CRD capital requirements applying on a solo basis during 2007). However such a *firm* may not apply the treatments in the table in *BIPRU* TP 17.11R but must instead apply the corresponding provisions in the part of *IPRU* that it is applying under *BIPRU* TP 3.

- 17.24 G The part of *IPRU(BANK)* that corresponds to *BIPRU* TP 17.15R is paragraph 2b) of part 3.1.1 of section 3 of Chapter CS as applied by Chapter LE for large exposures purposes.
- 17.25 G The reason for *BIPRU* TP 17.23R is that *BIPRU* TP 3 (Pre CRD capital requirements applying on a solo basis during 2007) already allows a *firm* to use the *IPRU* exemptions and partial exemptions listed in the table in *BIPRU* TP 17.11R so it is not necessary to give the *firm* an additional right to apply those treatments under this section.
- 17.26 G In general this section does not give any exemption that is not available under *IPRU*. However the exemption in row (1) of the table in *BIPRU* TP 17.10R (*exposures* within the *UK integrated group*) is not in *IPRU* although in practice a *firm* may find that the *IPRU* exemptions will cover most or all the things covered by the exemption in the table in *BIPRU* TP 17.10R.
- 17.27 G If row (2) of the table in *BIPRU* TP 17.10R (certain *exposures* to *UK counterparties*) treats an *exposure* as non-exempt a *firm* that applies *BIPRU* TP 3 (Pre CRD capital requirements applying on a solo basis during 2007) may still treat it as exempt if the relevant provisions of *IPRU* allow this.

Consolidation

- 17.28 G The application of this section on a consolidated basis is dealt with in *BIPRU* TP 19 (Large exposures: Exemptions for intra-group exposures on a consolidated basis).

- 18 Large exposures: Exemptions for intra-group exposures for building societies
- Application
- 18.1 R This section applies to a *building society*.
- 18.2 R This section does not apply to a *building society* that applies *BIPRU TP 3* (Pre CRD capital requirements applying on a solo basis during 2007).
- 18.3 G The reason for *BIPRU TP 18.2R* is that *BIPRU TP 18* reproduces (with amendments) part of the large exposures requirements of Volume 1 of *IPRU(BSOC)*. If a *firm* applies *BIPRU TP 3* (Pre CRD capital requirements applying on a solo basis during 2007) all the large exposure requirements of *IPRU(BSOC)* will apply. There is therefore no need to apply *BIPRU TP 18* in these circumstances.
- Purpose
- 18.4 G This section reproduces, with amendments, paragraphs 7.5.1 to 7.5.3 of Chapter 7 of volume 1 of *IPRU(BSOC)*. However it does not carry forward the 300% limit in paragraph 7.4.2(2) of that volume.
- Duration of transitional
- 18.5 R This section applies until 31 December 2009.
- General rule
- 18.6 R *BIPRU 10.5.6R* (25% exposure limit) does not apply to an *exposure* of a *building society* to a *subsidiary undertaking* of the *building society*. Instead the *building society* must ensure that:
- (1) the total amount of its *exposures* to any single *subsidiary undertaking* within the *building society's UK consolidation group* or to any sub-group of such *subsidiary undertakings* does not exceed 20% of its *capital resources*; and
 - (2) the total amount of its *exposures* to its *subsidiary undertakings* that are not within the *building society's UK consolidation group* does not exceed 20% of its *capital resources*.
- 18.7 G Exposures to *subsidiary undertakings* still count towards the overall limit of 800% of *capital resources* as set out in *BIPRU 10.5.8R* unless otherwise exempted.
- Effect of *BIPRU TP 18* on concentration risk exemptions in *BIPRU 10*

- 18.8 R *A building society* must choose between applying this section to all its *exposures* to its *subsidiary undertakings* or to none of them.
- 18.9 R If a *building society* applies this section, *BIPRU* 10.8 to *BIPRU* 10.10 (Integrated groups) do not apply.
- 18.10 G If a *firm* applies this section, *BIPRU* 10.7 (Treasury concession and intra-group securities financing transactions) continues to apply.
- Notification
- 18.11 R *BIPRU* TP 17.18R to *BIPRU* TP 17.22R (Notification) apply to this section as they do to *BIPRU* TP 17 (Large exposures: Exemptions for intra-group exposures for banks and investment firms).
- Consolidation
- 18.12 G The application of this section on a consolidated basis is dealt with in *BIPRU* TP 19 (Large exposures: Exemptions for intra-group exposures on a consolidated basis).

- 19 Large exposures: Exemptions for intra-group exposures on a consolidated basis
- Application
- 19.1 R This section applies to any *firm* to which *BIPRU* 8 (Group risk – consolidation) applies.
- Purpose
- 19.2 G The purpose of this section is to deal with how *BIPRU* TP 17 (Large exposures: Exemptions for intra-group exposures for banks and investment firms) and *BIPRU* TP 18 (Large exposures: Exemptions for intra-group exposures for building societies) are applied on a consolidated basis.
- Duration of transitional
- 19.3 R This section applies until 31 December 2009.
- General rule
- 19.4 R A *firm* may apply *BIPRU* TP 17 (Large exposures: Exemptions for intra-group exposures for banks and investment firms) and *BIPRU* TP 18 (Large exposures: Exemptions for intra-group exposures for building societies) on a consolidated basis with respect to a *UK consolidation group* or *non-EEA sub-group* for the purposes of *BIPRU* 8.9 (Consolidated concentration risk requirements). If a *firm* applies *BIPRU* TP 17 or *BIPRU* TP 18 on a consolidated basis, it must do so in the way set out in this section.
- Effect of this section on exemptions for intra-group exposures under *BIPRU* 8.9
- 19.5 R If a *firm* applies this section, *BIPRU* 8.9.8R to *BIPRU* 8.9.26R (Application of integrated groups policy on a consolidated basis) do not apply and a *firm* may not otherwise apply *BIPRU* 10.8 to *BIPRU* 10.10 (Integrated groups) on a consolidated basis.
- 19.6 G The purpose of *BIPRU* TP 19.5R is that a *firm* should choose between applying the *BIPRU* 8.9 integrated group regime to intra-group *exposures* or applying the regime in this section but that it should not mix the two approaches.

Parts of BIPRU TP 17 and BIPRU TP 18 that apply on a consolidated basis

- 19.7 R The table in *BIPRU* TP 19.8R sets out what parts of *BIPRU* TP 17 (Large exposures: Exemptions for intra-group exposures for banks and investment firms) and *BIPRU* TP 18 (Large exposures: Exemptions for intra-group exposures for building societies) are applied on a consolidated basis under *BIPRU* TP 19.4R. The answer depends on which of the categories in the first column of that table the *UK consolidation group* or *non-EEA sub-group* in question falls into.
- 19.8 R Table: Parts of *BIPRU* TP 17 and *BIPRU* TP 18 that apply on a consolidated basis
This table belongs to *BIPRU* TP 19.7R

Category of group	Applicable parts of <i>BIPRU</i> TP 17 and <i>BIPRU</i> TP 18	Remarks
Building society group	<i>BIPRU</i> TP 18 (Large exposures: Exemptions for intra-group exposures for building societies)	
Banking group	The provisions in <i>BIPRU</i> TP 17 (Large exposures: Exemptions for intra-group exposures for banks and investment firms) that apply to a <i>bank</i>	If the group is a <i>non-EEA sub-group</i> , the exemption in <i>BIPRU</i> TP 17.15R (Integrated banking groups) applies. If the group is a <i>UK consolidation group</i> , the exemption in <i>BIPRU</i> TP 17.15R does not apply.
Investment services group	The provisions in <i>BIPRU</i> TP 17 (Large exposures: Exemptions for intra-group exposures for banks and investment firms) that apply to the main <i>BIPRU investment firm</i>	Main <i>BIPRU investment firm</i> has the same meaning as it does in <i>BIPRU</i> TP 10.5R (Pre CRD capital requirements applying on a consolidated basis during 2007)
Note: The classes of group in the first column are defined in <i>BIPRU</i> TP 1.7R (Classification of groups for certain consolidation rules)		

19.9 G The reason that *BIPRU* TP 17.15R (Integrated banking groups) does not apply to a *UK consolidation group* is that *BIPRU* TP 17.15R requires the *firm* and the *counterparty* to be in the same *UK consolidation group*. The application of *BIPRU* TP 17.15R on a consolidated basis to a *UK consolidation group* would involve applying *BIPRU* TP 17.15R to *exposures* of members of the *UK consolidation group* to *counterparties* outside the *UK consolidation group*. Therefore the exemption in *BIPRU* TP 17.15R cannot apply to a *UK consolidation group*.

How this section applies to banking and investment services groups

- 19.10 R (1) If a *firm* applies *BIPRU* TP 17 (Large exposures: Exemptions for intra-group exposures for banks and investment firms) under this section it must do so in accordance with the principles in this *rule*.
- (2) A *firm* may only apply *BIPRU* TP 17 to *exposures* between members of its *UK consolidation group* or *non-EEA sub-group* and its *consolidation concentration risk group counterparties*.
- (3) A *firm* must treat each category of *exposure* in the first column of the table in *BIPRU* TP 19.11R in accordance with the corresponding treatment in the second column.

19.11 R Table: Treatment for types of group counterparty
This table belongs to *BIPRU* TP 19.10R

Type of <i>exposure</i>	Treatment
(A) <i>Exposures</i> meeting the following conditions: (a) the member of the group that has the <i>exposure</i> is a domestic <i>undertaking</i> and (b) the <i>exposure</i> is to a <i>consolidation concentration risk group counterparty</i> that qualifies for inclusion in the group's <i>consolidation UK integrated group</i>	Exempt
(B) The <i>exposure</i> is to a <i>consolidation concentration risk group counterparty</i> that meets the following conditions: (a) the <i>counterparty</i> is a domestic <i>undertaking</i> and (b) the <i>counterparty</i> does not meet the other conditions for inclusion in the group's <i>consolidation UK integrated group</i>	Not exempt or partially exempt unless an exemption outside this section is available

Type of <i>exposure</i>	Treatment
<p>(C) <i>Exposures</i> meeting either of the following conditions:</p> <p>(a) the <i>exposure</i> meets both the following conditions: (i) the member of the group that has the <i>exposure</i> is foreign and (ii) the <i>consolidation concentration risk group counterparty</i> qualifies for inclusion in the group's <i>consolidation UK integrated group</i>; or</p> <p>(b) the <i>exposure</i> is to a foreign <i>consolidation concentration risk group counterparty</i></p>	<p>Exempt if would be exempt under <i>BIPRU</i> 17.11R (Treatment of non-UK intra-group <i>exposures</i>)</p> <p>Partially exempt if would be partially exempt under <i>BIPRU</i> 17.11R</p> <p>Not exempt or partially exempt if would not qualify as exempt or partially exempt under <i>BIPRU</i> TP 17.11R unless an exemption outside this section is available</p>
<p>"Group" means the <i>UK consolidation group</i> or <i>non-EEA sub-group</i> in question</p>	
<p>An <i>undertaking</i> is a domestic <i>undertaking</i> if it meets the condition in <i>BIPRU</i> 10.8.4R(4) (Establishment in the <i>United Kingdom</i>)</p>	
<p>An <i>undertaking</i> is foreign if it does not meet the condition in <i>BIPRU</i> 10.8.4R(4)</p>	

- 19.12 G This section as it applies to banking groups and investment services groups (as defined in *BIPRU* TP 1.7R (Classification of groups for certain consolidation rules)) feeds back into the calculations in *BIPRU* 8.9 (Consolidated concentration risk requirements). So if an intra-group *exposure* is exempt under this section it is exempt for the purposes of *BIPRU* 8.9. Likewise, if an intra-group *exposure* is partially exempt under this section it is partially exempt for the purposes of *BIPRU* 8.9.
- 19.13 G (1) This paragraph describes the effect of *BIPRU* TP 19.11R
- (2) An *exposure* between a *UK* member of the group and a *UK counterparty* that meets the consolidated integrated group conditions in *BIPRU* 8.9.9R (Definition of *consolidation UK integrated group*) is exempt. Therefore this exemption is only available if both the group member and the counterparty are *UK undertakings*.
- (3) A *firm* may apply the *IPRU* treatments in the table in *BIPRU* TP 17.11R (Treatment of exposures to non-UK undertakings) to an *exposure* between an overseas member of the group and a *UK counterparty* that meets the consolidated integrated group conditions in *BIPRU* 8.9.9R.

- (4) A *firm* may also apply the *IPRU* and other treatments in the table in *BIPRU* TP 17.11R if the *counterparty* is foreign.
- (5) *Exposures* to *UK undertakings* that do not meet the consolidated integrated group conditions in *BIPRU* 8.9.9R are not exempt. Nor do they benefit from the exemptions and partial exemptions under *BIPRU* TP 17.11R.
- (6) The treatment in this paragraph only relates to *counterparties* who fall within the definition of *consolidation concentration risk group counterparty*.
- (7) In this paragraph "group" means the *UK consolidation group* or *non-EEA sub-group* in question.

- 19.14 G (1) A *consolidation concentration risk group counterparty* is defined in *BIPRU* 8.9.11R. It is the equivalent of a *concentration risk group counterparty* for the purposes of consolidation. Basically it means a *counterparty* that is not a member of the *UK consolidation group* or *non-EEA sub-group* but is a *parent undertaking* of a member of the *UK consolidation group* or *non-EEA sub-group* or a *subsidiary undertaking* of such a *parent undertaking*. It also includes a *subsidiary undertaking* of a member of the *UK consolidation group* or *non-EEA sub-group* that is not itself a member of the *UK consolidation group* or *non-EEA sub-group*.
- (2) The group and the *counterparty* should both be subject to consolidated supervision as part of a wider group by the *FSA*, another *EEA competent authority* or a *third country competent authority* that carries out consolidated supervision to equivalent standards. If this is not the case the *counterparty* is not a *consolidation concentration risk group counterparty*. *Exposures* to such a *counterparty* fall outside this section.
- (3) In this paragraph "group" means the *UK consolidation group* or *non-EEA sub-group*.

Integrated banking groups

- 19.15 G If *BIPRU* TP 17.15R (Integrated banking groups) applies on a consolidated basis, a *firm* may treat an *exposure* between a member of the *non-EEA sub-group* and a non-*UK counterparty* as exempt if the *counterparty* and the *non-EEA sub-group* are part of the same *UK consolidation group* and also part of the same integrated banking group. If the *counterparty* is set up in the *UK* the *exposure* will be exempt if it meets the conditions for inclusion in the group's *consolidation UK integrated group*, whether or not it meets the conditions in *BIPRU* TP 17.15R. If the *counterparty* is set up in the *UK* and does not meet the conditions for inclusion in the group's *consolidation UK integrated group*, there is no exemption, whether or not it meets the conditions in *BIPRU* TP 17.15R.

Building society groups

- 19.16 G If *BIPRU* TP 18 (Large exposures: Exemptions for intra-group exposures for building societies) applies on a consolidated basis to a *non-EEA sub-group* under this section there are two limits. Firstly the total amount of the *exposures* of the *non-EEA sub-group* to any single *subsidiary undertaking* in the *UK consolidation group* of which the *non-EEA sub-group* forms part or any sub-group of such *subsidiary undertakings* should not exceed 20% of the consolidated capital resources of the *non-EEA sub-group*. Secondly the total amount of the *exposures* of members of the *non-EEA sub-group* to *subsidiary undertakings* of the parent *building society* who are not part of the *UK consolidation group* should not exceed 20% of the consolidated capital resources of the *non-EEA sub-group*.
- 19.17 G If *BIPRU* TP 18 (Large exposures: Exemptions for intra-group exposures for building societies) applies on a consolidated basis to a *UK consolidation group* under this section the total amount of the *exposures* of the *UK consolidation group* to *subsidiary undertakings* of the parent *building society* who are not part of the *UK consolidation group* should not exceed 20% of the consolidated capital resources of the *UK consolidation group*. *Exposures* within the *UK consolidation group* are eliminated on consolidation in the usual way.
- 19.18 G The consolidated 25% exposure limit in *BIPRU* 8.9 (Consolidated concentration risk requirements) does not apply to *subsidiary undertakings* of the parent *building society* where the treatment described in *BIPRU* TP 19.16G or *BIPRU* TP 19.17G applies.

Notification

- 19.19 R *BIPRU* TP 17.18R to *BIPRU* TP 17.22R (Notification) apply to this section as they do to *BIPRU* TP 17. The notice referred to in *BIPRU* TP 17.18R must state what kind of group listed in *BIPRU* TP 1.7R (Classification of groups for certain consolidation rules) the *firm* belongs to rather than what category the *firm* falls into.

- TP 20 Standardised credit risk transitionals
- Application
- 20.1 R This section applies to a *BIPRU firm*.
- Days past due
- 20.2 R (1) This *rule* applies to an *exposure* in another *EEA State* of a type to which a *CRD implementation measure* in that *EEA State* for the first paragraph of Article 154(1) of the *Banking Consolidation Directive* (Transitional rule for days past due for claims on *PSEs* and *corporates* and *retail exposures*) applies.
- (2) If the number of days past due set under that *CRD implementation measure* is greater than the number in *BIPRU 3.4.96R* (Treatment of items past due for more than 90 days) that higher number applies.
- 20.3 R *BIPRU TP 20.2R* applies until 31 December 2011 or any earlier date on which the relevant *CRD implementation measure* ceases to apply.
- 20.4 G *BIPRU TP 20.2R* implements (in part) Article 154(1) of the *Banking Consolidation Directive*.
- Central government exposures
- 20.5 R Until 31 December 2012, a 0% *risk weight* applies to *exposures* to the central government of the *United Kingdom* and of the Bank of England denominated and funded in the currency of another *EEA State*.
- 20.6 R If the *CRD implementation measures* of another *EEA State* apply a 0% *risk weight* to *exposures* to its central government or *central bank* denominated and funded in the domestic currency of another *EEA State* a *firm* must *risk weight* such *exposures* in the same manner.
- 20.7 R *BIPRU TP 20.6R* applies until 31 December 2012 or any earlier date on which the relevant *CRD implementation measure* ceases to apply.
- 20.8 G *BIPRU TP 20.5R* to *BIPRU TP 20.7R* implements (in part) Article 153 of the *Banking Consolidation Directive*.

21 Close substitutes for commodities

Application

21.1 R This section applies to a *BIPRU firm* that on 31 December 2006 was applying the approach referred to in the first column of the table in *BIPRU TP 21.3R* with respect to particular grades or brands of the same *commodity*-class.

Commodities: close substitutes

21.2 R A notice given under the *IPRU* provision in the second column of the table in *BIPRU TP 21.3R* is treated as having been given under *BIPRU 7.4.23R* (Notice to the *FSA* about treatment of different grades or brands of the same *commodity*) for the purposes of *BIPRU 7.4.22R* (Treatment of different grades or brands of the same *commodity*) with respect to the *commodity* grades or brands referred to in *BIPRU TP 21.1R*.

21.3 R Table: Commodity treatments under *IPRU*
This table belongs to *BIPRU TP 21.2R*

<i>IPRU</i> provisions setting out <i>commodity</i> approach	<i>IPRU</i> provisions under which notice given
Paragraph 22(2) of appendix 6 of chapter 10 of <i>IPRU(INV)</i>	Paragraph 23 of appendix 6 of chapter 10 of <i>IPRU(INV)</i>
Paragraph 22(2) of chapter CM of <i>IPRU(BANK)</i>	Paragraph 23 of chapter CM of <i>IPRU(BANK)</i>

Explanation

21.3 G *BIPRU 7.4.22R(1)(b)* says that a *firm* should treat *positions* in different grades or brands of the same *commodity*-class as different *commodities* unless they are close substitutes and have price movements which have exhibited a stable correlation coefficient of at least 0.9 over the last 12 months. *BIPRU 7.4.23R* says that a *firm* should notify the *FSA* in writing at least 20 *business days* prior to the date the *firm* starts relying on this treatment. The purpose of this section is to allow a notice given under the corresponding provisions of chapter 10 of *IPRU(INV)* or *IPRU(BANK)* to continue to have effect without the *firm* having to serve a new notice under *BIPRU 7.4.23R*.

22 Solo consolidation

Application

22.1 R This section applies to a *BIPRU firm* that:

- (1) is a *bank* or *building society*; and
- (2) on 31 December 2006, was, in accordance with the provision of *IPRU* referred to in *BIPRU* TP 22.2R and in accordance with a concession (as defined in *BIPRU* TP 22.8R), solo-consolidating a *subsidiary undertaking*.

22.2 R The provisions of *IPRU* referred to in *BIPRU* TP 22.1R are:

- (1) (in the case of a *bank*) section 9 of chapter CS of *IPRU(BANK)*; and
- (2) (in the case of a *building society*) section 1.11 of chapter 1 of volume 1 of *IPRU(BSOC)*.

Deemed solo consolidation waiver

22.3 R A concession referred to in *BIPRU* TP 22.1R is treated as a *solo consolidation waiver* with respect to the *subsidiary undertaking* to which it relates if the *firm* notifies the *FSA* that the *firm* wishes to apply the treatment in *BIPRU* 2.1 (Solo consolidation) to that *subsidiary undertaking*.

Notice to the FSA

22.4 R The following requirements apply to a notice under *BIPRU* TP 22.3R:

- (1) the *firm* must give the *FSA* the notice on or after 1 June 2006 and on or before 29 December 2006;
- (2) the notice must contain details of the concession concerned;
- (3) the notice must give the name of the *subsidiary undertaking* concerned and say where it is incorporated and has its head office; and
- (4) the notice must say whether that *subsidiary undertaking* is a *body corporate* and state the legal form of that *subsidiary undertaking*.

Limitations

- 22.5 R Any condition, limitation or requirement to which a concession referred to in *BIPRU* TP 22.1R is subject continues to apply to the extent that it is compatible with *BIPRU*. In particular, if the concession was only for the purpose of large exposures it only has effect for the purposes of *BIPRU* 10 (Concentration risk) and if it was only for the purposes of capital adequacy it only has effect for the purposes of *GENPRU* 2.1.13R (Obligation to hold capital resources equal to or greater than the capital resources requirement) or *GENPRU* 2.1.60R (Calculation of base capital resources requirement for banks authorised before 1993).

Obligation to meet other qualifying conditions

- 22.6 R A *firm* with a deemed *solo consolidation waiver* under *BIPRU* TP 22.3R may not apply the treatment in *BIPRU* 2.1 (Solo consolidation) to the *subsidiary undertaking* concerned unless the conditions in *BIPRU* 2.1.12R and *BIPRU* 2.1.13R (Solo consolidation – Minimum standards) are met with respect to that *subsidiary undertaking*.

Notification of relevance etc of concession

- 22.7 R A *firm* which has the benefit of a concession that has effect under *BIPRU* TP 22.3R must notify the *FSA* immediately if it becomes aware of any matter which is material to the relevance or appropriateness of the concession.

Meaning of concession

- 22.8 R A concession means for the purposes of *BIPRU* TP 22:
- (1) a consent or approval by the *FSA* under the provisions of *IPRU(BANK)* or *IPRU(BSOC)* referred to in *BIPRU* TP 22.2R; and
 - (2) a concession also means for the purposes of *BIPRU* TP 22 a written concession as defined in *SUP* TP 1.4 (Grandfathering of concessions granted by the *FSA*'s predecessor regulators: rules in the Handbook) or *SUP* TP 1.2.6A (Grandfathering of concessions granted by the *FSA*'s predecessor regulators: guidance in the Handbook) that had effect for the purposes of the provisions of *IPRU(BANK)* or *IPRU(BSOC)* referred to in *BIPRU* TP 22.2R.
- 22.9 G *BIPRU* TP 22.8R(2) provides a mechanism for keeping in effect solo consolidation concessions granted by the Bank of England and the Building Societies Commission.

23 Record keeping transitionals

Application

23.1 R This section applies to a *BIPRU investment firm*.

Duration of transitional

23.2 R This section applies until 1 November 2007.

Continuing record keeping requirements

23.3 R A *firm* in the first column of the table in *BIPRU* TP 23.4R must comply with the *rules* in *IPRU(INV)* specified in the second column adjusted in accordance with *BIPRU* TP 23.5R.

23.4 R Table: List of IPRU reporting rules
This table belongs to *BIPRU* TP 23.3R

Type of <i>firm</i>	<i>IPRU(INV)</i> rules
<i>Investment management firm</i>	Rule 5.3.1 of chapter 5
<i>UCITS investment firm</i>	Rules 7.4.1(c) and 7.6.2 of chapter 7
<i>Securities and futures firm</i>	Rules 10-10, 10-11 and 10-12 of chapter 10
<i>Personal investment firm</i>	Rules 13..1.10 to 13.1.17 of chapter 13

Adjustments

23.5 R The adjustments referred to in *BIPRU* TP 23.3R are as follows:

- (1) a reference to a *firm's* financial resources requirements must be read as a reference to its obligations under *GENPRU* 2.1 (Calculation of capital resources requirement) and any capital resources requirement under *BIPRU* TP;
- (2) the terms *trading book* and *non-trading book* have the meanings in the *Glossary*; and
- (3) a reference to requirements in *IPRU(INV)* must be read as a reference to the requirements of *GENPRU* and *BIPRU* applicable to the *firm* concerned.

- 24 Mid market valuations
- Application
- 24.1 R This section applies to a *BIPRU firm*.
- Duration of transitional
- 24.2 R This section applies until 1 January 2008.
- Transitional rule
- 24.3 R When marking to market (see *GENPRU* 1.3.14R to *GENPRU* 1.3.16R (General requirements: Marking to market)) for the purposes of valuing a *trading book* item for the purpose of *BIPRU* 14 (Capital requirements for settlement and counterparty risk), a *firm* may choose between using the mid market value and the more prudent side of bid/offer whether or not the *firm* is a significant market maker in the item concerned. A *firm* must be consistent in the basis it chooses.

- 25 Exclusions from consolidation
- Application
- 25.1 R This section applies to a *firm* to which *BIPRU* 8 (Group risk – consolidation) applies.
- Duration of transitional
- 25.2 R This section applies until 1 January 2008. However *BIPRU* TP 25.8R continues in force until it is revoked.
- Transitional rule
- 25.3 R A *firm* may exclude a member of its *UK consolidation group* or *non-EEA sub-group* that would otherwise have been included under *BIPRU* 8.5 (Basis of consolidation) if, as at 31 December 2006, that member was excluded from the *firm's UK consolidation group* in accordance with any of the following:
- (1) bullet points one or three of paragraph 6 of section 4 of Chapter CS of *IPRU(BANK)* (exclusion from consolidation where inclusion would be inappropriate or misleading or where there are legal impediments to the transfer of information); or
 - (2) section 1.13 of Chapter 1 of Volume 1 of *IPRU(BSOC)* (exclusion of subsidiary undertakings where inclusion in the consolidation would be misleading or inappropriate); or
 - (3) *IPRU(INV)* 14.2.5R(2) (exclusion from consolidation where inclusion would be inappropriate or misleading); or
 - (4) any *waiver* from the consolidation provisions of Chapter 14 of *IPRU(INV)* or (in the case of *IPRU(BSOC)*) a written consent or approval by the *FSA* on the ground set out in indent one of Article 52(3) of the Directive 2000/12 (the previous version of the *Banking Consolidation Directive*) (exclusion from consolidation where there are legal impediments to the transfer of information).
- 25.4 R A *firm* may only apply *BIPRU* TP 25.3R to a member of its *UK consolidation group* or *non-EEA sub-group* if the *firm* or another member of its *UK consolidation group* notifies the *FSA* in writing that it intends to apply that *rule* to that member and the notice complies with the following requirements:
- (1) the *FSA* was notified on or after 1 November 2006 and on or before 29 December 2006;

- (2) the notice must give the name of the member concerned and say where it is incorporated and has its head office; and
- (3) the notice must say whether that member is a *body corporate* and state the legal form of that member.

Limitations

- 25.5 R Any condition, limitation or requirement to which the treatment in *BIPRU* TP 25.3R is subject continues to apply to the extent that it is compatible with *BIPRU*.

Obligation to meet other qualifying conditions

- 25.6 R A *firm* may only apply the treatment in *BIPRU* TP 25.3R if the conditions in whichever is applicable of Article 73(1)(a) (exclusion from consolidation where there are legal impediments to transfer of information) or Article 73(1)(c) (exclusion from consolidation where inclusion would be inappropriate or misleading) of the *Banking Consolidation Directive* continue to be satisfied.

Notification of relevance etc of concession

- 25.7 R A *firm* must notify the *FSA* immediately if it becomes aware of any matter which is material to the relevance or appropriateness of the continuance of the treatment in *BIPRU* TP 25.3R.

Small balance sheet size exclusion

- 25.8 R If a *firm* excluded a member of its *UK consolidation group* or *non-EEA subgroup* from the *firm's UK consolidation group* in accordance with:
- (1) bullet point two of paragraph 6 of section 4 of Chapter CS of *IPRU(BANK)* (exclusion from consolidation where combined balance sheet is below certain thresholds);
 - (2) *IPRU(INV)* 14.2.5R(1) (exclusion from consolidation where combined balance sheet is below certain thresholds); or
 - (3) a written consent or approval by the *FSA* under *IPRU(BSOC)* on the ground set out in indent two of Article 52(3) of the Directive 2000/12 (the previous version of the *Banking Consolidation Directive*) (exclusion from consolidation where combined balance sheet is below certain thresholds);

the *firm* need not notify the *FSA* under *BIPRU* 8.5.9R (exclusion from consolidation where combined balance sheet is below certain thresholds) as long as it has notified the *FSA* of its intention to take advantage of this *rule* and that notice complies with *BIPRU* TP 25.4R.

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Schedule 1

Record keeping requirements

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1 The aim of the *guidance* in the following table is to give the reader a quick overall view of the relevant record keeping requirements.

2 It is not a complete statement of those requirements and should not be relied on as if it were.

3 Table

Handbook reference	Subject of Record	Contents of Record	When record must be made	Retention Period
<i>BIPRU 2.2.5G</i>	<i>Firm's ICAAP</i>	<p>(1) The results of the <i>ICAAP</i></p> <p>(2) An explanation of the processes used</p> <p>(3) How the process is used internally and for what purpose</p> <p>(4) Internal governance</p> <p>(5) The main sources of risk to which the <i>firm</i> is exposed</p> <p>(6) How the <i>firm</i> is managing each of those risks</p>	Annually	Not specified

Handbook reference	Subject of Record	Contents of Record	When record must be made	Retention Period
		<p>(7) Details of stress and scenario testing that has been conducted</p> <p>(8) The rationale behind the chosen scenarios</p> <p>(9) The results of those scenario tests</p>		
<p><i>BIPRU</i> 5.2.3R, <i>BIPRU</i> 5.4.11R(2), <i>BIPRU</i> 9.5.1R(5)</p>	<p>Legal opinions confirming enforceability</p>	<p>A record of the legal review showing enforceability of credit protection arrangements in all relevant jurisdictions</p>	<p>Not specified, but before risk mitigant is recognised</p>	<p>Review conducted as necessary</p>
<p><i>BIPRU</i> 5.2.9R</p>	<p>Risk management processes</p>	<p>Documented risk management processes to control the risks that <i>firm</i> may be exposed to as a result of carrying out <i>credit risk mitigation</i></p>	<p>Not specified, but before risk mitigant is recognised</p>	<p>Not specified</p>
<p><i>BIPRU</i> 5.4.12R</p>	<p>Collateral procedures</p>	<p>(1) A clear and robust procedure for the liquidation of collateral</p> <p>(2) Documented policies covering the types and amounts of collateral accepted</p>	<p>Not specified, but before collateral is recognised</p>	<p>Not specified</p>

Handbook reference	Subject of Record	Contents of Record	When record must be made	Retention Period
<i>BIPRU</i> 5.4.59R, <i>BIPRU</i> 5.4.60R	Volatility adjustments for financial collateral	(1) Documentation of a system estimating volatility adjustments and the integration of the volatility adjustments in its risk management process (2) Review of system estimating volatility adjustments	Not specified, but before <i>own estimates of volatility adjustments approach</i> is used for capital purposes	Not specified
<i>BIPRU</i> 5.7.8R	System to manage concentration of risk arising from guarantees and credit derivatives	Documentation of a system to manage potential concentration risk arising from <i>unfunded credit protection</i> and how this interacts with its management of its overall risk profile	Not specified, but before <i>unfunded credit protection</i> is recognised	Not specified
<i>BIPRU</i> 7.10.53R, <i>BIPRU</i> 7.10.54G	Material risks not captured in the <i>firm's VaR model</i>	Documented risks not captured in the <i>VaR model</i> and creation of a prudent incremental <i>PRR</i> charge for the risk not captured	Not specified	Not specified
<i>BIPRU</i> 9.4.3R	Legal opinions for <i>securitised exposures</i>	A record of the legal opinions confirming that the <i>securitised exposures</i> have been put beyond the reach of the <i>originator</i>	Not specified, but before <i>securitised exposures</i> are excluded from capital calculation	Review conducted as necessary
<i>BIPRU</i> 9.13.12R (1)	Capital plan in case of early amortisation	For controlled amortisation, the	Not specified	Not specified

Handbook reference	Subject of Record	Contents of Record	When record must be made	Retention Period
		capital/liquidity plan to ensure that sufficient capital and liquidity are available in the event of early amortisation		
<i>BIPRU</i> 9.13.21R	Capital plan in case of either scheduled or early amortisation	The capital plan to address the capital implications of both scheduled and early amortisation	Not specified	Not specified
<i>BIPRU</i> 10.4.47R	<i>Exposure</i> to undisclosed counterparties	A record of the steps taken by the <i>firm</i> to satisfy itself that it will continue to meet the limits in <i>BIPRU</i> 10.5 for <i>non-trading book exposures</i> and <i>trading book exposures</i>	Not specified	Not specified
<i>BIPRU</i> 13.6.48R	Operation of <i>CCR</i> management system	Documented set of internal policies, controls and procedures concerning the operation of the <i>CCR</i> management system	Prior to application for <i>CCR internal model method permission</i>	Continuous
<i>BIPRU</i> 13.7.6R (2)	Legal opinion regarding netting agreements	A record of legal opinions that, in the event of a legal challenge, relevant courts and administrative authorities would find that the <i>firm's</i> claims and obligations would be	On entering into a transaction and making use of netting agreements	While transaction held

Handbook reference	Subject of Record	Contents of Record	When record must be made	Retention Period
		limited to the net sum in <i>BIPRU</i> 13.7.6R (1)		

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Schedule 2

Notification and reporting requirements

1 The aim of the *guidance* in the following table is to give the reader a quick overall view of the relevant notification requirements.

2 It is not a complete statement of those requirements and should not be relied on as if it were.

3 Table

Handbook reference	Matter to be notified	Contents of notification	Trigger event	Time allowed
<i>BIPRU</i> 1.2.30R	Adoption of or significant change to a <i>trading book policy statement</i>	Copy of the <i>trading book policy statement</i>	Adoption of or significant change to a <i>trading book policy statement</i>	Immediately
<i>BIPRU</i> 3.2.35R (1), (4) and (5)	Intention to apply <i>BIPRU</i> 3.2.25R	(1) and (4): Fact of intention (5): Fact of <i>exposure</i> or <i>firm</i> ceasing to meet the conditions in <i>BIPRU</i> 3.2.25R	(1) and (4): Intention to apply (5): Ceasing to meet conditions	(1) and (4): One month's prior notice (5): First report date after the obligation to notify becomes due
<i>BIPRU</i> 7.4.23R	Intention to rely on approach in <i>BIPRU</i> 7.4.22R (1)(b)	Fact of intention and details on which <i>commodities</i> the <i>firm</i> intends to treat as same <i>commodity-class</i>	Intention to rely	At least 20 <i>business days</i> prior to the date the <i>firm</i> starts relying on <i>BIPRU</i>

Handbook reference	Matter to be notified	Contents of notification	Trigger event	Time allowed
		and justification		7.4.23R
<i>BIPRU 7.5.4R</i>	Intention to use an exclusion under <i>BIPRU 7.5.4R (1)</i>	Fact of intention and the terms on which the relevant item will be excluded from the <i>firm's foreign currency PRR</i> calculation	Intention to use	Before use of the exclusion
<i>BIPRU 7.10.104R</i>	Occurrence of <i>backtesting exception</i>	Fact of <i>backtesting exception</i>	<i>Backtesting exception</i>	Orally within 2 <i>business days</i> , and written account of all <i>backtesting exceptions</i> that <i>Month</i> , within 5 <i>business days</i> after the <i>Month</i>
<i>BIPRU 7.10.129R</i>	Operation of the <i>VaR model</i> , systems and controls relating to it and changes to the <i>VaR model</i> and those systems and controls	Documentation specified in the <i>VaR model waiver/VaR model permission</i>	<i>FSA</i> specified requirements	No later than number of <i>business days</i> after the end of each quarter specified in the <i>VaR model permission</i>
<i>BIPRU 7.10.130R</i>	Details of significant planned changes to the <i>VaR model</i>	Information about the nature of the change and an estimate of the impact on <i>VaR numbers</i> and the <i>incremental</i>	Intention to change	Prior to any changes being implemented

Handbook reference	Matter to be notified	Contents of notification	Trigger event	Time allowed
		<i>default risk charge</i>		
<i>BIPRU</i> 8.4.18R (2)	Serious risk that could undermine the financial stability of the <i>CAD Article 22 group</i>	Fact of serious risk to group financial stability	Events/ activities leading to serious risk to group financial stability	As soon as the <i>firm</i> becomes aware of that risk
<i>BIPRU</i> 8.4.18R (3)	<i>Consolidated capital resources and consolidated capital resources requirement of the CAD Article 22 group as set out in the investment firm consolidation waiver</i>	Amount of <i>CAD Article 22 group consolidated capital resources and consolidated capital resources requirement</i>	Periodically as set out in the <i>investment firm consolidation waiver</i>	Not specified
<i>BIPRU</i> 8.4.18R (4)	Large exposures risks of the <i>CAD Article 22 group</i> including <i>undertakings</i> not located in a <i>Member State</i>	Large exposures risks of the <i>CAD Article 22 group</i> including <i>undertakings</i> not located in a <i>Member State</i>	Periodically as set out in the <i>investment firm consolidation waiver</i>	Not specified
<i>BIPRU</i> 8.5.9R	Intention to exclude an <i>undertaking</i> from consolidation	Fact of intention and details of <i>undertaking</i> to be excluded	Intention to exclude	In accordance with <i>SUP</i> 15.7
<i>BIPRU</i> 8.7.16R	(1) The choice of consolidation technique in <i>BIPRU</i> 8.7.13R it applies for which consolidated requirement component: and (2) to which members of the relevant group it is applying	(1) The choice of consolidation technique in 8.7.13R to be applied for each consolidated requirement component	See <i>SUP</i> 16	See <i>SUP</i> 16

Handbook reference	Matter to be notified	Contents of notification	Trigger event	Time allowed
	the different methods in BIPRU 8.7.13R	(2) the members of the relevant group to which it is applying the different methods in BIPRU 8.7.13R		
<i>BIPRU</i> 8.9.4R, <i>BIPRU</i> 8.9.27R	Use of Treasury concession in <i>BIPRU</i> 10.7 on a consolidated basis	See <i>BIPRU</i> 10.11	Intention to use Treasury concession	See <i>BIPRU</i> 10.11
<i>BIPRU</i> 8.9.8R, <i>BIPRU</i> 8.9.27R	Creation of a <i>consolidation UK integrated group</i>	See <i>BIPRU</i> 10.11	Intention to form <i>consolidation UK integrated group</i>	See <i>BIPRU</i> 10.11
<i>BIPRU</i> 9.6.2R	Provision of implicit support to a <i>securitisation</i>	(1) Provision of non-contractual support, and (2) The regulatory capital impact of providing implicit support	Provision of implicit support	Not specified
<i>BIPRU</i> 10.5.9R	Breaching the <i>large exposures</i> limits in <i>BIPRU</i> 10.5.6R or <i>BIPRU</i> 10.5.8R	Fact of breach or expectation of breach	Breach or expectation of breach	Immediately
<i>BIPRU</i> 10.5.14R	All cases of <i>trading book concentration risk excesses</i>	All cases in the three month period of each	End of three month period	Within 30 days of the end of each

Handbook reference	Matter to be notified	Contents of notification	Trigger event	Time allowed
	over a three month period	<i>trading book concentration risk excess</i> that existed in that period, giving the amount of the excess and the name of the <i>counterparty</i>		third <i>Month</i>
<i>BIPRU</i> 10.6.7R (2)	Intention to use capital maintenance agreement	Fact of intention and details of the terms and conditions of capital maintenance agreement	Intention to enter into agreement	One month before entering agreement
<i>BIPRU</i> 10.11.1R (1) and (4)	Intention to use the concession in <i>BIPRU</i> 10.7.1R, or <i>BIPRU</i> 10.7.4R or the <i>UK integrated groups</i> concession in <i>BIPRU</i> 10.8	Fact of intention	Intention to use <i>BIPRU</i> 10.7.1 R, or <i>BIPRU</i> 10.7.4, or <i>BIPRU</i> 10.8	One month prior to using the concessions in <i>BIPRU</i> 10.7.1 R or <i>BIPRU</i> 10.8 and <i>BIPRU</i> 10.8
<i>BIPRU</i> 10.11.1 (3)	Intention to stop applying <i>BIPRU</i> 10.7 or <i>BIPRU</i> 10.8	Fact of intention	Intention to stop using <i>BIPRU</i> 10.7.1 R, or <i>BIPRU</i> 10.7.4, or <i>BIPRU</i> 10.8	One month prior to using the concessions in <i>BIPRU</i> 10.7.1 R or <i>BIPRU</i> 10.7.4R or <i>BIPRU</i> 10.8
<i>BIPRU</i> 10.11.2R	<i>Exposure</i> being treated under <i>BIPRU</i> 10.7.1R or <i>BIPRU</i> 10.7.4R or <i>BIPRU</i> 10.8 or <i>BIPRU</i> 10.9 ceases	Fact or expectation of any exposure to which it has applied the	Awareness of situation	Not specified

Handbook reference	Matter to be notified	Contents of notification	Trigger event	Time allowed
	to meet the conditions for application of the relevant treatment	treatment ceases to meet the conditions for application of the relevant treatment		
<i>BIPRU</i> 10.12.6R	Artificial transfer, transaction or arrangement.	Fact of entry into a transfer, transaction or arrangement of the type mentioned in <i>BIPRU</i> 10.12.5R	Entry into an artificial transfer, transaction or arrangement	Not specified
<i>BIPRU</i> 13.2.2R	Counterparty risk <i>exposure</i> of non-standard type	Fact of <i>exposure</i> , <i>counterparty</i> involved, nature of the <i>exposure</i> and capital treatment adopted	Entry into non-standard <i>exposure</i>	Immediately
<i>BIPRU</i> 13.6.20R	Cessation to comply with requirements set out in <i>BIPRU</i> 13.6 for <i>CCR internal model method permission</i>	Plan for timely return to compliance or demonstration that the effect of non-compliance is immaterial	Ceasing to comply with requirements	Immediately

Prudential sourcebook for banks, building societies and investment firms (*BIPRU*)

Schedule 3

Fees and other requirement payments

G

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

Prudential sourcebook for banks, building societies and investment firms (*BIPRU*)

Schedule 4

Powers exercised

G

1 The following powers and related provisions in the *Act* have been exercised by the *FSA* to make the rules in *BIPRU*:

- (1) section 138 (General rule-making power);
- (2) section 148(3) (modification or waiver of rules);
- (3) section 149 (Evidential provisions);
- (4) section 150(2) (Actions for damages); and
- (5) section 156 (General supplementary powers).

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

- (1) section 157(1) (Guidance).

Prudential sourcebook for banks, building societies and investment firms (*BIPRU*)

Schedule 5

Rights of action for damages

1. The table below sets out the rules in *BIPRU* contravention of which by an *authorised person* may be actionable under section 150 of the *Act* (Actions for damages) by a person who suffers loss as a result of the contravention.

2. If a "Yes" appears in the column headed "For private person", the rule may be actionable by a private person under section 150 (or, in certain circumstances, his fiduciary or representative; see article 6(2) and (3)(c) of the Financial Services and Markets Act 2000 (Rights of Action) Regulations 2001 (SI 2001/2256)). A "Yes" in the column headed "Removed" indicates that the *FSA* has removed the right of action under section 150(2) of the *Act*. If so, a reference to the rule in which it is removed is also given.

3. The column headed "For other person" indicates whether the rule may be actionable by a person other than a private person (or his fiduciary or representative) under article 6(2) and (3) of those Regulations. If so, an indication of the type of person by whom the rule may be actionable is given.

Chapter/ Appendix	Section/ Annex	Right of action under section 150		
		For private person	Removed	For other person
<i>All rules in BIPRU</i>		No	Yes – <i>BIPRU</i> 1.4.1R	No

Prudential sourcebook for banks, building societies and investment firms (*BIPRU*)

Schedule 6

Rules than can be waived

The rules in *BIPRU* may be waived by the *FSA* under section 148 of the *Act* (Modification or waiver of rules). However, if the *rules* incorporate requirements laid down in European directives, it will not be possible for the *FSA* to grant a *waiver* that would be incompatible with the *United Kingdom's* responsibilities under those directives. It therefore follows that if a *rule* in *BIPRU* contains provisions which derive partly from a directive, and partly not, the *FSA* will be able to consider a *waiver* of the latter requirements only, unless the directive provisions are optional rather than mandatory.

THE CRD (CONSEQUENTIAL AMENDMENTS) INSTRUMENT 2006

Powers exercised

- A. The Financial Services Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):
- (1) section 138 (General rule-making power);
 - (2) section 141 (Insurance business rules);
 - (3) section 149 (Evidential provisions);
 - (4) section 150(2) (Actions for damages);
 - (5) section 156 (General supplementary powers);
 - (6) section 157(1) (Guidance);
 - (7) section 316(1) (Direction by Authority);
 - (8) section 340 (Appointment).
- B. The rule-making powers listed above are specified for the purpose of section 153(2) (Rule-making instruments) of the Act.

Commencement

- C. This instrument comes into force as follows:
- (1) The following provisions come into force on 1 January 2007, except that the words “including the services and activities provided for in Section A and B of Annex I of the MIFID when referring to the financial instruments provided for in Section C of Annex I of that Directive” in the amendment to the definition of financial institution in Annex A do not take effect until 1 November 2007:

Annex A	Parts 1B, 2B and 3B
Annex D	Part 2
Annex E	Whole
Annex F	Whole
Annex H	Whole
Annex I	Part 2
Annex J	Part 2
Annex L	Parts 2 and 4
Annex O	Whole
Annex P	Part 2
Annex Q	Whole
Annex S	Whole
Annex T	Part 2

- (2) The remainder of this instrument comes into force on 31 December 2006.

Amendments to the handbook

- D. (1) The provisions of the Lloyd's sourcebook ("LLD") listed in column (1) of the Table in Annex R to this instrument are:
- (a) redesignated to form part of the Handbook of rules and guidance in accordance with the corresponding entry in column (2) of the Table in Annex R; and
 - (b) restated and amended so that they read as set out in this instrument, in the Annex specified in column (3) of Table 1 in Annex R.
- (2) Other provisions of LLD are deleted in accordance with paragraph 2 of Annex R.
- E. The modules of the Handbook listed in column (1) below are amended in accordance with the Annexes to this instrument listed in column (2).

(1)	(2)
Glossary of definitions	Annex A
Threshold Conditions (COND)	Annex B
Senior Management Arrangements, Systems and Controls (SYSC)	Annex C
Integrated Prudential sourcebook (PRU)	Annex D
Interim Prudential sourcebook for Banks (IPRU(BANK))	Annex E
Interim Prudential sourcebook for Building Societies (IPRU(BSOC))	Annex F
Interim Prudential sourcebook for Insurers (IPRU(INS))	Annex G
Interim Prudential sourcebook for Investment Businesses (IPRU(INV))	Annex H
Insurance: Conduct of Business sourcebook (ICOB)	Annex I
Mortgages: Conduct of Business sourcebook (MCOB)	Annex J
Market Conduct sourcebook	Annex K
Supervision manual (SUP)	Annex L
Dispute Resolution : Complaints sourcebook (DISP)	Annex M
Compensation sourcebook (COMP)	Annex N
New Collective Investment Schemes sourcebook (COLL)	Annex O
Credit Unions sourcebook (CRED)	Annex P
Electronic Money sourcebook (ELM)	Annex Q
Listing Rules (LR)	Annex S

- F. Other provisions in the FSA's Handbook of rules and guidance are amended in accordance with Annexes T and U to this instrument.

Citation

- G. This instrument may be cited as the CRD (Consequential Amendments) Instrument 2006.

By order of the Board
23 November 2006

Annex A
Amendments to the Glossary

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

Where entirely new definitions are inserted, or where definitions are deleted, these are not shown underlined or struck through.

Part 1A (New definitions taking effect on 31 December 2006)

Insert the following definitions in the appropriate alphabetical position in the Glossary:

<i>GENPRU</i>	the General Prudential sourcebook
<i>INSPRU</i>	the Prudential sourcebook for Insurers
<i>individual capital guidance</i>	<i>guidance</i> given to a <i>firm</i> about the amount and quality of capital resources that the <i>FSA</i> thinks the <i>firm</i> should hold under the <i>overall financial adequacy rule</i> as it applies on a solo level or a consolidated level.

Part 1B (New definitions taking effect on 1 January 2007)

Insert the following definitions in the appropriate alphabetical position in the Glossary:

ABCP internal assessment approach the method for calculating the *risk weighted exposure amount* for a *securitisation position* in relation to an *asset backed commercial paper programme* as set out in *BIPRU 9.12.20R*.

ABCP programme (for the purposes of *BIPRU 9 (Securitisation)*) an *asset backed commercial paper programme*.

advanced measurement approach one of the following:

- (a) the adjusted method of calculating the *operational risk capital requirement* set out in *BIPRU 6.5 (Operational risk: advanced measurement approaches)*;
- (b) (where the approach in (a) is being applied on a consolidated basis) the method in (a) as applied on a consolidated basis in accordance with *BIPRU 8 (Group risk - consolidation)*; or
- (c) when the reference is to the rules of or administered by a *regulatory body* other than the *FSA*, whatever corresponds to the approach in (a) or (b), as the case may be, under those rules.

advanced IRB approach one of the following:

- (a) (in relation to the *sovereign, institutional and corporate IRB exposure class*) the approach under the *IRB approach* under which a *firm* supplies its own estimates of *LGD* and *conversion factors*;
- (b) (where the approach in (a) is being applied on a consolidated basis) the method in (a) as applied on a consolidated basis in accordance with *BIPRU 8 (Group risk - consolidation)*; or
- (c) when the reference is to the rules of or administered by a *regulatory body* other than the *FSA*, whatever corresponds to the approach in (a) or (b), as the case may be, under those rules.

advanced prudential calculation approach one of the following:

- (a) the *IRB approach*; or
- (b) the *advanced measurement approach*; or

- (c) the *VaR model approach*; or
- (d) the *CAD 1 model approach*; or
- (e) the *master netting agreement internal models approach*; or
- (f) the *CCR internal model method*;

including, in each case, whatever corresponds to that approach under the rules of or administered by a *regulatory body* other than the *FSA*.

advanced prudential calculation approach permission

one of the following:

- (a) an *IRB permission*; or
- (b) an *AMA permission*; or
- (c) a *VaR model permission*; or
- (d) a *CAD 1 model waiver*; or
- (e) a *master netting agreement internal models approach permission*; or
- (f) a *CCR internal model method permission*.

alternative standardised approach

one of the following:

- (a) a version of the *standardised approach to operational risk* under which a *firm* uses different indicators for certain business lines as referred to in *BIPRU 6.4.19R* (The alternative standardised approach);
- (b) (where the approach in (a) is being applied on a consolidated basis) the method in (a) as applied on a consolidated basis in accordance with *BIPRU 8* (Group risk - consolidation); or
- (c) when the reference is to the rules of or administered by a *regulatory body* other than the *FSA*, whatever corresponds to the approach in (a) or (b), as the case may be, under those rules.

AMA

the *advanced measurement approach*.

AMA permission

an *Article 129 implementing measure*, a *requirement* or a *waiver* that requires a *BIPRU firm* or an *institution* to use the *advanced measurement approach to operational risk* on a solo basis or, if the context requires, a consolidated basis.

<i>appropriate PRA</i>	<p>(1) (in relation to a <i>position</i> treated under <i>BIPRU</i> 7.6 (Option PRR)) the percentage figure applicable to that <i>position</i> under the table in <i>BIPRU</i> 7.6.8R (Appropriate PRR);</p> <p>(2) (for any other purpose and in relation to a <i>position</i>) the <i>PRA</i> applicable to that <i>position</i> under <i>BIPRU</i> 7 (Market risk).</p>
<i>Article 129 implementing measure</i>	<p>any:</p> <p>(a) measure taken by the <i>FSA</i> under regulations 7-9 of the <i>Capital Requirements Regulations 2006</i>; or</p> <p>(b) corresponding measure taken by another <i>competent authority</i> to apply an <i>Article 129 permission</i> as referred to in the last paragraph of Article 129(2) of the <i>Banking Consolidation Directive</i>.</p>
<i>Article 129 permission</i>	a permission of the type referred to in Article 129(2) of the <i>Banking Consolidation Directive</i> (permission to apply the <i>IRB approach</i> , the <i>AMA approach</i> or the <i>CCR internal model method</i> on a consolidated basis) or Article 37(2) of the <i>Capital Adequacy Directive</i> (permission to apply the <i>VaR model approach</i> on a consolidated basis) excluding an <i>Article 129 implementing measure</i> .
<i>Article 129 procedure</i>	the procedure described in Article 129(2) of the <i>Banking Consolidation Directive</i> (permission to apply the <i>IRB approach</i> , the <i>AMA approach</i> or the <i>CCR internal model method</i> on a consolidated basis) or that applies under Article 37(2) of the <i>Capital Adequacy Directive</i> (permission to apply the <i>VaR model approach</i> on a consolidated basis) for the purpose of applying for and granting or refusing an <i>Article 129 permission</i> or the procedure for varying or revoking an <i>Article 129 permission</i> in accordance with the <i>Banking Consolidation Directive</i> or the <i>Capital Adequacy Directive</i> .
<i>Article 134 relationship</i>	<p>(in accordance with Article 134 of the <i>Banking Consolidation Directive</i>) a relationship of one of the following kinds:</p> <p>(a) where a <i>person</i> exercises a significant influence over one or more <i>persons</i>, but without holding a <i>participation</i> or other capital ties in these <i>persons</i> and without being a <i>parent undertaking</i> of these <i>persons</i>; or</p> <p>(b) where two or more <i>persons</i> are placed under single management other than pursuant to a contract or clauses of their memoranda or articles of association.</p>
<i>asset backed commercial paper programme</i>	(for the purposes of <i>BIPRU</i> 9 (Securitisation) and in accordance with Part 1 of Annex IX of the <i>Banking Consolidation Directive</i> (Securitisation definitions)) a programme of <i>securitisations</i> (within the meaning of paragraph (2) of the definition of securitisation) the securities issued by which predominantly take the form of commercial paper with an original maturity of one year or less.

<i>at the money</i>	(for the purposes of <i>BIPRU 7</i> (Market risk) and in relation to an <i>option</i> or <i>warrant</i>) the strike price of that <i>option</i> or <i>warrant</i> being equal to the current market value of the underlying instrument.
<i>backtesting exception</i>	(in <i>BIPRU 7.10</i> (Use of a value at risk model)) an exception (excluding a <i>specific risk backtesting exception</i>) arising out of backtesting a <i>VaR model</i> as more fully defined in <i>BIPRU 7.10.103R</i> .
<i>banking and investment services conglomerate</i>	a <i>financial conglomerate</i> that is identified in paragraph 4.3 of <i>GENPRU 3 Ann 1R</i> (Types of financial conglomerate) as a <i>banking and investment services conglomerate</i>
<i>banking and investment services sector</i>	(in relation to a <i>financial sector</i> in a <i>consolidation group</i> or a <i>financial conglomerate</i> and in accordance with <i>GENPRU 3.1</i> (Cross sector groups)), the <i>investment services sector</i> and the <i>banking sector</i> taken together
<i>basic indicator approach</i>	the approach to calculating the <i>ORCR</i> set out in <i>BIPRU 6.3</i> (Operational risk: Basic indicator approach)
<i>BIPRU</i>	the Prudential sourcebook for Banks, Building Societies and Investment Firms.
<i>BIPRU 50K firm</i>	has the meaning in <i>BIPRU 1.1.20R</i> (Types of investment firm: <i>BIPRU 50K firm</i>) which in summary is a <i>BIPRU investment firm</i> that satisfies the following conditions: <ul style="list-style-type: none"> (a) it satisfies the conditions in <i>BIPRU 1.1.19R(1)</i> (does not <i>deal on own account</i> or underwrite issues of <i>financial instruments</i> on a firm commitment basis) and <i>BIPRU 1.1.19R(3)</i> (offers one or more of certain specified services); (b) it does not hold clients' money or securities in relation to <i>investment services</i> it provides and it is not authorised to do so; and (c) it is not a <i>UCITS investment firm</i>.
<i>BIPRU 125K firm</i>	has the meaning in <i>BIPRU 1.1.19R</i> (Types of investment firm: <i>BIPRU 125K firm</i>) which in summary is a <i>BIPRU investment firm</i> that satisfies the following conditions: <ul style="list-style-type: none"> (1) it does not <i>deal on own account</i> or underwrite issues of <i>financial instruments</i> on a firm commitment basis; (2) it holds clients' money or securities in relation to <i>investment services</i> it provides or is authorised to do so; (3) it offers one or more of certain specified services; and (4) it is not a <i>UCITS investment firm</i>.

<i>BIPRU 730K firm</i>	has the meaning in <i>BIPRU</i> 1.1.21R (Types of investment firm: <i>BIPRU</i> 730K firm) which in summary is a <i>BIPRU investment firm</i> that is not a <i>UCITS investment firm</i> , a <i>BIPRU 50K firm</i> or a <i>BIPRU 125K firm</i> .
<i>BIPRU firm</i>	<p>has the meaning set out <i>BIPRU</i> 1.1.6 (The definition of a <i>BIPRU firm</i>), which is in summary a <i>firm</i> that is:</p> <ul style="list-style-type: none"> (a) a <i>building society</i>; or (b) a <i>bank</i>; or (c) a <i>full scope BIPRU investment firm</i>; or (d) a <i>BIPRU limited licence firm</i>; or (e) a <i>BIPRU limited activity firm</i>; <p>but excluding <i>firms</i> of the type listed in <i>BIPRU</i> 1.1.7R (Exclusion of certain types of <i>firm</i> from the definition of <i>BIPRU firm</i>).</p>
<i>BIPRU investment firm</i>	<p>has the meaning set out <i>BIPRU</i> 1.1.8R (Definition of a <i>BIPRU investment firm</i>), which is in summary one of the following types of <i>BIPRU firm</i>:</p> <ul style="list-style-type: none"> (a) a <i>full scope BIPRU investment firm</i>; or (b) a <i>BIPRU limited licence firm</i>; or (c) a <i>BIPRU limited activity firm</i>; <p>including a <i>UCITS investment firm</i> that is not excluded under <i>BIPRU</i> 1.1.7R (Exclusion of certain types of <i>firm</i> from the definition of <i>BIPRU firm</i>).</p>
<i>BIPRU limited activity firm</i>	<p>has the meaning in <i>BIPRU</i> 1.1.17R (Types of <i>BIPRU investment firm</i>), which is in summary a <i>limited activity firm</i> that meets the following conditions:</p> <ul style="list-style-type: none"> (a) it is a <i>firm</i>; and (b) its head office is in the <i>United Kingdom</i> and it is not otherwise excluded from the definition of <i>BIPRU firm</i> under <i>BIPRU</i> 1.1.7R (Exclusion of certain types of <i>firm</i> from the definition of <i>BIPRU firm</i>).
<i>BIPRU limited licence firm</i>	<p>has the meaning in <i>BIPRU</i> 1.1.17R (Types of <i>BIPRU investment firm</i>), which is in summary a <i>limited licence firm</i> that meets the following conditions:</p> <ul style="list-style-type: none"> (a) it is a <i>firm</i>; and

	(b) its head office is in the <i>United Kingdom</i> and it is not otherwise excluded from the definition of <i>BIPRU firm</i> under <i>BIPRU 1.1.7R</i> (Exclusion of certain types of <i>firm</i> from the definition of <i>BIPRU firm</i>).
<i>CAD 1 model</i>	a risk management model of the type described in <i>BIPRU 7.9</i> (Use of a CAD 1 model).
<i>CAD 1 model approach</i>	one of the following: <ul style="list-style-type: none"> (a) the approach to calculating part of the <i>market risk capital requirement</i> set out in <i>BIPRU 7.9</i> (Use of a CAD 1 model); (b) (where the approach in (a) is being applied on a consolidated basis) the method in (a) as applied on a consolidated basis in accordance with <i>BIPRU 8</i> (Group risk - consolidation); or (c) when the reference is to the rules of or administered by a <i>regulatory body</i> other than the <i>FSA</i>, whatever corresponds to the approach in (a) or (b), as the case may be, under those rules.
<i>CAD 1 model waiver</i>	a <i>waiver</i> that requires a <i>firm</i> to use the <i>CAD 1 model approach</i> on a solo basis or, if the context requires, a consolidated basis.
<i>CAD Article 22 group</i>	a <i>UK consolidation group</i> or <i>non-EEA sub-group</i> that meets the conditions in <i>BIPRU 8.4.9R</i> (Definition of a CAD Article 22 group).
<i>CAD full scope firm</i>	has the meaning set out <i>BIPRU 1.1.13R</i> (Types of investment firm: CAD full scope firm), which in summary is a <i>CAD investment firm</i> that is not a <i>limited activity firm</i> or a <i>limited licence firm</i> .
<i>CAD investment firm</i>	has the meaning set out <i>BIPRU 1.1.14R</i> (Types of investment firm: CAD investment firm), which in summary is an <i>investment firm</i> that is subject to the requirements imposed by the <i>ISD</i> (or which would be subject to that Directive if its head office were in an <i>EEA State</i>) but excluding a <i>bank</i> , a <i>building society</i> , an <i>ELMI</i> , a <i>credit institution</i> , a <i>local</i> and an <i>exempt CAD firm</i> .
<i>capital instrument</i>	(in <i>GENPRU</i> and <i>BIPRU</i> and in relation to an <i>undertaking</i>) any <i>security</i> issued by or loan made to that <i>undertaking</i> or any other investment in, or external contribution to the capital of, that <i>undertaking</i> .
<i>capital market-driven transaction</i>	(in accordance with point 2 of Part 1 of Annex VIII of the <i>Banking Consolidation Directive</i> (Eligible forms of credit risk mitigation)) any transaction giving rise to an <i>exposure</i> secured by collateral which includes a provision conferring upon the <i>person</i> with the <i>exposure</i> the right to receive margin frequently.
<i>capital resources gearing rules</i>	(1) (in relation to an <i>insurer</i>) <i>GENPRU 2.2.29R</i> , <i>GENPRU 2.2.30R</i> and <i>GENPRU 2.2.32R</i> to <i>GENPRU 2.2.41R</i> .

	(2) (in relation to an <i>bank</i> or <i>building society</i>) <i>GENPRU 2.2.29R, GENPRU 2.2.30R, GENPRU 2.2.46R and GENPRU 2.2.49R.</i>
	(3) (in relation to an <i>BIPRU investment firm</i>) <i>GENPRU 2.2.30R, GENPRU 2.2.46R and GENPRU 2.2.49R to GENPRU 2.2.50R.</i>
<i>capital resources table</i>	(in relation to an <i>insurer</i> or <i>BIPRU firm</i>) the table specified in <i>GENPRU 2.2.19R</i> (Applicable capital resources calculation) which in summary is as follows: <ul style="list-style-type: none"> (1) (in the case of an <i>insurer</i>) <i>GENPRU 2 Annex 1R;</i> (2) (in the case of a <i>bank</i>) <i>GENPRU 2 Annex 2R;</i> (3) (in the case of a <i>building society</i>) <i>GENPRU 2 Annex 3R;</i> and (4) (in relation to a <i>BIPRU investment firm</i>) whichever of the tables in <i>GENPRU 2 Annex 4R, GENPRU 2 Annex 5R or GENPRU 2 Annex 6R</i> applies to the <i>firm</i> under <i>GENPRU 2.2.19R.</i>
<i>cash assimilated instrument</i>	(in accordance with Article 4(35) of the <i>Banking Consolidation Directive</i> (Definitions)) a certificate of deposit or other similar instrument issued by a <i>lending firm.</i>
<i>CCR</i>	<i>counterparty credit risk</i>
<i>CCR internal model method</i>	one of the following: <ul style="list-style-type: none"> (a) the method of calculating the amount of an <i>exposure</i> set out in <i>BIPRU 13.6</i> (CCR internal model method); (b) (where the approach in (a) is being applied on a consolidated basis) the method in (a) as applied on a consolidated basis in accordance with <i>BIPRU 8</i> (Group risk - consolidation); or (c) when the reference is to the rules of or administered by a <i>regulatory body</i> other than the <i>FSA</i>, whatever corresponds to the approach in (a) or (b), as the case may be, under those rules.
<i>CCR internal model method permission</i>	an <i>Article 129 implementing measure, Article 129 permission, a requirement</i> or a <i>waiver</i> that requires a <i>BIPRU firm</i> or an <i>institution</i> to use the <i>CCR internal model method.</i>
<i>CCR mark to market method</i>	the method of calculating the amount of an <i>exposure</i> set out in <i>BIPRU 13.4</i> (CCR mark to market method).
<i>CCR standardised method</i>	the method of calculating the amount of an <i>exposure</i> set out in <i>BIPRU 13.5</i> (CCR standardised method).

<i>central bank</i>	(in accordance with Article 4(23) of the <i>Banking Consolidation Directive</i> (Definitions) and for the purposes of <i>GENPRU</i> and <i>BIPRU</i>) includes the European Central Bank unless otherwise indicated.
<i>central counterparty</i>	(in accordance with Part 1 of Annex III of the <i>Banking Consolidation Directive</i> (Definitions) and for the purpose of <i>BIPRU</i> 13 (The calculation of counterparty risk exposure values for financial derivatives, securities financing transactions and long settlement transactions)) an entity that legally interposes itself between counterparties to contracts traded within one or more financial markets, becoming the buyer to every seller and the seller to every buyer.
<i>CFD</i>	<i>contract for differences</i> .
<i>CIU</i>	collective investment undertaking.
<i>CIU look through method</i>	one of the <i>standard CIU look through method</i> or the <i>modified CIU look through method</i> .
<i>CIU PRR</i>	the <i>collective investment undertaking PRR</i> .
<i>clean hypothetical profit and loss figure</i>	(in <i>BIPRU</i> 7.10 (Use of a value at risk model) and in relation to a <i>business day</i>) the <i>clean profit and loss figure</i> that would have occurred for that <i>business day</i> if the portfolio on which the <i>VaR number</i> for that <i>business day</i> is based remained unchanged, as more fully defined in <i>BIPRU</i> 7.10.111R (Backtesting: Hypothetical profit and loss).
<i>clean profit and loss figure</i>	(in <i>BIPRU</i> 7.10 (Use of a value at risk model) and in relation to a <i>business day</i>) a <i>firm's</i> actual profit or loss for that day in respect of the trading activities within the scope of the <i>firm's VaR model permission</i> , adjusted by stripping out specified items, as more fully defined in <i>BIPRU</i> 7.10.100R (Backtesting: Calculating the clean profit and loss).
<i>clean-up call option</i>	(for the purposes of <i>BIPRU</i> 9 (Securitisation), in relation to a <i>securitisation</i> (within the meaning of paragraph (2) of the definition of securitisation) and in accordance with Part 1 of Annex IX of the <i>Banking Consolidation Directive</i> (Securitisation definitions)) a contractual option for the <i>originator</i> to repurchase or extinguish the <i>securitisation positions</i> before all of the underlying <i>exposures</i> have been repaid, when the amount of outstanding <i>exposures</i> falls below a specified level.
<i>closely related</i>	(in <i>GENPRU</i> and <i>BIPRU</i>) describes a relationship between two or more <i>persons</i> under which one or more of the following applies: <ul style="list-style-type: none"> (a) the insolvency or default of one of them is likely to be associated with the insolvency or default of the others;

- (b) it would be prudent when assessing the financial condition or creditworthiness of one to consider that of the others; or
- (c) there is, or there is likely to be, a close relationship between the financial performance of those *persons*.

<i>CNCOM</i>	the <i>concentration risk capital component</i> .
<i>collective investment undertaking PRR</i>	the part of the <i>market risk capital requirement</i> calculated in accordance with <i>BIPRU 7.7.5R</i> (Calculation of the collective investment undertaking PRR).
<i>commodity extended maturity ladder approach</i>	the method of calculating the <i>commodity PRR</i> in <i>BIPRU 7.4.32R</i> (Extended maturity ladder approach).
<i>commodity maturity ladder approach</i>	the method of calculating the <i>commodity PRR</i> in <i>BIPRU 7.4.25R</i> (Maturity ladder approach).
<i>commodity PRR</i>	the part of the <i>market risk capital requirement</i> calculated in accordance with <i>BIPRU 7.4</i> (Commodity PRR) or, in relation to a particular <i>position</i> , the portion of the overall <i>commodity PRR</i> attributable to that <i>position</i> .
<i>commodity simplified approach</i>	the method of calculating the <i>commodity PRR</i> in <i>BIPRU 7.4.24R</i> (Simplified approach).
<i>concentration risk group counterparty</i>	(in accordance with Article 113(2) of the <i>Banking Consolidation Directive</i> (Limits on <i>large exposures</i>) and in relation to a <i>person</i>) a <i>parent undertaking</i> of the <i>person</i> , a <i>subsidiary undertaking</i> of the <i>person</i> or a <i>subsidiary undertaking</i> of the <i>person's parent undertaking</i> , provided that (in each case) both the counterparty and the <i>person</i> satisfy the condition in <i>BIPRU 3.2.27R</i> (Requirement to be subject to the same consolidation for the purposes of applying a zero <i>risk weight</i> to intra-group <i>exposures</i>).
<i>concentration risk capital component</i>	the part of the <i>credit risk capital requirement</i> calculated in accordance with <i>BIPRU 10.5.20R</i> (How to calculate the concentration risk capital component).
<i>connected counterparty</i>	(for the purpose of <i>BIPRU 10</i> (Concentration risk requirements) and in relation to a <i>firm</i>) has the meaning set out in <i>BIPRU 10.3.8R</i> (Connected counterparties), which is in summary a <i>person</i> to whom the <i>firm</i> has an <i>exposure</i> and who fulfils at least one of the conditions set out in <i>BIPRU 10.3.8R</i> .
<i>connected lending of a capital nature</i>	(in accordance with <i>GENPRU 2.2.222R</i> (Deductions from tiers one and two: Connected lending of a capital nature)) all lending within <i>GENPRU 2.2.227R</i> or <i>GENPRU 2.2.229R</i> and guarantees within <i>GENPRU 2.2.231R</i> or <i>GENPRU 2.2.233R</i> .

<i>consolidated capital resources</i>	(in relation to a <i>UK consolidation group</i> or a <i>non-EEA sub-group</i> and in <i>GENPRU</i> and <i>BIPRU</i>) that group's capital resources calculated in accordance with <i>BIPRU</i> 8.6 (Consolidated capital resources).
<i>consolidated capital resources requirement</i>	(in relation to a <i>UK consolidation group</i> or a <i>non-EEA sub-group</i> and in <i>GENPRU</i> and <i>BIPRU</i>) an amount of <i>consolidated capital resources</i> that that group must hold in accordance with <i>BIPRU</i> 8.7 (Consolidated capital resources requirement).
<i>consolidated credit risk requirement</i>	(in relation to a <i>UK consolidation group</i> or a <i>non-EEA sub-group</i> and in <i>GENPRU</i> and <i>BIPRU</i>) has the meaning in <i>BIPRU</i> 8.7 (Consolidated capital resources requirements) which is in summary the part of that group's <i>consolidated capital resources requirement</i> relating to credit risk calculated in accordance with <i>BIPRU</i> 8.7.11R (Calculation of the consolidated requirement components) and as adjusted under <i>BIPRU</i> 8.7.
<i>consolidated fixed overheads requirement</i>	(in relation to a <i>UK consolidation group</i> or a <i>non-EEA sub-group</i> and in <i>GENPRU</i> and <i>BIPRU</i>) has the meaning in <i>BIPRU</i> 8.7 (Consolidated capital resources requirements) which is in summary the part of that group's <i>consolidated capital resources requirement</i> relating to the fixed overheads requirement (as referred to Article 21 of the <i>Capital Adequacy Directive</i> and the definition of <i>fixed overheads requirement</i>) calculated in accordance with <i>BIPRU</i> 8.7.11R (Calculation of the consolidated requirement components) and as adjusted under <i>BIPRU</i> 8.7.
<i>consolidated indirectly issued capital</i>	has the meaning in <i>BIPRU</i> 8.6.12R (Indirectly issued capital and group capital resources), which is in summary any <i>capital instrument</i> issued by a member of a <i>UK consolidation group</i> or <i>non-EEA sub-group</i> where the conditions in <i>BIPRU</i> 8.6.12R are met.
<i>consolidated market risk requirement</i>	(in relation to a <i>UK consolidation group</i> or a <i>non-EEA sub-group</i> and in <i>GENPRU</i> and <i>BIPRU</i>) has the meaning in <i>BIPRU</i> 8.7 (Consolidated capital resources requirement) which is in summary the part of that group's <i>consolidated capital resources requirement</i> relating to <i>market risk</i> calculated in accordance with <i>BIPRU</i> 8.7.11R (Calculation of the consolidated requirement components) and as adjusted under <i>BIPRU</i> 8.7.
<i>consolidated operational risk requirement</i>	(in relation to a <i>UK consolidation group</i> or a <i>non-EEA sub-group</i> and in <i>GENPRU</i> and <i>BIPRU</i>) has the meaning in <i>BIPRU</i> 8.7 (Consolidated capital resources requirements) which is in summary the part of that group's <i>consolidated capital resources requirement</i> relating to <i>operational risk</i> calculated in accordance with <i>BIPRU</i> 8.7.11R (Calculation of the consolidated requirement components) and as adjusted under <i>BIPRU</i> 8.7.
<i>consolidated requirement component</i>	has the meaning in <i>BIPRU</i> 8.7.11R (Calculation of the consolidated requirement components), which in summary is one of the following:

	<ul style="list-style-type: none"> (a) the <i>consolidated credit risk requirement</i>; or (b) the <i>consolidated fixed overheads requirement</i>; or (c) the <i>consolidated market risk requirement</i>; or (d) the <i>consolidated operational risk requirement</i>.
<i>consolidation concentration risk group counterparty</i>	has the meaning in <i>BIPRU</i> 8.9.11R (UK integrated groups: Definition of consolidation concentration risk group counterparty).
<i>consolidation UK integrated group</i>	(with respect to a <i>UK consolidation group</i> or <i>non-EEA sub-group</i>) all <i>undertakings</i> falling into <i>BIPRU</i> 8.9.9R (UK integrated groups: Definition of consolidation UK integrated group) with respect to that <i>UK consolidation group</i> or <i>non-EEA sub-group</i> .
<i>consolidation wider integrated group</i>	(with respect to a <i>UK consolidation group</i> or <i>non-EEA sub-group</i>) all <i>undertakings</i> falling into <i>BIPRU</i> 8.9.19R (Wider integrated groups: Definition of wider integrated group) with respect to that <i>UK consolidation group</i> or <i>non-EEA sub-group</i> .
<i>contractual cross product netting agreement</i>	(for the purpose of <i>BIPRU</i> 13.7 (Contractual netting)) has the meaning set out in <i>BIPRU</i> 13.7.2R, which is in summary a written bilateral agreement between a <i>firm</i> and a counterparty which creates a single legal obligation covering all included bilateral master agreements and transactions belonging to different product categories.
<i>conversion factor</i>	(in accordance with Article 4(28) of the <i>Banking Consolidation Directive</i> (Definitions)) the ratio of the currently undrawn amount of a commitment that will be drawn and outstanding at default to the currently undrawn amount of the commitment; the extent of the commitment is determined by the advised limit, unless the unadvised limit is higher.
<i>convertible</i>	(for the purposes of <i>BIPRU</i>) a <i>security</i> which gives the investor the right to convert the <i>security</i> into a <i>share</i> at an agreed price or on an agreed basis.
<i>corporate</i>	(in relation to the <i>IRB approach</i> or the <i>standardised approach</i> to credit risk) a <i>person</i> an <i>exposure</i> to whom is a <i>corporate exposure</i> .
<i>corporate exposure</i>	<ul style="list-style-type: none"> (1) (in relation to the <i>IRB approach</i>) an <i>exposure</i> falling into <i>BIPRU</i> 4.3.2R(3) (IRB exposure classes). (2) (in relation to the <i>standardised approach</i> to credit risk) an <i>exposure</i> falling into <i>BIPRU</i> 3.2.9R(7) (Standardised approach to credit risk exposure classes).
<i>core market participant</i>	an entity of a type listed in <i>BIPRU</i> 5.4.64R (The financial collateral comprehensive method: Conditions for applying a 0% volatility adjustment).

<i>counterparty credit risk</i>	(in accordance with Part 1 of Annex III of the <i>Banking Consolidation Directive</i> (Definitions)) the risk that the counterparty to a transaction could default before the final settlement of the transaction's cash flows.
<i>counterparty exposure</i>	(for the purposes of <i>BIPRU</i> 10 (Concentration risk requirements)) has the meaning in <i>BIPRU</i> 10.4.19R and <i>BIPRU</i> 10.4.20R (Definition of counterparty exposures).
<i>counterparty risk capital component</i>	the part of the <i>credit risk capital requirement</i> calculated in accordance with <i>BIPRU</i> 14.2.1R (Calculation of the counterparty risk capital component).
<i>covered bond</i>	<p>(1) (in accordance with Article 22(4) of the <i>UCITS Directive</i> and except for the purposes of the <i>IRB approach</i> or the <i>standardised approach</i> to credit risk) a bond that is issued by a <i>credit institution</i> which has its registered office in an <i>EEA State</i> and is subject by law to special public supervision designed to protect bondholders and in particular protection under which sums deriving from the issue of the bond must be invested in conformity with the law in assets which, during the whole period of validity of the bond, are capable of covering claims attaching to the bond and which, in the event of failure of the issuer, would be used on a priority basis for the reimbursement of the principal and payment of the accrued interest.</p> <p>(2) (in accordance with point 68 of Part 1 of Annex VI of the <i>Banking Consolidation Directive</i> (Exposures in the form of covered bonds) and for the purposes of the <i>IRB approach</i> or the <i>standardised approach</i> to credit risk) a covered bond as defined in (1) collateralised in accordance with <i>BIPRU</i> 3.4.107R (Exposures in the form of covered bonds).</p>
<i>CRD financial instrument</i>	has the meaning set out in <i>BIPRU</i> 1.2.7R to <i>BIPRU</i> 1.2.8R (CRD financial instruments), which is in summary any contract that gives rise to both a financial asset of one party and a financial liability or equity instrument of another party.
<i>CRD implementation measure</i>	(in relation to an <i>person</i> , a provision of the <i>Banking Consolidation Directive</i> or the <i>Capital Adequacy Directive</i> and an <i>EEA State</i> other than the <i>United Kingdom</i>) a measure implementing that provision of that Directive for that type of <i>person</i> in that <i>EEA State</i> .
<i>credit default swap PRR method</i>	the <i>ordinary credit default swap PRR method</i> or the <i>securitisation credit default swap PRR method</i> .

<i>credit enhancement</i>	(in accordance with Article 4(43) of the <i>Banking Consolidation Directive</i> (Definitions)) a contractual arrangement whereby the credit quality of a <i>position</i> in a <i>securitisation</i> (within the meaning of paragraph (2) of the definition of <i>securitisation</i>) is improved in relation to what it would have been if the enhancement had not been provided, including the enhancement provided by more junior <i>tranches</i> in the <i>securitisation</i> and other types of credit protection.
<i>credit quality assessment scale</i>	<p>the credit quality assessment scale:</p> <ol style="list-style-type: none"> (1) onto which the credit assessments of an export credit agency are mapped under the table in <i>BIPRU</i> 3.4.9R (Exposure for which a credit assessment by an export credit agency is recognised); or (2) published by the <i>FSA</i> in accordance with the <i>Capital Requirements Regulations 2006</i> which determines: <ol style="list-style-type: none"> (a) (in relation to a <i>eligible ECAI</i> whose recognition is for <i>risk weighting</i> purposes other than those in (2)(b)) with which of the <i>credit quality steps</i> set out in <i>BIPRU</i> 3.4 (Risk weights under the standardised approach to credit risk) the relevant credit assessments of a <i>recognised ECAI</i> are to be associated; or (b) (in relation to a <i>eligible ECAI</i> whose recognition is for <i>securitisation risk-weighting</i> purposes) with which of the <i>credit quality steps</i> set out in <i>BIPRU</i> 9 (Securitisation) the relevant credit assessments of the <i>recognised ECAI</i> are to be associated.
<i>credit quality step</i>	a credit quality step in a <i>credit quality assessment scale</i> as set out in <i>BIPRU</i> 3.4 (Risk weights under the standardised approach to credit risk) and <i>BIPRU</i> 9 (Securitisation).
<i>credit risk capital component</i>	the part of the <i>credit risk capital requirement</i> calculated in accordance with <i>BIPRU</i> 3.1.5R (Calculation of the credit risk capital component).
<i>credit risk capital requirement</i>	the part of the <i>capital resources requirement</i> of a <i>BIPRU firm</i> in respect of credit risk, calculated in accordance with <i>GENPRU</i> 2.1.51R (Calculation of the credit risk capital requirement).
<i>credit risk mitigation</i>	(in accordance with Article 4(30) of the <i>Banking Consolidation Directive</i> (Definitions)) a technique used by an <i>undertaking</i> to reduce the credit risk associated with an <i>exposure</i> or <i>exposures</i> which the <i>undertaking</i> continues to hold.
<i>credit valuation adjustment</i>	(in accordance with Part 1 of Annex III of the <i>Banking Consolidation Directive</i> (Definitions)) an adjustment to the mid-market valuation of the portfolio of transactions with a counterparty; and so that this adjustment:

	(a)	reflects the market value of the credit risk due to any failure to perform on contractual agreements with a counterparty; and
	(b)	may reflect the market value of the credit risk of the counterparty or the market value of the credit risk of both the <i>firm</i> and the counterparty.
<i>CRM eligibility conditions</i>	(1)	(in relation to the <i>standardised approach</i> to credit risk), <i>BIPRU 5.3.1R-BIPRU 5.3.2R, BIPRU 5.4.1R-BIPRU 5.4.8R, BIPRU 5.5.1R, BIPRU 5.5.4R, BIPRU 5.5.8R, BIPRU 5.6.1R</i> and <i>BIPRU 5.7.1R-BIPRU 5.7.4R</i> ; or
	(2)	(in relation to the <i>IRB approach</i>), the provisions in (1) and <i>BIPRU 4.4.83R, BIPRU 4.10.R-BIPRU 4.10.7R, BIPRU 4.10.9R, BIPRU 4.10.10R-BIPRU 4.10.12R, BIPRU 4.10.14R, BIPRU 4.10.16R, BIPRU 4.10.19R, and BIPRU 4.10.38R-BIPRU 4.10.39R.</i>
<i>CRM minimum requirements</i>	(1)	in relation to the <i>standardised approach</i> to credit risk); <i>BIPRU 5.2.9R-BIPRU 5.2.10R, BIPRU 5.3.3R, BIPRU 5.4.9R-BIPRU 5.4.13R, BIPRU 5.5.2R, BIPRU 5.5.5R-BIPRU 5.5.6R, BIPRU 5.6.2R-BIPRU 5.6.3R, BIPRU 5.7.6R-BIPRU 5.7.14R</i> ; or
	(2)	(in relation to the <i>IRB approach</i>), the provisions in (1) and <i>BIPRU 4.4.85R, BIPRU 4.10.13R, BIPRU 4.10.15R, and BIPRU 4.10.18R-BIPRU 4.10.19R.</i>
<i>cross product netting</i>		(in accordance with Part 1 of Annex III of the <i>Banking Consolidation Directive</i> (Definitions) and for the purpose of <i>BIPRU 13</i> (The calculation of counterparty risk exposure values for financial derivatives, securities financing transactions and long settlement transactions)) the inclusion of transactions of different product categories within the same <i>netting set</i> pursuant to the <i>rules</i> about cross-product netting set out in <i>BIPRU 13</i> .
<i>current exposure</i>		(in accordance with Part 1 of Annex III of the <i>Banking Consolidation Directive</i> (Definitions) and for the purpose of <i>BIPRU 13</i> (The calculation of counterparty risk exposure values for financial derivatives, securities financing transactions and long settlement transactions)) the larger of zero, or the market value of a transaction or portfolio of transactions within a <i>netting set</i> with a counterparty that would be lost upon the default of the counterparty, assuming no recovery on the value of those transactions in bankruptcy.
<i>current market value</i>		(in accordance with Part 1 of Annex III of the <i>Banking Consolidation Directive</i> (Definitions) and for the purpose of <i>BIPRU 13.5</i> (CCR standardised method)) the net market value of the portfolio of transactions within the <i>netting set</i> with the counterparty; both positive and negative market values are used in computing <i>current market value</i> .

<i>deal on own account</i>	(for the purposes of <i>GENPRU</i> and <i>BIPRU</i>) has the meaning in <i>BIPRU</i> 1.1.23R (Meaning of dealing on own account) which is in summary the service referred to in paragraph 2 of Schedule A to the Annex to the <i>ISD</i> , subject to the adjustments in <i>BIPRU</i> 1.1.23R(2) and (3) (Implementation of Article 5(2) of the <i>Capital Adequacy Directive</i>).
<i>default</i>	(in relation to the <i>IRB approach</i>) has the meaning in <i>BIPRU</i> 4.3 (The IRB approach: Provisions common to different exposure classes).
<i>designated committee</i>	<p>(in relation to a <i>firm</i>) a management body of the <i>firm</i> with delegated authority from the <i>firm's governing body</i> for approving either:</p> <ul style="list-style-type: none"> (a) (in relation to a <i>firm</i> that uses the <i>IRB approach</i>) all material aspects of the <i>firm's rating systems</i> and material changes to the <i>firm's rating systems</i>; or (b) (in relation to a <i>firm</i> that uses the <i>advanced measurement approach</i>) all material aspects of the <i>advanced measurement approach</i> as carried out by the <i>firm</i> and material changes to the <i>firm's advanced measurement approach</i>; and (c) a policy statement defining the <i>firm's</i> overall approach to material aspects of rating and estimation processes for all <i>rating systems</i> including non-material <i>rating systems</i> in relation to the <i>IRB approach</i>, or its overall approach to the <i>advanced measurement approach</i>, as relevant; <p>at least one of whose members is a member of the <i>firm's governing body</i>.</p>
<i>designated clearing house</i>	<p>one of the following <i>clearing houses</i>:</p> <ul style="list-style-type: none"> (a) ASX Settlement and Transfer Corporation Pty Ltd (ASTC); (b) Austrian Kontroll Bank (OKB); (c) Board of Trade Clearing Corporation; (d) Cassa di Compensazione e Garanzia S.p.A (CCG); (e) Commodity Clearing Corporation; (f) Emerging Markets Clearing Corporation; (g) FUTOP Clearing Centre (FUTOP Clearing Centralen A/S); (h) Hong Kong Futures Exchange Clearing Corporation Ltd; (i) Hong Kong Securities Clearing Company Ltd; (j) Kansas City Board of Trade Clearing Corporation;

- (k) Norwegian Futures & Options Clearing House (Norsk Opsjonsentral A.S. (NOS));
- (l) N.V. Nederlandse Liquidatiekas (NLKKAS);
- (m) OM Stockholm Exchange;
- (n) Options Clearing Corporation;
- (o) Options Clearing House Pty Ltd (OCH);
- (p) Sydney Futures Exchange Clearing House (SFECH Ltd); and
- (q) TNS Clearing Pty Ltd (TNSC).

dilution risk (in accordance with Article 4(24) of the *Banking Consolidation Directive* (Definitions)) the risk that an amount receivable is reduced through cash or non-cash credits to the obligor.

distribution of exposures (in accordance with Part 1 of Annex III of the *Banking Consolidation Directive* (Definitions) and for the purpose of *BIPRU* 13 (The calculation of counterparty risk exposure values for financial derivatives, securities financing transactions and long settlement transactions)) the forecast of the probability distribution of market values that is generated by setting forecast instances of negative net market values equal to zero.

distribution of market values (in accordance with Part 1 of Annex III of the *Banking Consolidation Directive* (Definitions) and for the purpose of *BIPRU* 13 (The calculation of counterparty risk exposure values for financial derivatives, securities financing transactions and long settlement transactions)) the forecast of the probability distribution of net market values of transactions within a *netting set* for some future date (the forecasting horizon), given the realised market value of those transactions up to the present time.

diverse block (for the purposes of *BIPRU* 8 (Group risk – consolidation) and *BIPRU* 10 (Concentration risk requirements)):

- (a) (in relation to a *firm* with a *wider integrated group permission* that applies on a solo basis) has the meaning in *BIPRU* 10.9.6R (Definition of diverse block) which is in summary all *undertakings* in the *wider integrated group* designated as a single *diverse block* by the applicable *wider integrated group permission*;

- (b) (in relation to a *firm* with a *wider integrated group permission* that applies on a consolidated basis) has the meaning in *BIPRU* 8.9.22R (Wider integrated groups: Definition of diverse block) which is in summary a group of *exposures* that satisfy specified eligibility conditions and that are to *undertakings* that are designated by the *wider integrated group permission* as being associated with the same *diverse block*.

<i>early amortisation provision</i>	(in accordance with Article 100 of the <i>Banking Consolidation Directive</i> (Securitisation of revolving exposures) and in relation to a <i>securitisation</i> within the meaning of paragraph (2) of the definition of securitisation) a contractual clause which requires, on the occurrence of defined events, investors' positions to be redeemed prior to the originally stated maturity of the securities issued.
<i>ECAI</i>	an external credit assessment institution.
<i>EE</i>	<i>expected exposure</i> .
<i>EEA parent financial holding company</i>	(in accordance with Article 4(17) of the <i>Banking Consolidation Directive</i> (Definitions) and Article 3 of the <i>Capital Adequacy Directive</i> (Definitions)) a <i>parent financial holding company in a Member State</i> which is not a <i>subsidiary undertaking</i> of an <i>institution</i> authorised in any <i>EEA State</i> or of another <i>financial holding company</i> set up in any <i>EEA State</i> .
<i>EEA parent institution</i>	(in accordance with Article 4(16) of the <i>Banking Consolidation Directive</i> and Article 2 of the <i>Capital Adequacy Directive</i> (Definitions)) a <i>parent institution in a Member State</i> which is not a <i>subsidiary undertaking</i> of another <i>institution</i> authorised in any <i>EEA State</i> , or of a <i>financial holding company</i> set up in any <i>EEA State</i> .
<i>effective EE</i>	<i>effective expected exposure</i> .
<i>effective EPE</i>	<i>effective expected positive exposure</i> .
<i>effective expected exposure</i>	(in accordance with Part 1 of Annex III of the <i>Banking Consolidation Directive</i> (Definitions) and for the purpose of <i>BIPRU</i> 13 (The calculation of counterparty risk exposure values for financial derivatives, securities financing transactions and long settlement transactions) and as at a specific date) the maximum <i>expected exposure</i> that occurs at that date or any prior date; alternatively, it may be defined for a specific date as the greater of the <i>expected exposure</i> at that date, or the <i>effective exposure</i> at the previous date.

<i>effective expected positive exposure</i>	(in accordance with Part 1 of Annex III of the <i>Banking Consolidation Directive</i> (Definitions)) the weighted average over time of <i>effective expected exposure</i> over the first year, or, if all the contracts within the <i>netting set</i> mature before one year, over the time period of the longest maturity contract in the <i>netting set</i> , where the weights are the proportion that an individual <i>expected exposure</i> represents of the entire time interval.
<i>effective maturity</i>	(in accordance with Part 1 of Annex III of the <i>Banking Consolidation Directive</i> (Definitions), for the purpose of the <i>CCR internal model method</i> and with respect to a <i>netting set</i> with maturity greater than one year) the ratio of the sum of <i>expected exposure</i> over the life of the transactions in the <i>netting set</i> discounted at the risk-free rate of return divided by the sum of <i>expected exposure</i> over one year in a <i>netting set</i> discounted at the risk-free rate; this effective maturity may be adjusted to reflect <i>rollover risk</i> by replacing <i>expected exposure</i> with <i>effective expected exposure</i> for forecasting horizons under one year.
<i>EL</i>	<i>expected loss</i> .
<i>eligible ECAI</i>	an <i>ECAI</i> : <ul style="list-style-type: none"> (a) (for <i>exposure risk weighting</i> purposes other than those in (b)) recognised by the <i>FSA</i> under regulation 22 of the <i>Capital Requirements Regulations 2006</i> (Recognition for exposure risk-weighting purposes); or (b) (for <i>securitisation risk weighting</i> purposes) recognised by the <i>FSA</i> under regulation 23 of the <i>Capital Requirements Regulations 2006</i> (Recognition for securitisation risk-weighting purposes).
<i>eligible partnership capital</i>	(in relation to a <i>BIPRU firm</i>) has the meaning in <i>GENPRU 2.2.93R</i> .
<i>EPE</i>	<i>expected positive exposure</i> .
<i>equity</i>	(for the purposes of <i>BIPRU 7</i>) a <i>share</i> .
<i>equity exposure</i>	(in relation to the <i>IRB approach</i>) an <i>exposure</i> falling into the <i>IRB exposure class</i> referred to in <i>BIPRU 4.3.2R(5)</i> (equity exposures).
<i>equity PRR</i>	the part of the <i>market risk capital requirement</i> calculated in accordance with <i>BIPRU 7.3</i> (Equity PRR and basic interest rate PRR for equity derivatives) but so that: <ul style="list-style-type: none"> (a) the <i>equity PRR</i> excludes the part of the <i>market risk capital requirement</i> calculated under <i>BIPRU 7.3.45R</i> (Basic interest rate PRR for equity derivatives); and (b) in relation to a particular <i>position</i>, it means the portion of the overall <i>equity PRR</i> attributable to that <i>position</i>.

<i>excess spread</i>	(for the purposes of <i>BIPRU</i> 9 (Securitisation), in relation to a <i>securitisation</i> (within the meaning of paragraph (2) of the definition of securitisation) and in accordance with Part 1 of Annex IX of the <i>Banking Consolidation Directive</i> (Securitisation definitions)) finance charge collections and other fee income received in respect of the <i>securitised exposures</i> net of costs and expenses.
<i>excess trading book position</i>	has the meaning in <i>GENPRU</i> 2.2.264R (Deductions from total capital: Excess trading book position).
<i>exempt BIPRU commodities firm</i>	a <i>BIPRU firm</i> to which the exemption in <i>BIPRU</i> TP 15.6R (Exemption for a <i>BIPRU firm</i> whose main business relates to <i>commodities</i>) applies.
<i>expected exposure</i>	(in accordance with Part 1 of Annex III of the <i>Banking Consolidation Directive</i> (Definitions) and for the purpose of <i>BIPRU</i> 13 (The calculation of counterparty risk exposure values for financial derivatives, securities financing transactions and long settlement transactions)) the average of the distribution of <i>exposures</i> at any particular future date before the longest maturity transaction in the <i>netting set</i> matures.
<i>expected loss</i>	(in accordance with Article 4(29) of the <i>Banking Consolidation Directive</i> (Definitions) and for the purposes of the <i>IRB approach</i> and the <i>standardised approach</i> to credit risk) the ratio of the amount expected to be lost on an <i>exposure</i> from a potential <i>default</i> of a counterparty or dilution over a one year period to the amount outstanding at <i>default</i> .
<i>expected positive exposure</i>	(in accordance with Part 1 of Annex III of the <i>Banking Consolidation Directive</i> (Definitions) and for the purpose of <i>BIPRU</i> 13 (The calculation of counterparty risk exposure values for financial derivatives, securities financing transactions and long settlement transactions)) the weighted average over time of <i>expected exposures</i> where the weights are the proportion that an individual <i>expected exposure</i> represents of the entire time interval; when calculating the minimum capital requirement, the average is taken over the first year or, if all the contracts within the <i>netting set</i> mature before one year, over the time period of the longest-maturity contract in the <i>netting set</i> .
<i>facility grade</i>	(in relation to the <i>advanced IRB approach</i> and the <i>sovereign, institutional and corporate IRB exposure class</i> and in accordance with <i>BIPRU</i> 4.4.49R) a risk category within a <i>rating system's</i> facility scale to which <i>exposures</i> are assigned on the basis of a specified and distinct set of rating criteria from which own estimates of <i>LGDs</i> are derived.
<i>financial collateral comprehensive method</i>	the method for calculating the effects of <i>credit risk mitigation</i> described in those parts of <i>BIPRU</i> 5.4 (Financial collateral) that are expressed to apply to that method.

<i>financial collateral simple method</i>	the method for calculating the effects of <i>credit risk mitigation</i> described in those parts of <i>BIPRU 5.4</i> (Financial collateral) that are expressed to apply to that method.
<i>financial derivative instrument</i>	has the meaning in <i>BIPRU 13.3.3R</i> (Definition of a financial derivative instrument); the definition is adjusted for the purposes of the definition of <i>counterparty risk capital component</i> in accordance with <i>BIPRU 14.2.3R</i> (Credit derivatives).
<i>fixed overheads requirement</i>	the part of the <i>capital resources requirement</i> calculated in accordance with <i>GENPRU 2.1.53R</i> (Calculation of the fixed overheads requirement).
<i>foreign currency PRR</i>	the part of the <i>market risk capital requirement</i> calculated in accordance with <i>BIPRU 7.5</i> (Foreign currency PRR) or, in relation to a particular <i>position</i> , the portion of the overall <i>foreign currency PRR</i> attributable to that <i>position</i> .
<i>forward</i>	a contract to buy or sell where the date for settlement has been agreed as a particular date in the future but excluding a <i>future</i> .
<i>forward rate agreement</i>	an agreement under which one party agrees to pay another an amount of interest based on an agreed interest rate for a specified period from a specified settlement date applied to an agreed principal amount but under which no commitment is made by either party to lend or borrow the principal amount.
<i>foundation IRB approach</i>	one of the following: <ul style="list-style-type: none"> (a) (in relation to the <i>sovereign, institutional and corporate IRB exposure class</i>) the approach under the <i>IRB approach</i>, described in <i>BIPRU 4.4</i> (The IRB approach: Exposures to corporates, institutions and sovereigns) under which a <i>firm</i> uses the values for <i>LGD</i> and <i>conversion factors</i> set out in <i>BIPRU 4.4</i> rather than supplying its own estimates; (b) (where the approach in (a) is being applied on a consolidated basis) the method in (a) as applied on a consolidated basis in accordance with <i>BIPRU 8</i> (Group risk - consolidation); or (c) when the reference is to the rules of or administered by a <i>regulatory body</i> other than the <i>FSA</i>, whatever corresponds to the approach in (a) or (b), as the case may be, under those rules.
<i>FRA</i>	<i>forward rate agreement</i> .
<i>free delivery</i>	a transaction of the type set out in <i>BIPRU 14.4.2R</i> (Requirement to hold capital resources with respect to free deliveries) which, in summary, is a transaction under which a <i>person</i> :

	<ul style="list-style-type: none"> (a) has paid for <i>securities, foreign currencies</i> or <i>commodities</i> before receiving them or it has delivered <i>securities, foreign currencies</i> or <i>commodities</i> before receiving payment for them; and (b) in the case of cross-border transactions, one day or more has elapsed since it made that payment or delivery.
<i>full scope BIPRU investment firm</i>	<p>has the meaning in <i>BIPRU</i> 1.1.17R (Types of BIPRU investment firm) which is in summary a <i>CAD full scope firm</i> that satisfies the following conditions:</p> <ul style="list-style-type: none"> (a) it is a <i>firm</i>; and (b) its head office is in the <i>United Kingdom</i> and it is not otherwise excluded from the definition of <i>BIPRU firm</i> under <i>BIPRU</i> 1.1.7R (Exclusion of certain types of <i>firm</i> from the definition of <i>BIPRU firm</i>).
<i>funded credit protection</i>	<p>(in accordance with Article 4(31) of the <i>Banking Consolidation Directive</i> (Definitions)) a technique of <i>credit risk mitigation</i> where the reduction of the credit risk on the <i>exposure</i> of an <i>undertaking</i> derives from the right of the <i>undertaking</i>, in the event of the default of the counterparty or on the occurrence of other specified credit events relating to the counterparty, to liquidate, or to obtain transfer or appropriation of, or to retain certain assets or amounts, or to reduce the amount of the <i>exposure</i> to, or to replace it with, the amount of the difference between the amount of the <i>exposure</i> and the amount of a claim on the <i>undertaking</i>.</p>
<i>general market risk</i>	<p>(in accordance with paragraph 12 of Annex I of the <i>Capital Adequacy Directive</i>) the risk of a price change in an <i>investment</i>:</p> <ul style="list-style-type: none"> (a) (in relation to items that may or must be treated under <i>BIPRU</i> 7.2 (Interest Rate PRR)) owing to a change in the level of interest rates; or (b) (in relation to items that may or must be treated under <i>BIPRU</i> 7.3 (Equity PRR and basic interest rate PRR for equity derivatives) except insofar as <i>BIPRU</i> 7.3 relates to the calculation of the <i>interest rate PRR</i>) owing to a broad equity-market movement unrelated to any specific attributes of individual <i>securities</i>.
<i>general market risk PRA</i>	<p>a <i>PRA</i> with respect to <i>general market risk</i>.</p>
<i>general stress and scenario testing rule</i>	<p><i>GENPRU</i> 1.2.42R (Stress and scenario tests).</p>

<i>general wrong-way risk</i>	(in accordance with Part 1 of Annex III of the <i>Banking Consolidation Directive</i> (Definitions) and for the purpose of <i>BIPRU 13</i> (The calculation of counterparty risk exposure values for financial derivatives, securities financing transactions and long settlement transactions)) the risk that arises when the probability of default of counterparties is positively correlated with general market risk factors.
<i>GENPRU</i>	the General Prudential sourcebook.
<i>group of connected clients</i>	(in accordance with Article 4(45) of the <i>Banking Consolidation Directive</i> (Definitions)) one of the following: <ul style="list-style-type: none"> (a) two or more <i>persons</i> who, unless it is shown otherwise, constitute a single risk because one of them is the <i>parent undertaking</i>, direct or indirect, of the other or others; or (b) two or more <i>persons</i> between whom there is no relationship as set out in (a) but who are to be regarded as constituting a single risk because they are so interconnected that, if one of them were to experience financial problems, the other or all of the others would be likely to encounter repayment difficulties.
<i>hedging set</i>	(in accordance with Part 1 of Annex III of the <i>Banking Consolidation Directive</i> (Definitions) and for the purpose of <i>BIPRU 13</i> (The calculation of counterparty risk exposure values for financial derivatives, securities financing transactions and long settlement transactions)) a group of <i>risk positions</i> from the transactions within a single <i>netting set</i> for which only their balance is relevant for determining the <i>exposure</i> value under the <i>CCR standardised method</i> .
<i>higher stage of capital</i>	(with respect to a particular item of capital in the <i>capital resources table</i>) a stage in the <i>capital resources table</i> above that in which that item of capital appears.
<i>ICAAP</i>	the <i>internal capital adequacy assessment process</i> .
<i>ICAAP rules</i>	the <i>rules</i> in <i>GENPRU 1.2.30R</i> to <i>GENPRU 1.2.39R</i> (Systems, strategies, processes and reviews), <i>GENPRU 1.2.42R</i> (Main Requirements: Stress and scenario tests) and <i>GENPRU 1.2.60R</i> to <i>GENPRU 1.2.61R</i> (Documentation of risk assessments) as they apply on a solo level and on a consolidated level.
<i>ICG</i>	<i>individual capital guidance</i> .
<i>illiquid asset</i>	has the meaning in <i>GENPRU 2.2.260R</i> (Deductions from total capital: Illiquid assets).

<i>incremental default risk charge</i>	(in <i>BIPRU</i> 7.10 (Use of a value at risk model)) has the meaning in <i>BIPRU</i> 7.10.116R (Capital calculations for <i>VaR models</i>), which is in summary, in relation to a <i>business day</i> , the incremental default risk charge required under the provisions in <i>BIPRU</i> 7.10 about <i>specific risk</i> , in respect of the previous <i>business day</i> 's close-of-business <i>positions</i> with respect to which those provisions apply.
<i>individual counterparty CNCOM</i>	has the meaning in <i>BIPRU</i> 10.5.20R (How to calculate the concentration risk capital component), which is in summary the sum of a <i>firm's individual CNCOMs</i> with respect to a <i>counterparty</i> or <i>group of connected clients</i> or to its <i>connected counterparties</i> .
<i>individual CNCOM</i>	the amount calculated with respect to an individual <i>exposure</i> under <i>BIPRU</i> 10.5.20R (How to calculate the concentration risk capital component).
<i>initial commitment</i>	(for the purposes of <i>BIPRU</i> and in relation to <i>underwriting</i>) the date specified in <i>BIPRU</i> 7.8.13R (Time of initial commitment).
<i>institution</i>	(in accordance with Article 3(1)(c) of the <i>Capital Adequacy Directive</i> and Article 4(6) of the <i>Banking Consolidation Directive</i> (Definitions) and for the purposes of <i>GENPRU</i> and <i>BIPRU</i>) a <i>credit institution</i> or a <i>CAD investment firm</i> , whether or not it is incorporated in, or has its head office in, an <i>EEA State</i> .
<i>internal capital adequacy assessment process</i>	a <i>firm's</i> assessment of the adequacy of its capital and financial resources, as required by the <i>ICAAP rules</i> .
<i>international organisation</i>	(for the purposes of <i>GENPRU</i> and <i>BIPRU</i>) an organisation referred to in <i>BIPRU</i> 3.4.30R (Exposures to international organisations).
<i>interest rate duration method</i>	the method of calculating the part of the <i>interest rate PRR</i> that relates to <i>general market risk</i> set out in <i>BIPRU</i> 7.2.63R (General market risk calculation: Duration method).
<i>interest rate maturity method</i>	the method of calculating the part of the <i>interest rate PRR</i> that relates to <i>general market risk</i> set out in <i>BIPRU</i> 7.2.59R (General market risk calculation: The maturity method).
<i>interest rate PRR</i>	the part of the <i>market risk capital requirement</i> calculated in accordance with <i>BIPRU</i> 7.2 (Interest rate PRR) or <i>BIPRU</i> 7.3.45R (Basic interest rate PRR for equity derivatives) or, in relation to a particular <i>position</i> , the portion of the overall <i>interest rate PRR</i> attributable to that <i>position</i> .
<i>interest rate simplified maturity method</i>	the method of calculating the part of the <i>interest rate PRR</i> that relates to <i>general market risk</i> set out in <i>BIPRU</i> 7.2.56R (General market risk calculation: Simplified maturity method).
<i>in the money percentage</i>	(for the purposes of <i>BIPRU</i> 7 (Market risk) and in relation to an <i>option</i> or <i>warrant</i>) the percentage calculated under <i>BIPRU</i> 7.6.6R (The in the money percentage).

<i>investment firm consolidation waiver</i>	a <i>waiver</i> (described in <i>BIPRU</i> 8.4 (CAD Article 22 groups and investment firm consolidation waiver)) that disapplies certain requirements so far as they apply on a consolidated basis with respect to a <i>CAD Article 22 group</i> .
<i>IRB approach</i>	one of the following: <ul style="list-style-type: none"> (a) the adjusted method of calculating the <i>credit risk capital component</i> set out in <i>BIPRU</i> 4 (IRB approach) and <i>BIPRU</i> 9.12 (Calculation of risk weighted exposure amounts under the internal ratings based approach), including that approach as applied under <i>BIPRU</i> 14 (Capital requirements for settlement and counterparty risk); (b) (where the approach in (a) is being applied on a consolidated basis) the method in (a) as applied on a consolidated basis in accordance with <i>BIPRU</i> 8 (Group risk - consolidation); or (c) when the reference is to the rules of or administered by a <i>regulatory body</i> other than the <i>FSA</i>, whatever corresponds to the approach in (a) or (b), as the case may be, under those rules.
<i>IRB exposure class</i>	(in relation to the <i>IRB approach</i>) one of the classes of <i>exposure</i> set out in <i>BIPRU</i> 4.3.2R (exposure classes).
<i>IRB permission</i>	an <i>Article 129 implementing measure</i> , a <i>requirement</i> or a <i>waiver</i> that requires a <i>BIPRU firm</i> or an <i>institution</i> to use the <i>IRB approach</i> .
<i>issuer exposure</i>	(for the purposes of <i>BIPRU</i> 10 (Concentration risk requirements)) has the meaning in <i>BIPRU</i> 10.4.5R (Definition of issuer exposures).
K_{IRB}	(for the purposes of <i>BIPRU</i> 9 (Securitisation), in relation to a <i>securitisation</i> (within the meaning of paragraph (2) of the definition of securitisation) and in accordance with Part 1 of Annex IX of the <i>Banking Consolidation Directive</i> (Securitisation definitions)) 8% of the <i>risk weighted exposure amounts</i> that would be calculated under the <i>IRB approach</i> in respect of the <i>securitised exposures</i> , had they not been <i>securitised</i> , plus the amount of <i>expected losses</i> associated with those <i>exposures</i> calculated under the <i>IRB approach</i> .
<i>large exposure</i>	has the meaning set out in <i>BIPRU</i> 10.5.1R, which in summary is the <i>total exposure</i> of a <i>firm</i> to a <i>counterparty</i> , <i>connected counterparties</i> or a <i>group of connected clients</i> , whether in the <i>firm's non-trading book</i> or <i>trading book</i> or both, which in aggregate equals or exceeds 10% of the <i>firm's capital resources</i> .
<i>lending firm</i>	(in accordance with Article 90 of the <i>Banking Consolidation Directive</i> (Credit risk mitigation) and for the purposes of <i>rules</i> about <i>credit risk mitigation</i>) a <i>firm</i> that has an <i>exposure</i> , whether or not deriving from a loan.
<i>LGD</i>	<i>loss given default</i> .

<i>limited activity firm</i>	has the meaning set out <i>BIPRU 1.1.11R</i> (Types of investment firm: Limited activity firms).
<i>limited licence firm</i>	has the meaning set out <i>BIPRU 1.1.12R</i> (Types of investment firm: Limited licence firms).
<i>liquidity facility</i>	(for the purposes of <i>BIPRU 9</i> (Securitisation), in relation to a <i>securitisation</i> (within the meaning of paragraph (2) of the definition of securitisation) and in accordance with Part 1 of Annex IX of the <i>Banking Consolidation Directive</i> (Securitisation definitions)) the <i>securitisation position</i> arising from a contractual agreement to provide funding to ensure timeliness of cash-flows to investors.
<i>long settlement transaction</i>	(in accordance with Part 1 of Annex III of the <i>Banking Consolidation Directive</i> (Definitions)) a transaction where a counterparty undertakes to deliver a security, a <i>commodity</i> , or a <i>foreign currency</i> amount against cash, other <i>CRD financial instruments</i> , or <i>commodities</i> , or vice versa, at a settlement or delivery date that is contractually specified as more than the lower of the market standard for this particular transaction and five <i>business days</i> after the date on which the <i>person</i> enters into the transaction.
<i>loss</i>	(in accordance with Article 4(26) of the <i>Banking Consolidation Directive</i> (Definitions) and for the purposes of the <i>IRB approach</i> , the <i>standardised approach</i> to credit risk and <i>BIPRU 5</i> (Credit risk mitigation)) economic loss, including material discount effects, and material direct and indirect costs associated with collecting on the instrument.
<i>loss given default</i>	(in accordance with Article 4(27) of the <i>Banking Consolidation Directive</i> (Definitions) and in relation to the <i>IRB approach</i>) the ratio of the <i>loss</i> on an <i>exposure</i> due to the <i>default</i> of a counterparty to the amount outstanding at <i>default</i> .
<i>lower stage of capital</i>	(with respect to a particular item of capital in the <i>capital resources table</i>) a stage in the <i>capital resources table</i> below that in which that item of capital appears.
<i>lower tier three capital</i>	an item of capital that is specified in stage P of the <i>capital resources table</i> (Lower tier three).
<i>lower tier three capital resources</i>	the sum calculated at stage P of the <i>capital resources table</i> (Lower tier three).
<i>main BIPRU firm Pillar 1 rules</i>	<i>GENPRU 2.1.40R</i> (Variable capital requirement for <i>BIPRU firms</i>), <i>GENPRU 2.1.41R</i> (Base capital resources requirement for <i>BIPRU firms</i>), <i>GENPRU 2.1.48R</i> (Table: Base capital resources requirement for a <i>BIPRU firm</i>) and, where applicable, <i>GENPRU 2.1.60R</i> (Calculation of base capital resources requirement for banks authorised before 1993).

<i>margin agreement</i>	(in accordance with Part 1 of Annex III of the <i>Banking Consolidation Directive</i> (Definitions) and for the purpose of <i>BIPRU</i> 13 (The calculation of counterparty risk exposure values for financial derivatives, securities financing transactions and long settlement transactions)) a contractual agreement or provisions to an agreement under which one counterparty must supply collateral to a second counterparty when an <i>exposure</i> of that second counterparty to the first counterparty exceeds a specified level.
<i>margin lending transaction</i>	(in accordance with Part 1 of Annex III of the <i>Banking Consolidation Directive</i> (Definitions) and for the purpose of <i>BIPRU</i> 13 (The calculation of counterparty risk exposure values for financial derivatives, securities financing transactions and long settlement transactions)) transactions in which a <i>person</i> extends credit in connection with the purchase, sale, carrying or trading of securities; the definition does not include other loans that happen to be secured by securities collateral.
<i>margin period of risk</i>	(in accordance with Part 1 of Annex III of the <i>Banking Consolidation Directive</i> (Definitions) and for the purpose of <i>BIPRU</i> 13 (The calculation of counterparty risk exposure values for financial derivatives, securities financing transactions and long settlement transactions)) the time period from the last exchange of collateral covering a <i>netting set</i> of transactions with a defaulting counterpart until that counterpart is closed out and the resulting market risk is re-hedged.
<i>margin threshold</i>	(in accordance with Part 1 of Annex III of the <i>Banking Consolidation Directive</i> (Definitions) and for the purpose of <i>BIPRU</i> 13 (The calculation of counterparty risk exposure values for financial derivatives, securities financing transactions and long settlement transactions)) the largest amount of an <i>exposure</i> that remains outstanding until one party has the right to call for collateral.
<i>market risk capital requirement</i>	the part of the <i>capital resources requirement</i> of a <i>BIPRU</i> firm in respect of <i>market risk</i> , calculated in accordance with <i>GENPRU</i> 2.1.52R (Calculation of the market risk capital requirement).
<i>master netting agreement internal models approach</i>	one of the following: <ul style="list-style-type: none"> (a) the method of calculating the effect of <i>credit risk mitigation</i> described in <i>BIPRU</i> 5.6.16R to <i>BIPRU</i> 5.6.28G; (b) (where the approach in (a) is being applied on a consolidated basis) the method in (a) as applied on a consolidated basis in accordance with <i>BIPRU</i> 8 (Group risk - consolidation); or (c) when the reference is to the rules of or administered by a <i>regulatory body</i> other than the <i>FSA</i>, whatever corresponds to the approach in (a) or (b), as the case may be, under those rules.

<i>master netting agreement internal models approach permission</i>	a <i>requirement</i> or a <i>waiver</i> that requires a <i>firm</i> to use the <i>master netting agreement internal models approach</i> on a solo basis or, if the context requires, a consolidated basis.
<i>matched principal exemption conditions</i>	the conditions set out in <i>BIPRU 1.1.23R(2)</i> (Meaning of dealing on own account).
<i>material insurance holding</i>	has the meaning in <i>GENPRU 2.2.212R</i> (Material holdings).
<i>minimum IRB standards</i>	(in relation to the <i>IRB approach</i>) <i>BIPRU 4.3.9R, BIPRU 4.3.11R-BIPRU 4.3.29R, BIPRU 4.3.33R-BIPRU 4.3.40R, BIPRU 4.3.43R-BIPRU 4.3.44R, BIPRU 4.3.46R-BIPRU 4.3.48R, BIPRU 4.3.50R-BIPRU 4.3.51R, BIPRU 4.3.54R, BIPRU 4.3.56R-BIPRU 4.3.57R, BIPRU 4.3.63R, BIPRU 4.3.70R-BIPRU 4.3.71R, BIPRU 4.3.73R-BIPRU 4.3.74R, BIPRU 4.3.83R-BIPRU 4.3.85R, BIPRU 4.3.88R, BIPRU 4.3.90R-BIPRU 4.3.92R, BIPRU 4.3.94R, BIPRU 4.3.99R, BIPRU 4.3.103R, BIPRU 4.3.116R-BIPRU 4.3.123R, BIPRU 4.3.125R-BIPRU 4.3.131R, BIPRU 4.4.6R-BIPRU 4.4.9R, BIPRU 4.4.11R-BIPRU 4.4.13R, BIPRU 4.4.15R-BIPRU 4.4.18R, BIPRU 4.4.21R-BIPRU 4.4.22R, BIPRU 4.4.24R-BIPRU 4.4.25R, BIPRU 4.4.27R-BIPRU 4.4.28R, BIPRU 4.4.30R-BIPRU 4.4.31R, BIPRU 4.4.48R-BIPRU 4.4.51R, BIPRU 4.4.53R, BIPRU 4.4.54R, BIPRU 4.5.5R, BIPRU 4.6.6R-BIPRU 4.6.9R, BIPRU 4.6.11R-BIPRU 4.6.12R, BIPRU 4.6.14R, BIPRU 4.6.18R, BIPRU 4.6.20R-BIPRU 4.6.21R, BIPRU 4.6.24R-BIPRU 4.6.34R, BIPRU 4.6.37R-BIPRU 4.6.39R, BIPRU 4.7.19R, BIPRU 4.7.27R-BIPRU 4.7.35R, BIPRU 4.8.5R-BIPRU 4.8.9R, BIPRU 4.8.11R-BIPRU 4.8.15R, BIPRU 4.10.40R-BIPRU 4.10.48R.</i>
<i>minimum multiplication factor</i>	(in <i>BIPRU 7.10</i> (Use of a value at risk model)) has the meaning in <i>BIPRU 7.10.119R</i> (Capital calculations: Multiplication factors), which is in summary the number three or any higher amount the <i>VaR model permission</i> defines it as.
<i>MIPRU</i>	the Prudential sourcebook for Mortgage and Home Finance Firms, and Insurance Intermediaries
<i>model PRR</i>	the part of the <i>market risk capital requirement</i> calculated under a <i>VaR model permission</i> as more fully defined in <i>BIPRU 7.10</i> (Use of a Value at Risk Model).
<i>modified CIU look through method</i>	the method for calculating <i>PRR</i> for a <i>CIU</i> set out in <i>BIPRU 7.7.4R, BIPRU 7.7.7R to BIPRU 7.7.8R</i> and <i>BIPRU 7.7.11R to BIPRU 7.7.12R</i>
<i>multiplication factor</i>	(in <i>BIPRU 7.10</i> (Use of a value at risk model)) a multiplication factor applied to a <i>VaR measure</i> for the purpose of calculating the <i>model PRR</i> made up of the <i>minimum multiplication factor</i> as increased by the <i>plus factor</i> , all as more fully defined in <i>BIPRU 7.10.118R</i> (Capital calculations: Multiplication factors).

<i>netting set</i>	(in accordance with Part 1 of Annex III of the <i>Banking Consolidation Directive</i> (Definitions) and for the purpose of <i>BIPRU</i> 13 (The calculation of counterparty risk exposure values for financial derivatives, securities financing transactions and long settlement transactions)) a group of transactions with a single counterparty that are subject to a legally enforceable bilateral netting arrangement and for which netting is recognised under <i>BIPRU</i> 13.7 (Contractual netting), <i>BIPRU</i> 5 (Credit risk mitigation) and, if applicable, <i>BIPRU</i> 4.10 (The IRB approach: Credit risk mitigation); each transaction that is not subject to a legally enforceable bilateral netting arrangement, which is recognised under <i>BIPRU</i> 13.7 must be interpreted as its own <i>netting set</i> for the purpose of <i>BIPRU</i> 13.
<i>net underwriting exposure</i>	has the meaning in <i>BIPRU</i> 7.8.34R (Large exposure risk from underwriting securities: Calculating the net underwriting exposure) which is in summary the amount calculated by applying the reduction factors in the table in <i>BIPRU</i> 7.8.35R to the <i>net underwriting position</i> .
<i>net underwriting position</i>	the net underwriting position calculated under <i>BIPRU</i> 7.8.17R (Calculating the net underwriting position).
<i>nominated ECAI</i>	<p>(a) (in the case of an eligible ECAI within paragraph (a) of the definition of that term (Recognition for exposure risk-weighting purposes)) an <i>eligible ECAI</i> nominated by a <i>firm</i> in accordance with <i>BIPRU</i> 3.6 (Use of rating agencies' credit assessments for the determination of risk weights under the standardised approach to credit risk) for the purpose of calculating its <i>risk-weighted exposure amounts</i> under the <i>standardised approach</i> to credit risk except under (b);</p> <p>(b) (in the case of an eligible ECAI within paragraph (b) of the definition of that term (Recognition <i>securitisation risk-weighting</i> purposes)) an <i>eligible ECAI</i> nominated by a <i>firm</i> in accordance with <i>BIPRU</i> 9.8 (Use of ECAI credit assessments for the determination of applicable risk weights) for the purpose of calculating its <i>securitisation risk-weighted exposure amounts</i>.</p>
<i>non credit-obligation asset</i>	(in relation to the <i>IRB approach</i>) an <i>exposure</i> in the form of a non credit-obligation asset or falling under <i>BIPRU</i> 4.9.5R (Non credit-obligation assets).
<i>non-EAA sub-group</i>	a group of <i>undertakings</i> identified as a <i>non-EEA sub-group</i> in <i>BIPRU</i> 8.3.1R (Main consolidation rule for non-EEA sub-groups); however where the provision in question refers to a <i>non-EAA sub-group</i> in another <i>EEA State</i> it means a group of <i>undertakings</i> identified in Article 73(2) of the <i>Banking Consolidation Directive</i> (Non-EAA sub-groups) required to be supervised on a consolidated basis under Article 73(2) of the <i>Banking Consolidation Directive</i> by a <i>competent authority</i> in that <i>EEA State</i> .

<i>non-trading book</i>	<i>positions, exposures</i> , assets and liabilities that are not in the <i>trading book</i> .
<i>obligor grade</i>	(in relation to the <i>IRB approach</i> and the <i>sovereign, institutional and corporate IRB exposure class</i> and in accordance with <i>BIPRU 4.4.8R</i>) a risk category within a <i>rating system's</i> obligor rating scale, to which obligors are assigned on the basis of a specified and distinct set of rating criteria, from which estimates of <i>PD</i> are derived.
<i>one-day VaR measure</i>	(in <i>BIPRU 7.10</i> (Use of a value at risk model)) has the meaning in <i>BIPRU 7.10.98R</i> (Backtesting: One day VaR measure), which is in summary and in relation to a particular <i>business day</i> , the <i>VaR number</i> for that <i>business day</i> calibrated to a one <i>business day</i> holding period and a 99% one-tailed confidence level.
<i>one-sided credit valuation adjustment</i>	(in accordance with Part 1 of Annex III of the <i>Banking Consolidation Directive</i> (Definitions)) a <i>credit valuation adjustment</i> that reflects the market value of the credit risk of the counterparty to a <i>firm</i> , but does not reflect the market value of the credit risk of the <i>firm</i> to the counterparty.
<i>open currency position</i>	the amount calculated under <i>BIPRU 7.5.19R</i> (Open currency position) as part of the calculation of the <i>foreign currency PRR</i> .
<i>operational risk</i>	(in accordance with Article 4(22) of the <i>Banking Consolidation Directive</i>) the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events, including legal risk.
<i>operational risk capital requirement</i>	the part of the <i>capital resources requirement</i> of a <i>BIPRU firm</i> falling within <i>BIPRU 6.1.1R</i> in respect of <i>operational risk</i> , calculated in accordance with <i>BIPRU 6.2</i> .
<i>option hedging method</i>	the method of calculating the <i>option PRR</i> in <i>BIPRU 7.6.24R</i> (The hedging method).
<i>option PRR</i>	the part of the <i>market risk capital requirement</i> calculated in accordance with <i>BIPRU 7.6</i> (Option PRR) or, in relation to a particular <i>position</i> , the portion of the overall <i>option PRR</i> attributable to that <i>position</i> .
<i>option standard method</i>	the method of calculating the <i>option PRR</i> in <i>BIPRU 7.6.20R</i> to <i>BIPRU 7.6.22R</i> (The standard method).
<i>ordinary credit default swap PRR method</i>	the method for calculating the <i>specific risk</i> portion of the <i>interest rate PRR</i> for credit default swaps that are not <i>securitisation positions</i> set out in <i>BIPRU 7.11.24R</i> to <i>BIPRU 7.11.37R</i> .
<i>originator</i>	(in accordance with Article 4(41) of the <i>Banking Consolidation Directive</i> (Definitions) and in relation to a <i>securitisation</i> within the meaning of paragraph (2) of the definition of <i>securitisation</i>) either of the following:

- (a) an entity which, either itself or through related entities, directly or indirectly, was involved in the original agreement which created the obligations or potential obligations of the debtor or potential debtor giving rise to the *exposures* being *securitised*; or
- (b) an entity which purchases a third party's *exposures* onto its balance sheet and then *securitises* them.

<i>ORCR</i>	the <i>operational risk capital requirement</i> .
<i>out of the money</i>	(for the purposes of <i>BIPRU 7</i> (Market risk) and in relation to an <i>option</i> or <i>warrant</i>) that <i>option</i> or <i>warrant</i> being neither <i>at the money</i> nor <i>in the money</i> .
<i>overall financial adequacy rule</i>	<i>GENPRU 1.2.26R</i> (Requirement for certain <i>firms</i> to have adequate financial resources).
<i>overall Pillar 2 rule</i>	<i>GENPRU 1.2.30R</i> (Systems, strategies, processes and reviews for certain <i>firms</i>).
<i>own estimates of volatility adjustments approach</i>	the approach to calculating volatility adjustments under the <i>financial collateral comprehensive method</i> under which the <i>firm</i> uses its own estimates of such adjustments, as more fully described in <i>BIPRU 5.4</i> (Financial collateral) and including that approach as applied to master netting agreements as described in <i>BIPRU 5.6</i> (Master netting agreements).
<i>parent financial holding company in a Member State</i>	(in accordance with Article 4(15) of the <i>Banking Consolidation Directive</i> (Definitions) and Article 3 of the <i>Capital Adequacy Directive</i> (Definitions)) a <i>financial holding company</i> which is not itself a <i>subsidiary undertaking</i> of an <i>institution</i> authorised in the same <i>EEA State</i> , or of a <i>financial holding company</i> set up in the same <i>EEA State</i> .
<i>parent institution in a Member State</i>	(in accordance with Article 4(14) of the <i>Banking Consolidation Directive</i> and Article 2 of the <i>Capital Adequacy Directive</i> (Definitions)) an <i>institution</i> which has an <i>institution</i> or a <i>financial institution</i> as a <i>subsidiary undertaking</i> or which holds a <i>participation</i> in such an institution, and which is not itself a <i>subsidiary undertaking</i> of another <i>institution</i> authorised in the same <i>EEA State</i> , or of a <i>financial holding company</i> set up in the same <i>EEA State</i> .
<i>payment leg</i>	(for the purposes of the <i>CCR standardised method</i> and as more fully defined in <i>BIPRU 13.5.2R</i> (Derivation of risk position: payment legs) the contractually agreed gross payments under a <i>financial derivative instrument</i> , including the notional amount of the transaction.
<i>PD/LGD approach</i>	the method for treating <i>equity exposures</i> under the <i>IRB approach</i> set out in <i>BIPRU 4.7.14R-BIPRU 4.7.22R</i> .

<i>peak exposure</i>	(in accordance with Part 1 of Annex III of the <i>Banking Consolidation Directive</i> (Definitions) and for the purpose of <i>BIPRU</i> 13 (The calculation of counterparty risk exposure values for financial derivatives, securities financing transactions and long settlement transactions)) a high percentile of the distribution of <i>exposures</i> at any particular future date before the maturity date of the longest transaction in the <i>netting set</i> .
<i>permanent interest bearing shares</i>	any shares of a class defined as deferred shares for the purposes of section 119 of the Building Societies Act 1986 which are issued as permanent interest-bearing shares and on terms which qualify them as own funds for the purposes of the <i>Banking Consolidation Directive</i> .
<i>physical commodities</i>	a physical holding of a <i>commodity</i> , or documents evidencing title to a <i>commodity</i> .
<i>PIBS</i>	<i>permanent interest-bearing shares</i> .
<i>plus factor</i>	(in <i>BIPRU</i> 7.10 (Use of a value at risk model)) an increase to the <i>minimum multiplication factor</i> based on <i>backtesting exceptions</i> as more fully defined in <i>BIPRU</i> 7.10.124R (Capital calculations: Multiplication factors).
<i>position</i>	(in accordance <i>BIPRU</i> 1.2.4 (Definition of the trading book: Positions)) includes proprietary positions and positions arising from client servicing and market making.
<i>position risk requirement</i>	a capital requirement applied to a <i>position</i> treated under <i>BIPRU</i> 7 (Market risk) as part of the calculation of the <i>market risk capital requirement</i> or, if the relevant provision of the <i>Handbook</i> distinguishes between <i>general market risk</i> and <i>specific risk</i> , the portion of that capital requirement with respect to whichever of <i>general market risk</i> or <i>specific risk</i> is specified by that provision.
<i>PRA</i>	a percentage applied to a <i>position</i> as part of the process of calculating the <i>PRR</i> in relation to that <i>position</i> as set out in the tables in <i>BIPRU</i> 7.2.44R (Specific risk PRAs), <i>BIPRU</i> 7.2.57R (General market risk PRAs), <i>BIPRU</i> 7.3.30R (Simplified equity method PRAs), <i>BIPRU</i> 7.3.34R (PRAs for specific risk under the standard equity method) and <i>BIPRU</i> 7.6.8R (The appropriate PRA) and also as set out in <i>BIPRU</i> 7.2.46R to <i>BIPRU</i> 7.2.47R.
<i>probability of default</i>	(in accordance with Article 4(25) of the <i>Banking Consolidation Directive</i> (Definitions)) the probability of default of a counterparty over a one year period; for the purposes of the <i>IRB approach</i> , default has the meaning in the definition of <i>default</i> .
<i>protection buyer</i>	(in relation to a credit derivative and in accordance with paragraph 8 of Annex I of the <i>Capital Adequacy Directive</i> (Calculating capital requirements for position risk)) the <i>person</i> who transfers credit risk.

<i>protection seller</i>	(in relation to a credit derivative and in accordance with paragraph 8 of Annex I of the <i>Capital Adequacy Directive</i> (Calculating capital requirements for position risk)) the <i>person</i> who assumes the credit risk.
<i>PRR</i>	<i>position risk requirement</i> .
<i>PRR charge</i>	one of the following: <ul style="list-style-type: none"> (a) the <i>interest rate PRR</i>; (b) the <i>equity PRR</i>; (c) the <i>commodity PRR</i>; (d) the <i>foreign currency PRR</i>; (e) the <i>option PRR</i>; (f) the <i>collective investment undertaking PRR</i>; and (g) (if the context requires) the <i>model PRR</i>.
<i>PRR item</i>	a <i>commodity</i> or a <i>CRD financial instrument</i> .
<i>PRR identical product netting rules</i>	the following: <ul style="list-style-type: none"> (a) <i>BIPRU 7.2.37R</i> (Deriving the net position in each debt security: Netting positions in the same debt security); (b) <i>BIPRU 7.2.40R</i> (Deriving the net position in each debt security: Netting zero-specific-risk securities with different maturities); (c) <i>BIPRU 7.3.23R</i> (Deriving the net position in each equity); (d) <i>BIPRU 7.4.20R</i> and <i>BIPRU 7.4.22R</i> (Calculating the PRR for each commodity: General); (e) <i>BIPRU 7.5.19R(1)</i> (Open currency position); and (f) the obligation under <i>BIPRU 7.5.20R</i> (Net gold position) to calculate a separate <i>foreign exchange PRR</i> charge for gold).
<i>PSE</i>	a <i>public sector entity</i> .
<i>public sector entity</i>	(in accordance with Article 4(18) of the <i>Banking Consolidation Directive</i> (Definitions)) any of the following: <ul style="list-style-type: none"> (a) non-commercial administrative bodies responsible to central governments, regional governments or local authorities; or (b) authorities that exercise the same responsibilities as regional and local authorities; or

	(c) non commercial <i>undertakings</i> owned by central governments that have explicit guarantee arrangements; or
	(d) self administered bodies governed by law that are under public supervision.
<i>qualifying equity</i>	a <i>share</i> that satisfies the conditions in <i>BIPRU</i> 7.3.35R (Definition of a qualifying equity).
<i>qualifying equity index</i>	an <i>equity</i> index falling into in <i>BIPRU</i> 7.3.38R (Definition of a qualifying equity index).
<i>qualifying holding</i>	has the meaning in <i>GENPRU</i> 2.2.203R (Qualifying holdings), which is in summary a direct or indirect holding of a <i>bank</i> or <i>building society</i> in a non-financial <i>undertaking</i> which represents 10% or more of the capital or of the voting rights or which makes it possible to exercise a significant influence over the management of that <i>undertaking</i> .
<i>qualifying revolving retail exposure</i>	(in relation to the <i>IRB approach</i>) <i>retail exposures</i> falling into <i>BIPRU</i> 4.6.44R(2) (Qualifying revolving retail exposures).
<i>rated position</i>	(for the purposes of <i>BIPRU</i> 9 (Securitisation), in accordance with Part 1 of Annex IX of the <i>Banking Consolidation Directive</i> (Securitisation definitions) and in relation to a <i>securitisation position</i>) describes a <i>securitisation position</i> which has an eligible credit assessment by an <i>eligible ECAI</i> .
<i>ratings based method</i>	(for the purposes of <i>BIPRU</i> 9 (Securitisation) and in accordance with Part 1 of Annex IX of the <i>Banking Consolidation Directive</i> (Securitisation definitions)) the method of calculating <i>risk weighted exposure amounts</i> for <i>securitisation positions</i> set out in <i>BIPRU</i> 9.12.10R- <i>BIPRU</i> 9.12.19R and <i>BIPRU</i> 9.14.2R.
<i>rating system</i>	(in relation to the <i>IRB approach</i> and in accordance with <i>BIPRU</i> 4.3.25R) comprises all of the methods, processes, controls, data collection and IT systems that support the assessment of credit risk, the assignment of <i>exposures</i> to grades or pools (rating), and the quantification of <i>default</i> and <i>loss</i> estimates for a certain type of <i>exposure</i> .
<i>reciprocal cross-holding</i>	has the meaning in <i>GENPRU</i> 2.2.219R (Deductions from tiers one and two: Reciprocal cross holdings) which is in summary a holding of a <i>firm</i> of <i>shares</i> , any other interest in the capital, and subordinated debt, whether in the <i>trading book</i> or <i>non-trading book</i> , in: <ul style="list-style-type: none"> (a) a <i>credit institution</i>; or (b) a <i>financial institution</i>; that satisfies the conditions in <i>GENPRU</i> 2.2.219R.
<i>recognised third country credit institution</i>	a <i>full BCD credit institution</i> that satisfies the following conditions:

- (a) its head office is outside the *EEA*;
- (b) it is authorised by a *third country competent authority* in the state or territory in which the *credit institution's* head office is located;
- (c) that *third country competent authority* is named in Part 1 of *BIPRU* 8 Annex 6R (Non –*EEA* banking regulators' requirements deemed *CRD* -equivalent for individual risks); and
- (d) there is a tick against that *third country competent authority* in each of the columns headed "Market risk", "Credit risk" and "Operational Risk" in the table referred to in (c).

reduced net underwriting position

the *net underwriting position* as adjusted under *BIPRU* 7.8.27R (Calculating the reduced net underwriting position).

regulatory high risk category

(for the purposes of the *standardised approach* to credit risk) an item that falls into *BIPRU* 3.4.104R (Items belonging to regulatory high risk categories under the standardised approach to credit risk).

repurchase agreement

see *repurchase transaction*.

repurchase transaction

(in accordance with Article 3(1)(m) of the *Capital Adequacy Directive* and Article 4(33) of the *Banking Consolidation Directive* (Definitions)) any agreement in which an *undertaking* or its counterparty transfers securities or *commodities* or guaranteed rights relating to title to securities or *commodities* where that guarantee is issued by a *designated investment exchange* or *recognised investment exchange* which holds the rights to the securities or *commodities* and the agreement does not allow an *undertaking* to transfer or pledge a particular security or *commodity* to more than one counterparty at one time, subject to a commitment to repurchase them or substituted securities or *commodities* of the same description at a specified price on a future date specified, or to be specified, by the transferor, being a *repurchase agreement* for the *undertaking* selling the securities or *commodities* and a *reverse repurchase agreement* for the *undertaking* buying them.

resecuritisation

(in accordance with point 49 of Part 4 of Annex IX of the *Banking Consolidation Directive* (Ratings based method)) *securitisation* of *securitisation exposures* (*securitisation* having the meaning in paragraph (2) of the definition of *securitisation* for these purposes).

residual block

- (1) (for the purposes of *BIPRU* 10 (Concentration risk requirements)):

	(a)	(subject to (b)) has the meaning in <i>BIPRU</i> 10.8.12R (Definition of residual block) which is in summary, in relation to a <i>firm</i> and its <i>UK integrated group</i> , a <i>concentration risk group counterparty</i> of the <i>firm</i> which is not a member of the <i>firm's UK integrated group</i> ;
	(b)	(if a <i>firm</i> has a <i>wider integrated group permission</i>) has the meaning in <i>BIPRU</i> 10.9.7R (Definition of residual block) which is in summary, in relation to a <i>firm</i> and its <i>wider integrated group</i> , a <i>concentration risk group counterparty</i> of the <i>firm</i> which is not a member of the <i>firm's UK integrated group</i> or <i>wider integrated group</i> .
	(2)	(for the purposes of <i>BIPRU</i> 8 (Group risk – consolidation)) has the meaning in <i>BIPRU</i> 8.9.24R (Wider integrated groups: Definition of residual block) which is in summary all <i>exposures</i> to <i>group concentration risk group counterparties</i> falling into <i>BIPRU</i> 8.9.20R(2) not included in a <i>diverse block</i> .
<i>retail exposure</i>	(1)	(in relation to the <i>IRB approach</i> and with respect to an <i>exposure</i>) an <i>exposure</i> falling into the <i>IRB exposure class</i> listed in <i>BIPRU</i> 4.3.2R(4) (Retail exposures).
	(2)	(in relation to the <i>standardised approach</i> to credit risk and with respect to an <i>exposure</i>) an <i>exposure</i> falling into the <i>standardised credit risk exposure class</i> listed in <i>BIPRU</i> 3.2.9R(8) (Retail exposures).
<i>retail SME</i>	(1)	(in relation to the <i>IRB approach</i>) a small or medium sized entity, an <i>exposure</i> to which may be treated as a <i>retail exposure</i> under <i>BIPRU</i> 4.6.2R (Definition of retail exposures).
	(2)	(in relation to the <i>standardised approach</i> to credit risk) a small or medium sized entity, an <i>exposure</i> to which may be treated as a <i>retail exposure</i> under <i>BIPRU</i> 3.2.10R (Definition of retail exposures).
<i>retail SME exposure</i>		(in relation to the <i>IRB approach</i> or the <i>standardised approach</i> to credit risk) an <i>exposure</i> to a <i>retail SME</i> .
<i>reverse repurchase agreement</i>		see <i>repurchase transaction</i> .
<i>revolving exposure</i>		(for the purpose of <i>BIPRU</i> 9.13 (Securitisations of revolving exposures with early amortisation provisions) and in accordance with Article 100 of the Banking Consolidation Directive (Securitisations of revolving exposures)) an <i>exposure</i> whereby customers' outstanding balances are permitted to fluctuate based on their decisions to borrow and repay, up to an agreed limit.

<i>risk capital requirement</i>	<p>(1) (in relation to the <i>FSA's rules</i>) one of the following:</p> <ul style="list-style-type: none"> (a) the <i>credit risk capital requirement</i>; (b) the <i>fixed overheads requirement</i>; (c) the <i>market risk capital requirement</i>; or (d) the <i>operational risk capital requirement</i>; or <p>(2) (in relation to the rules of another <i>regulatory body</i>) whatever corresponds to the items in (1) under the rules of that <i>regulatory body</i>.</p>
<i>risk position</i>	(in accordance with Part 1 of Annex III of the <i>Banking Consolidation Directive</i> (Definitions) and for the purpose of <i>BIPRU</i> 13 (The calculation of counterparty risk exposure values for financial derivatives, securities financing transactions and long settlement transactions)) a risk number that is assigned to a transaction under the <i>CCR standardised method</i> following a predetermined algorithm.
<i>risk weight</i>	(in relation to an <i>exposure</i>) a degree of risk expressed as a percentage assigned to that <i>exposure</i> in accordance with whichever is applicable of the <i>standardised approach</i> to credit risk and the <i>IRB approach</i> , including (in relation to a <i>securitisation position</i>) under <i>BIPRU</i> 9 (Securitisation).
<i>risk weighted exposure amount</i>	(in relation to an <i>exposure</i>) the value of an <i>exposure</i> for the purposes of the calculation of the <i>credit risk capital component</i> after application of a <i>risk weight</i> .
<i>rollover risk</i>	(in accordance with Part 1 of Annex III of the <i>Banking Consolidation Directive</i> (Definitions) and for the purpose of <i>BIPRU</i> 13 (The calculation of counterparty risk exposure values for financial derivatives, securities financing transactions and long settlement transactions)) the amount by which <i>expected positive exposure</i> is understated when future transactions with a counterparty are expected to be conducted on an ongoing basis; the additional <i>exposure</i> generated by those future transactions is not included in calculation of <i>expected positive exposure</i> .
<i>same stage of capital</i>	(with respect to a particular item of capital in the <i>capital resources table</i>) the stage in the <i>capital resources table</i> in which that item of capital appears.
<i>secured lending transaction</i>	(in accordance with point 2 of Part 1 of Annex VIII of the <i>Banking Consolidation Directive</i> (Eligibility of credit risk mitigation)) any transaction giving rise to an <i>exposure</i> secured by collateral which does not include a provision conferring upon the <i>person</i> with the <i>exposure</i> the right to receive margin frequently.

<i>securities financing transaction</i>	<p>any of the following:</p> <p>(a) a <i>repurchase transaction</i>; or</p> <p>(b) a <i>securities or commodities lending or borrowing transaction</i>; or</p> <p>(c) a <i>margin lending transaction</i>.</p>
<i>securities or commodities borrowing</i>	see <i>securities or commodities lending or borrowing transaction</i> .
<i>securities or commodities lending</i>	see <i>securities or commodities lending or borrowing transaction</i> .
<i>securities or commodities lending or borrowing transaction</i>	(in accordance with Article 4(34) of the <i>Banking Consolidation Directive</i> and Article 3(1)(n) of the <i>Capital Adequacy Directive</i> (Definitions)) any transaction in which an <i>undertaking</i> or its counterparty transfers securities or <i>commodities</i> against appropriate collateral subject to a commitment that the borrower will return equivalent securities or <i>commodities</i> at some future date or when requested to do so by the transferor, that transaction being <i>securities or commodities lending</i> for the <i>undertaking</i> transferring the securities or <i>commodities</i> and being <i>securities or commodities borrowing</i> for the <i>undertaking</i> to which they are transferred.
<i>securities PRR</i>	<p>the <i>interest rate PRR</i>, the <i>equity PRR</i>, the <i>option PRR</i> (but only in relation to <i>positions</i> which under <i>BIPRU 7.6.5R</i> (Table: Appropriate calculation for an option or warrant) may be subject to one of the other <i>PRR</i> charges listed in this definition or which would be subject to such a <i>PRR</i> charge if <i>BIPRU 7.6.5R</i> did not require an <i>option PRR</i> to be calculated), the <i>CIU PRR</i> and the <i>PRR</i> calculated under <i>BIPRU 7.11</i> (Credit derivatives in the trading book) and so that:</p> <p>(a) the <i>securities PRR</i> includes any <i>PRR charge</i> calculated under a <i>CAD 1 permission</i>; and</p> <p>(b) the <i>securities PRR</i> does not include any <i>PRR charge</i> calculated under a <i>VaR model permission</i> unless the provision in question provides otherwise.</p>
<i>securitisation credit default swap PRR method</i>	the method for calculating the <i>specific risk</i> portion of the <i>interest rate PRR</i> for credit default swaps that are <i>securitisation positions</i> set out in <i>BIPRU 7.11.39R</i> to <i>BIPRU 7.11.53R</i> .
<i>securitisation position</i>	(in accordance with Article 4(40) (Definitions) and Article 96 (Securitisation) of the <i>Banking Consolidation Directive</i>) an <i>exposure</i> to a <i>securitisation</i> within the meaning of paragraph (2) of the definition of <i>securitisation</i> ; and so that:

- (a) where there is an *exposure* to different *tranches* in a *securitisation*, the *exposure* to each *tranche* must be considered as a separate *securitisation position*;
- (b) the providers of credit protection to *securitisation positions* must be considered to hold positions in the *securitisation*; and
- (c) *securitisation positions* include *exposures* to a *securitisation* arising from interest rate or currency derivative contracts.

securitisation special purpose entity

(in accordance with Article 4(44) of the *Banking Consolidation Directive* (Definitions)) a corporation, trust or other entity, other than a *credit institution*, organised for carrying on a *securitisation* or *securitisations* (within the meaning of paragraph (2) of the definition of *securitisation*), the activities of which are limited to those appropriate to accomplishing that objective, the structure of which is intended to isolate the obligations of the *SSPE* from those of the *originator*, and the holders of the beneficial interests in which have the right to pledge or exchange those interests without restriction.

securitised exposure

an *exposure* in the pool of *exposures* that has been securitised, either via a *traditional securitisation* or a *synthetic securitisation*. The cash-flows generated by the securitised exposures are used to make payments to the *securitisation positions*.

senior management

(in *BIPRU* 7.10 (Use of a value at risk model) and in relation to a *firm*) the *firm's governing body* and those of the *firm's senior managers* and other senior management who have responsibilities relating to the measurement and control of the risks which the *firm's VaR model* is designed to measure or whose responsibilities require them to take into account those risks.

SFT

securities financing transaction.

simple capital issuer

a *BIPRU firm* that meets the following conditions:

- (a) it does not raise capital through a special purpose vehicle;
- (b) it only includes non-convertible and non-exchangeable *capital instruments* in its *capital resources*;
- (c) (if it includes *capital instruments* in its *capital resources* on which *coupons* are payable) such *coupons* are not subject to a *step-up*;
- (d) it only includes *capital instruments* in its *tier one capital resources* consisting of ordinary *shares*, *PIBS*, perpetual non-cumulative preference *shares* or partnership or *limited liability partnership* capital accounts;
- (e) it only includes non-redeemable *capital instruments* in its *tier one capital resources*; and

	(f) (if it includes <i>capital instruments</i> in its <i>tier one capital resources</i> on which <i>coupons</i> are payable) such <i>coupons</i> are non-cumulative, non-mandatory and in cash.
<i>simplified equity method</i>	the method of calculating the <i>equity PRR</i> set out in <i>BIPRU 7.3.29R</i> (Simplified equity method).
<i>solo consolidation waiver</i>	a <i>waiver</i> of the type described in <i>BIPRU 2.1</i> (Solo consolidation).
<i>sovereign, institutional and corporate IRB exposure class</i>	(in relation to the <i>IRB approach</i>) an <i>exposure</i> falling into the <i>IRB exposure classes</i> referred to in <i>BIPRU 4.3.2R(1)-(3)</i> (Sovereigns, institutions and corporates).
<i>specialised lending exposure</i>	(in relation to the <i>IRB approach</i>) an <i>exposure</i> falling into <i>BIPRU 4.5.3R</i> (Definition of specialised lending).
<i>specific risk PRA</i>	a <i>PRA</i> for <i>specific risk</i> including any such <i>PRA</i> as applied under <i>BIPRU 7.6.8R</i> (Table: Appropriate PRA).
<i>specific risk backtesting exception</i>	(in <i>BIPRU 7.10</i> (Use of a value at risk model) and in relation to a <i>firm</i>) an exception arising out of backtesting a <i>VaR model</i> with respect to <i>specific risk</i> as more fully defined in that <i>firm's VaR model permission</i> .
<i>specific wrong-way risk</i>	(in accordance with Part 1 of Annex III of the <i>Banking Consolidation Directive</i> (Definitions) and for the purpose of <i>BIPRU 13</i> (The calculation of counterparty risk exposure values for financial derivatives, securities financing transactions and long settlement transactions)) the risk that arises when the exposure to a particular counterparty is positively correlated with the <i>probability of default</i> of the counterparty due to the nature of the transactions with the counterparty; a <i>firm</i> is exposed to <i>specific wrong-way risk</i> if the future exposure to a specific counterparty is expected to be high when the counterparty's <i>probability of default</i> is also high.
<i>SPV</i>	(1) (in <i>GENPRU 2.2</i> (Capital resources)) has the meaning in <i>GENPRU 2.2.126R</i> (Other tier one capital: innovative tier one capital: indirectly issued tier one capital). (2) (in <i>BIPRU 8</i> (Group risk - consolidation)) has the meaning in <i>BIPRU 8.6.15R</i> (Indirectly issued capital and group capital resources).
<i>SREP</i>	the <i>supervisory review and evaluation process</i> .
<i>SSPE</i>	a <i>securitisation special purpose entity</i> .
<i>standard CIU look through method</i>	the method for calculating the <i>PRR</i> for a <i>position</i> in a <i>CIU</i> set out in <i>BIPRU 7.7.4R</i> and <i>BIPRU 7.7.7R</i> to <i>BIPRU 7.7.10R</i> .
<i>standard equity method</i>	the method of calculating the <i>equity PRR</i> set out in <i>BIPRU 7.3.32R</i> (Standard equity method).
<i>standardised approach</i>	one of the following:

- (a) (where expressed to relate to credit risk) the method for calculating capital requirements for credit risk in *BIPRU 3* (Credit risk) and *BIPRU 9.2.1R(1)* and *BIPRU 9.11* (Standardised approach);
- (b) (where expressed to relate to *operational risk*) the method for calculating capital requirements for *operational risk* in *BIPRU 6.3* (Standardised approach);
- (c) (where not expressed to relate to any risk and used in *BIPRU 3*, *BIPRU 4* (IRB approach), *BIPRU 5* (Credit risk mitigation), *BIPRU 9* (Securitisation) or *BIPRU 10* (Concentration risk requirements)) it has the meaning in (a);
- (d) (where not expressed to relate to any risk and used in *BIPRU 6* (Operational risk)) it has the meaning in (b);
- (e) (where the one of the approaches in (a) to (d) is being applied on a consolidated basis) that approach as applied on a consolidated basis in accordance with *BIPRU 8* (Group risk - consolidation); or
- (f) when the reference is to the rules of or administered by a *regulatory body* other than the *FSA*, whatever corresponds to the approach in (a) to (e), as the case may be, under those rules.

standardised credit risk exposure class

(in relation to the *standardised approach* to credit risk) one of the classes of *exposure* set out in *BIPRU 3.2.9R* (Exposure classes).

standard market risk PRR rules

the *rules* relating to the calculation of the *market risk capital requirement* excluding the *VaR model approach* and any *rules* modified so as to provide for the *CAD 1 model approach*.

stock financing

a transaction where a *physical commodity* is sold forward and the cost of funding is locked in until the date of the forward sale.

supervisory formula method

(for the purposes of *BIPRU 9* (Securitisation), in relation to a *securitisation* within the meaning of paragraph (2) of the definition of securitisation and in accordance with Part 1 of Annex IX of the *Banking Consolidation Directive* (Securitisation definitions)) the method of calculating *risk weighted exposure amounts* for *securitisation positions* set out in *BIPRU 9.12.21R-BIPRU 9.12.23R* and *BIPRU 9.14.3R*.

supervisory review and evaluation process

the *FSA's* assessment of the adequacy of certain *firms'* capital, as more fully described in *BIPRU 2.2.9G* and *INSRU 7.1.8G*.

<i>supervisory volatility adjustments approach</i>	the approach to calculating volatility adjustments under the <i>financial collateral comprehensive method</i> under which the <i>firm</i> uses the adjustments specified in <i>BIPRU 5.4</i> (Financial collateral) rather than in its own estimates, as more fully described in <i>BIPRU 5.4</i> and including that approach as applied to master netting agreements as described in <i>BIPRU 5.6</i> (Master netting agreements).
<i>swap</i>	a transaction in which two counterparties agree to exchange streams of payments over time according to a predetermined basis or a <i>contract for differences</i> .
<i>synthetic securitisation</i>	(in accordance with Article 4(38) of the <i>Banking Consolidation Directive</i> (Definitions)) a <i>securitisation</i> (within the meaning of paragraph (2) of the definition of securitisation) where the <i>tranching</i> is achieved by the use of credit derivatives or guarantees, and the pool of <i>exposures</i> is not removed from the balance sheet of the <i>originator</i> .
<i>third country banking or investment services undertaking</i>	(in <i>BIPRU</i>) an <i>institution</i> , a <i>financial institution</i> or an <i>asset management company</i> in a <i>non-EEA state</i> .
<i>third country BIPRU firm</i>	an <i>overseas firm</i> that: <ul style="list-style-type: none"> (a) is not an <i>EEA firm</i>; (b) has its head office outside the <i>EEA</i>; and (c) would be a <i>BIPRU firm</i> if it had been a <i>UK domestic firm</i>, it had carried on all its business in the <i>United Kingdom</i> and had obtained whatever authorisations for doing so are required under the <i>Act</i>.
<i>third country competent authority</i>	a <i>regulatory body</i> of a state or territory that is not an <i>EEA State</i> .
<i>tier three capital</i>	an item of capital that is <i>upper tier three capital</i> or <i>lower tier three capital</i> .
<i>tier three capital resources</i>	the sum calculated at stage Q of the <i>capital resources table</i> (Total tier three capital).
<i>tier three instrument</i>	an item of capital that falls into <i>GENPRU 2.2.242R</i> (Tier three capital: upper tier three capital resources) and is eligible to form part of a <i>firm's upper tier three capital resources</i> .
<i>total exposure</i>	(in relation to a <i>counterparty</i> or <i>group of connected clients</i> and a <i>person</i> or in relation to a <i>person</i> and its <i>connected counterparties</i>) all that <i>person's exposures</i> to that <i>counterparty</i> or <i>group of connected clients</i> or to that <i>person's connected counterparties</i> or the total amount of those <i>exposures</i> .
<i>trading book concentration risk excess</i>	has the meaning in <i>BIPRU 10.5.20R</i> (How to calculate the concentration risk capital component).

<i>trading book policy statement</i>	has the meaning in <i>BIPRU</i> 1.2.29R (Trading book policy statements) which is in summary a single document of a <i>person</i> recording the policies and procedures referred to in <i>BIPRU</i> 1.2.26R and <i>BIPRU</i> 1.2.27R.
<i>trading book systems and controls rules</i>	<i>GENPRU</i> 1.3.13R(2) to (3) (General requirements: Methods of valuation and systems and controls), <i>GENPRU</i> 1.3.14R to <i>GENPRU</i> 1.3.16R (Marking to market), <i>GENPRU</i> 1.3.17R to <i>GENPRU</i> 1.3.25R (Marking to model), <i>GENPRU</i> 1.3.26R to <i>GENPRU</i> 1.3.28R (Independent price verification), <i>GENPRU</i> 1.3.30R to <i>GENPRU</i> 1.3.33R (Valuation adjustments or reserves), <i>GENPRU</i> 2.2.86R (Core tier one capital: profit and loss account and other reserves: Losses arising from valuation adjustments) and <i>GENPRU</i> 2.2.248R to <i>GENPRU</i> 2.2.249R (Tier three capital: lower tier three capital resources).
<i>traditional securitisation</i>	<p>(in accordance with Article 4(37) of the <i>Banking Consolidation Directive</i> (Definitions)) a <i>securitisation</i> (within the meaning of paragraph (2) of the definition of securitisation) involving the economic transfer of the <i>exposures</i> being <i>securitised</i> to a <i>securitisation special purpose entity</i> which issues securities; and so that:</p> <ul style="list-style-type: none"> (a) this must be accomplished by the transfer of ownership of the <i>securitised exposures</i> from the <i>originator</i> or through sub-participation; and (b) the securities issued do not represent payment obligations of the <i>originator</i>.
<i>tranche</i>	(in accordance with Article 4(39) of the <i>Banking Consolidation Directive</i> (Definitions) and in relation to a <i>securitisation</i> within the meaning of paragraph (2) of the definition of securitisation) a contractually established segment of the credit risk associated with an <i>exposure</i> or number of <i>exposures</i> , where a position in the segment entails a risk of credit loss greater than or less than a position of the same amount in each other such segment, without taking account of credit protection provided by third parties directly to the holders of positions in the segment or in other segments.
<i>UK consolidation group</i>	<p>a group that is identified as a <i>UK consolidation group</i> in accordance with the decision tree in <i>BIPRU</i> 8 Annex 1R (Decision tree identifying a UK consolidation group); the members of that group are:</p> <ul style="list-style-type: none"> (a) where either Test 1A or Test 1B in <i>BIPRU</i> 8 Ann 1R apply, the members of the <i>consolidation group</i> made up of the <i>sub-group</i> of the <i>parent institution in a Member State</i> identified in <i>BIPRU</i> 8 Ann 1R together with any other <i>person</i> who is a member of that <i>consolidation group</i> because of a <i>consolidation Article 12(1) relationship</i> or an <i>Article 134 relationship</i>; or

- (b) where either Test 1C or Test 1D in *BIPRU 8 Ann 1R* apply, the members of the *consolidation group* made up of the *sub-group* of the *parent financial holding company in a Member State* identified in *BIPRU 8 Ann 1R* together with any other *person* who is a member of that *consolidation group* because of a *consolidation Article 12(1) relationship* or an *Article 134 relationship*;

in each case only *persons* included under *BIPRU 8.5* (Basis of consolidation) are included in the *UK consolidation group*.

UK integrated group

(in relation to a *firm*) all *undertakings* which, in relation to the *firm*, satisfy the conditions set out in *BIPRU 10.8.4R* (Definition of UK integrated group).

UK parent financial holding company in a Member State

a *parent financial holding company in a Member State* where the *EEA State* in question is the *United Kingdom*.

underwrite

(for the purposes of *BIPRU 7* (Market risk)) to undertake a firm commitment to buy a specified quantity of new *securities* on a given date and at a given price if no other has purchased or acquired them; and so that:

- (a) new is defined in *BIPRU 7.8.12R* (New securities);
- (b) a *firm* still underwrites *securities* at a time before the exact quantity of *securities* being underwritten or their price has been determined if it is committed at that time to underwrite them when the quantity and price is fixed;
- (c) (in the case of provisions of the *Handbook* that distinguish between *underwriting* and *sub-underwriting*) *underwriting* does not include *sub-underwriting*; and
- (d) (in any other case) *underwriting* includes *sub-underwriting*.

unfunded credit protection

(in accordance with Article 4(32) of the *Banking Consolidation Directive* (Definitions)) a technique of *credit risk mitigation* where the reduction of the credit risk on the *exposure* of an *undertaking* derives from the undertaking of a third party to pay an amount in the event of the default of the borrower or on the occurrence of other specified events.

unrated position

(for the purposes of *BIPRU 9* (Securitisation), in accordance with Part 1 of Annex IX of the *Banking Consolidation Directive* (Securitisation definitions) and in relation to a *securitisation position*) describes a *securitisation position* which does not have an eligible credit assessment by an *eligible ECAI*.

upper tier three capital

an item of capital that is specified in stage O of the *capital resources table* (Upper tier three).

<i>upper tier three capital resources</i>	the sum calculated at stage O of the <i>capital resources table</i> (Upper tier three).
<i>upper tier three instrument</i>	an item of capital that meets the conditions in <i>GENPRU 2.2.242R</i> (Tier three capital: upper tier three capital resources) and is eligible to form part of a <i>firm's upper tier three capital resources</i> .
<i>value at risk</i>	(in relation to risk modelling or estimation) the measure of risk described in <i>BIPRU 7.10.146R</i> (Requirement to use value at risk methodology).
<i>VaR</i>	<i>value at risk</i> .
<i>VaR measure</i>	an estimate by a <i>VaR model</i> of the worst expected loss on a portfolio resulting from market movements over a period of time with a given confidence level.
<i>VaR model</i>	a value at risk model as described in <i>BIPRU 7.10</i> (Use of a Value at Risk Model).
<i>VaR model approach</i>	one of the following: <ul style="list-style-type: none"> (a) the approach to calculating part of the <i>market risk capital requirement</i> set out in <i>BIPRU 7.10</i> (Use of a value at risk model); (b) (where the approach in (a) is being applied on a consolidated basis) the method in (a) as applied on a consolidated basis in accordance with <i>BIPRU 8</i> (Group risk - consolidation); or (c) when the reference is to the rules of or administered by a <i>regulatory body</i> other than the <i>FSA</i>, whatever corresponds to the approach in (a) or (b), as the case may be, under those rules.
<i>VaR model permission</i>	an <i>Article 129 implementing measure</i> , a <i>requirement</i> or a <i>waiver</i> that requires a <i>BIPRU firm</i> or an <i>institution</i> to use the <i>VaR model approach</i> on a solo basis or, if the context requires, a consolidated basis.
<i>VaR number</i>	has the meaning in <i>BIPRU 7.10.115R</i> (Capital calculations: General) which in summary is (in relation to a <i>business day</i> and a <i>VaR model</i>) the <i>VaR measure</i> , in respect of the previous <i>business day's</i> close-of-business <i>positions</i> in products coming within the scope of the <i>VaR model permission</i> , calculated by the <i>VaR model</i> and in accordance with <i>BIPRU 7.10</i> (Use of a Value at Risk Model) and any methodology set out in the <i>VaR model permission</i> .
<i>VaR specific risk minimum requirements</i>	<i>BIPRU 7.10.46R</i> to <i>BIPRU 7.10.52R</i> (Model standards: Risk factors: Specific risk) and <i>BIPRU 7.10.107R</i> (Backtesting: Specific risk backtesting).

<i>wider integrated group</i>	(in relation to a <i>firm</i>) has the meaning in <i>BIPRU</i> 10.9.5R (Definition of wider integrated group), which is in summary each <i>concentration risk group counterparty</i> of the <i>firm</i> that is not a member of the <i>firm's UK integrated group</i> but satisfies all the conditions for membership of the <i>firm's UK integrated group</i> except for <i>BIPRU</i> 10.8.4R(4) (Establishment in the <i>United Kingdom</i>).
<i>wider integrated group waiver</i>	a <i>waiver</i> that has the result of requiring a <i>firm</i> to apply <i>BIPRU</i> 10.9 (Wider Integrated Group) or, if the context requires, <i>BIPRU</i> 8.9.16R to <i>BIPRU</i> 8.9.24R (Wider integrated groups for consolidation purposes) and the other <i>rules</i> in <i>BIPRU</i> 8.9 (Consolidated concentration risk requirements) that relate to those <i>rules</i> .
<i>working day 0</i>	has the meaning in <i>BIPRU</i> 7.8.23R (Working day 0), which is in summary (in relation to an <i>underwriter</i>) the <i>business day</i> on which a <i>firm</i> that is <i>underwriting</i> or <i>sub-underwriting</i> becomes unconditionally committed to accepting a known quantity of <i>securities</i> at a specified price.
<i>zero-specific-risk security</i>	a notional debt <i>security</i> used, for the purpose of calculating <i>PRR</i> , to represent the interest rate <i>general market risk</i> arising from certain <i>derivative</i> and forward transactions as specified in <i>BIPRU</i> 7.2 (Interest rate <i>PRR</i>).

Part 2A (Revised definitions taking effect on 31 December 2006)

Amend the following definitions in the Glossary as shown:

<i>actuarial health insurance</i>	(in PRU) (in the context of the <i>rules in PRU 7.2 INSPRU 1.1</i> concerning the calculation of the <i>general insurance capital requirement</i>), health insurance which meets all the conditions set out in PRU 7.2.72R <u>INSPRU 1.1.72R</u> .
<i>actuarial valuation date</i>	(in PRU) the date as at which the <i>mathematical reserves</i> are calculated.
<i>admissible asset</i>	<ol style="list-style-type: none">(1) (in LLD for the purpose of the <i>rules in GENPRU and INSPRU as they apply to members of the Society of Lloyd's, the Society and managing agents</i>) an asset that falls into one or more categories in <u>GENPRU 2 Ann 74R</u> as modified by LLD 19.3.19R <u>GENPRU 2.3.34R</u>.(2) otherwise:<ol style="list-style-type: none">(a) (in relation to an <i>insurer</i> which is not a <i>pure reinsurer</i>) an asset that falls into one or more categories in <u>GENPRU 2 Ann 74R</u>; or(b) ...
<i>ancillary risk</i>	in relation to an <i>insurer</i> with <i>permission</i> under the <i>Act</i> to insure a principal risk belonging to one <i>class</i> (as defined for the purposes of <i>AUTH, PRU, LLD INSPRU</i> and <i>SUP</i>) of <i>general insurance business</i>) a risk included in another such class which is:...
<i>annualised net written premiums</i>	(for the purposes of PRU 7.5 <u>INSPRU 1.4</u>) in relation to a financial year, ...
<i>approved derivative</i>	... <ol style="list-style-type: none">(2) (in <u>INSPRU</u>) a <i>derivative</i> in respect of which the conditions in PRU 4.3.5 R <u>INSPRU 3.2.5R</u> are met.
<i>approved quasi-derivative</i>	a <i>quasi-derivative</i> in respect of which the conditions in PRU 4.3.5 R <u>INSPRU 3.2.5R</u> are met.
<i>Approved security</i>	<ol style="list-style-type: none">(1) ...(2) (in LLD and <u>INSPRU</u>) any of the following: ...
<i>approved stock lending</i>	a <i>stock lending</i> transaction in respect of which the conditions in PRU 4.3.36 R <u>INSPRU 3.2.36R</u> have been met.

<i>transaction</i>	
<i>assessable mutual</i>	(for the purposes of PRU 7.5 <u>INSPRU 1.4</u>) ...
<i>asset management company</i>	(for the purpose of ELM and PRU and in accordance with Article 2(5) of the <i>Financial Groups Directive</i> (Definitions)) ...
<i>asset-related capital requirement</i>	... as set out in PRU 3.3 <u>INSPRU 2.2</u> .
<i>balancing amount</i>	(in LLD) in respect of a <i>syndicate</i> , ...
<i>Broker</i>	(in <i>MAR</i> and <u>INSPRU</u>) any person when dealing as agent.
<i>brought forward amount</i>	an amount, as defined in PRU 7.2.51R <u>INSPRU 1.1.51R</u> , ...
<i>Byelaw</i>	(in LLD) any Byelaw, direction, regulation or other instrument...
<i>callable contribution</i>	(in LLD) amounts that <i>members</i> are liable to pay ...
<i>central assets</i>	(in LLD) the <i>Society's</i> own assets ...
<i>Central Fund</i>	(in LLD) the Central Fund ...
<i>claim</i>	(1) ... (2) (in <i>COB</i> , <i>ICOB</i> , <u>INSPRU</u> , LLD , <i>SUP</i> and <i>TC</i>) a claim under a <i>contract of insurance</i> .
<i>claims amount</i>	an amount, as defined in PRU 7.2.47R <u>INSPRU 1.1.47R</u> , ...
<i>class</i>	(1) (in <i>AUTH</i> , PRU , LLD <u>GENPRU</u> , <u>INSPRU</u> and <i>SUP</i>) (in relation to a <i>contract of insurance</i>) any class ...
<i>closed</i>	(in LLD) (in relation to a <i>syndicate year</i>) closed by ...
<i>collateral</i>	... (3) (in <u>INSPRU</u>) ...
<i>commitment</i>	a commitment represented by <i>insurance business</i> of any of the <i>classes</i> (as defined for the purposes of <i>AUTH</i> , PRU , LLD <u>INSPRU</u> and <i>SUP</i>) of <i>long-term insurance business</i> .
<i>contingency funding plan</i>	a plan ... prepared under PRU 5.1.86E <u>SYSC 11.1.24E</u> .
<i>core provision</i>	(in LLD) (as defined in section 316(3) of the <i>Act</i> (Direction by Authority)) a provision ...
<i>counterparty</i>	(1) (in LLD) (in relation to the <i>Society</i> , a <i>syndicate</i> or <i>member</i>): (a) any individual; or

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

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

(2) ~~(in PRU~~ for the purposes of the *rules* relating to *insurers* in GENPRU and INSPRU) (in relation to an *insurer*, the Society, a syndicate or member ('A')):

- (a) any one individual; or
- (b) any one unincorporated body of *persons*; or
- (c) any company which is not a member of a *group*; or
- (d) any *group* of companies excluding:
 - (i) (for the purposes of ~~PRU 3.2~~ INSPRU 2.1) any companies within the *group* which are *subsidiary undertakings* of the ~~insurer A~~ and which fall within ~~PRU 1.3.31R~~ GENPRU 1.3.43R; and
 - (ii) (for all other purposes) any companies within the *group* which are *subsidiary undertakings* of the ~~insurer A~~; or
- (e) any government of a State together with all the public bodies, local authorities or nationalised industries of that State,

in which the ~~insurer A~~, or any of its *subsidiary undertakings*, has made investments or against whom, or in respect of whom, it, or any of its *subsidiary undertakings*, has rights or obligations under a contract entered into by the ~~insurer A~~ or any of its *subsidiary undertakings*.

credit equalisation provision

the provision required to be established by ~~PRU 7.5.43R~~ INSPRU 1.4.43R.

<i>Disciplinary Tribunal</i>	(in LLD) a Tribunal appointed ...
<i>discounting</i>	(in PRU) discounting or deductions ...
<i>EEA MCR</i>	the <i>MCR</i> ... in accordance with PRU 7.6.46R <u>INSPRU 1.5.46R</u> .
<i>enhanced capital requirement</i>	(1) (in relation to a <i>firm</i> carrying on <i>general insurance business</i>) the amount calculated in accordance with PRU 2.3.11R <u>INSPRU 7.1.11R</u> . (2) (in relation to a <i>firm</i> carrying on <i>long-term insurance business</i>) the amount of <i>capital resources</i> that a <i>firm</i> must hold as set out in PRU 2.1.34R <u>GENPRU 2.1.38R</u> .
<i>equalisation provision</i>	a provision required to be established under the <i>rules</i> in <u>INSPRU 7.5 1.4</u> .
<i>equity market adjustment ratio</i>	(1) (in relation to the <i>resilience capital requirement</i>) has the meaning set out in PRU 4.2.19R <u>INSPRU 3.1.19R</u> . (2) (in relation to the <i>market risk</i> scenario for the <i>risk capital margin</i> of a <i>with-profits fund</i>) has the meaning set out in PRU 7.4.71 R <u>INSPRU 1.3.71R</u> .
<i>financial year</i>	(1) ... (2) (in LLD) a calendar year (3) (in <u>GENPRU</u> and <u>INSPRU</u>) the period at the end of which the balance of the accounts of the <i>insurer</i> is struck...
<i>financial year in question</i>	(for the purposes of PRU 7.2 <u>INSPRU 1.1</u> and of the definition of <i>non-directive insurer</i>)...
<i>former member</i>	(in LLD) a <i>person</i> who has ceased to be a <i>member</i> , ...
<i>general insurance capital requirement</i>	The highest of the <i>premiums amount</i> , <i>claims amount</i> and <i>brought forward amount</i> as set out in PRU 7.2 <u>INSPRU 1.1</u> .
<i>gross adjusted claims amount</i>	(for the purposes of PRU 7.2 <u>INSPRU 1.1</u>) an amount, as defined in PRU 7.2.60R <u>INSPRU 1.1.60R</u> to PRU 7.2.65G <u>INSPRU 1.1.65G</u> , used in calculating the <i>claims amount</i> .
<i>gross adjusted premiums amount</i>	(for the purposes of PRU 7.2 <u>INSPRU 1.1</u>) an amount as defined in PRU 7.2.56R <u>INSPRU 1.1.56R</u> to PRU 7.2.59G <u>INSPRU 1.1.59G</u> , used in calculating the <i>premiums amount</i> .
<i>group capital resources</i>	in relation to an <i>undertaking</i> in PRU 8.3.17R <u>INSPRU 6.1.17R</u> , that <i>undertaking's</i> group capital resources as calculated in accordance with PRU 8.3.36R <u>INSPRU 6.1.36R</u> .
<i>group capital resources requirement</i>	in relation to an <i>undertaking</i> in PRU 8.3.17R <u>INSPRU 6.1.17R</u> , that <i>undertaking's</i> group capital resources requirement as calculated in

accordance with ~~PRU 8.3.33R~~INSPRU 6.1.33R.

guarantee fund

(1)

(a) ...

(b) where the *firm* is required to calculate a *UK MCR* or an *EEA MCR* under ~~PRU 7.2~~ INSPRU 1.1, for the purposes of that section...

(2)

(a) ...

(b) where the *firm* is required to calculate a *UK MCR* or an *EEA MCR* under ~~PRU 7.6~~ INSPRU 1.5, for the purposes of that section...

and the reference to the *base capital resources requirement* is replaced by the amount which is one half of the *base capital resources requirement* applicable to the *firm* set out in ~~PRU 2.1.26R~~GENPRU 2.1.29R.

IBNR

(in relation to *claims* (as defined for the purposes of INSPRU, ~~LLD~~, *SUP* and *TC*)) *claims* that have been incurred but not reported...

implicit items

(in relation to *long-term insurance business*) economic reserves arising in respect of future profits, *zillmerising* or hidden reserves as more fully described in GENPRU 2 Annex 2 Ann 8G.

individual capital resources requirement

has the meaning in ~~PRU 8.3.34R~~INSPRU 6.1.34R.

individual member

(~~in LLD~~) a *member*, ...

insurance business grouping

a grouping comprising descriptions of *general insurance business* determined in accordance with ~~PRU 7.5.12R~~INSPRU 1.4.12R.

insurance death risk capital component

one of the components of the *long-term insurance capital requirement* as set out in ~~PRU 7.2.81R~~INSPRU 1.1.81R to ~~PRU 7.2.83R~~INSPRU 1.1.83R.

insurance expense risk capital component

one of the components of the *long-term insurance capital requirement* as set out in ~~PRU 7.2.88R~~INSPRU 1.1.88R.

insurance health risk capital component

one of the components of the *long-term insurance capital requirement* as set out in ~~PRU 7.2.85R~~INSPRU 1.1.85R to ~~PRU 7.2.86R~~INSPRU 1.1.86R.

insurance market risk capital component

one of the components of the *long-term insurance capital requirement* as set out in ~~PRU 7.2.89R~~INSPRU 1.1.89R.

insurance related

a component of the calculation of the *ECR* for a *firm* carrying on

<i>capital requirement</i>	<i>general insurance business</i> as set out in PRU 7.2.76R <u>INSPRU 1.1.76R</u> to PRU 7.2.79R <u>INSPRU 1.1.79R</u> .
<i>listed</i>	(1) (except in <i>LR</i> , <i>ENF</i> 21 and <u>INSPRU</u>) included in an <i>official list</i> . (2) (in <u>INSPRU</u>) ...
<i>Lloyd's member's contribution</i>	(in LLD) assets:...
<i>Lloyd's Return</i>	the financial report that the <i>Society</i> is required to submit to the <i>FSA</i> under LLD 15.2.1R <u>IPRU(INS) 9.48(1)</u> .
<i>Lloyd's trust deed</i>	(in LLD) a trust deed ...
<i>Lloyd's trust fund</i>	(in LLD) a fund held on the terms of ...
<i>long-term insurance asset</i>	has the meaning set out in PRU 7.6.21R <u>INSPRU 1.5.21R</u> .
<i>long-term insurance capital requirement</i>	... the <i>firm</i> must hold calculated in accordance with PRU 2.1.32R <u>GENPRU 2.1.36R</u> .
<i>long-term insurance fund</i>	has the meaning set out in PRU 7.6.22R <u>INSPRU 1.5.22R</u> .
<i>management expenses</i>	(1) (except in <u>INSPRU</u>)... (2) (in <u>INSPRU</u>) ...
<i>minimum capital requirement</i>	an amount of capital resources that a <i>firm</i> must hold as set out in PRU 2.1.21R <u>GENPRU 2.1.24R</u> and PRU 2.1.22R <u>GENPRU 2.1.25R</u> .
<i>minimum guarantee fund</i>	(in LLD) ...
<i>non-credit equalisation provision</i>	the provision required to be established under PRU 7.5.17R <u>INSPRU 1.4.17R</u> .
<i>parent undertaking</i>	... (a) ... (i) (vii) (except in <i>REC</i> and LLD or for the purposes of the <u>rules in GENPRU and INSPRU as they apply to members of the Society of Lloyd's or to the Society or managing agents in respect of members</u>) he is an

individual and would be a *parent undertaking* if he were an *undertaking*; or

- (viii) (except in REC and ~~LLD~~ or for the purposes of rules in GENPRU and INSPRU as they apply to members of the Society of Lloyd's or to the Society or managing agents in respect of members) it is incorporated in or formed under the law of another *EEA State* and is a parent undertaking within the meaning of any rule of law in that State for purposes connected with the implementation of the Seventh Company Law Directive;

...

<i>premiums amount</i>	(for the purposes of PRU 7.2 <u>INSPRU 1.1</u>), an amount, as defined in PRU 7.2.45R <u>INSPRU 1.1.45R</u> ...
<i>real estate market adjustment ratio</i>	has the meaning set out, in relation to the <i>resilience capital requirement</i> , in PRU 4.2.21R <u>INSPRU 3.1.21R</u> .
<i>realistic basis life firm</i>	a <i>firm</i> to which PRU 2.1.15R <u>GENPRU 2.1.18R</u> applies (and which is therefore required to calculate a <i>with-profits insurance capital component</i> in accordance with PRU 7.4 <u>INSPRU 1.3</u>).
<i>realistic current liabilities</i>	(in relation to a <i>with-profits fund</i>) the realistic current liabilities of the <i>with-profits fund</i> calculated in accordance with PRU 7.4.190R <u>INSPRU 1.3.190R</u> .
<i>realistic excess capital</i>	(in relation to a <i>with-profits fund</i>) the excess, if any, of the <i>realistic value of assets</i> for the <i>with-profits fund</i> over the sum of the <i>realistic value of liabilities</i> and the <i>risk capital margin</i> for that fund, calculated in accordance with PRU 7.4.32R <u>INSPRU 1.3.32R</u> .
<i>realistic value of assets</i>	(in relation to a <i>with-profits fund</i>) has the meaning set out in PRU 7.4.33R <u>INSPRU 1.3.33R</u> .
<i>receivable</i>	(in LLD) (in relation to a <i>member</i> , a period and a <i>premium</i>) ...
<i>regulated market</i>	(1) ... (2) (in <u>INSPRU</u>) ...
<i>regulatory current liabilities</i>	(in relation to a <i>with-profits fund</i>) the regulatory current liabilities of the <i>with-profits fund</i> calculated in accordance with PRU 7.4.30R <u>INSPRU 1.3.30R</u> .
<i>regulatory excess capital</i>	(in relation to a <i>with-profits fund</i>) has the meaning set out in PRU 7.4.32R <u>INSPRU 1.3.32R</u> .
<i>regulatory surplus value</i>	has the meaning set out in PRU 1.3.36R <u>GENPRU 1.3.48R</u> .
<i>regulatory value of</i>	(in relation to a <i>with-profits fund</i>) has the meaning set out in PRU

<i>assets</i>	7.4.24R <u>INSPRU 1.3.24R</u> .
<i>regulatory value of liabilities</i>	(in relation to a <i>with-profits fund</i>) has the meaning set out in PRU 7.4.29R <u>INSPRU 1.3.29R</u> .
<i>relevant capital sum</i>	for the purposes of PRU 7.3.43R <u>INSPRU 1.3.43R</u> , ...
<i>resilience capital requirement</i>	the capital component for <i>long-term insurance business</i> calculated in accordance with the rules in PRU 4.2.9G <u>INSPRU 3.1.9G</u> to PRU 4.2.26R <u>INSPRU 3.1.26R</u> .
<i>risk capital margin</i>	the risk capital margin for a <i>with-profits fund</i> calculated in accordance with the rules in PRU 7.4.43R <u>INSPRU 1.3.43R</u> to PRU 7.4.103G <u>INSPRU 1.3.103G</u> .
<i>secured debt</i>	(in PRU) a debt fully secured on:...
<i>Society GICR</i>	(in LLD) the <i>general insurance capital requirement</i> calculated by the <i>Society</i> as if it were an <i>insurer</i> under LLD 19.2.13R <u>GENPRU 2.3.13R</u> .
<i>syndicate assets</i>	(in LLD) assets managed by or at the direction of ...
<i>syndicate ICA</i>	(in LLD) the capital assessment performed by a <i>managing agent</i> under PRU 1.2.26R <u>the overall Pillar 2 rule</u> , LLD 18.2.1R(1) <u>GENPRU 1.5.1R(1)</u> , PRU 2.3 <u>INSPRU 7.1</u> and LLD 19.4.1R(1) <u>INSPRU 1.1.57R(1)</u> in respect of each <i>syndicate</i> managed by it.
<i>technical provision</i>	(in PRU) a technical provision established: <ul style="list-style-type: none"> (a) for <i>general insurance business</i>, in accordance with PRU 7.2.12R <u>INSPRU 1.1.12R</u>; and (b) for <i>long-term insurance business</i>, in accordance with PRU 7.2.16R <u>INSPRU 1.1.16R</u>.
<i>total group tier one capital</i>	the sum calculated at stage A of the calculation in PRU 8.3.43R <u>INSPRU 6.1.43R</u> .
<i>total group tier two capital</i>	the sum calculated at stage B of the calculation in PRU 8.3.43R <u>INSPRU 6.1.43R</u> .
<i>UK MCR</i>	the <i>MCR</i> calculated in accordance with PRU 7.6.44R <u>INSPRU 1.5.44R</u> ...
<i>unpaid initial fund</i>	part of the <i>initial fund</i> of a <i>mutual</i> which the <i>mutual</i> is prevented from including in its <i>tier one capital resources</i> as <i>permanent share capital</i> by reason of PRU 2.2.29R <u>GENPRU 2.2.64R</u> because it is not fully paid.
<i>with-profits benefits reserves</i>	(in relation to a <i>with-profits fund</i>) the with-profits benefits reserve for the <i>with-profits fund</i> calculated in accordance with the rules in PRU 7.4.116R <u>INSPRU 1.3.116R</u> to PRU 7.4.135G <u>INSPRU</u>

1.3.135G.

with-profits fund

(1) ...

(2) for the purposes of INSPRU, a long-term insurance fund...

*with-profits insurance
capital component*

the capital component for *with-profits insurance business* of a *realistic basis life firm* calculated in accordance with ~~PRU 7.4~~ INSPRU 1.3.

Part 2B (Revised definitions taking effect on 1 January 2007)

Amend the following definitions in the Glossary as shown:

- ancillary insurance services undertaking* (1) (in relation to any *undertaking* in a *consolidation group*, *sub-group* or other group of *persons*) an *undertaking* complying with the following conditions:
- (a) its principal activity consists of:
 - (i) owning or managing property; or
 - (ii) managing data-processing services; or
 - (iii) any other similar activity;
 - (b) the activity in (a) is ancillary to the principal activity of one or more *insurance undertakings*; and
 - (c) those *insurance undertakings* are also members of that *consolidation group*, *sub-group* or other group of *persons*; ~~and~~
 - (d) ~~(for the purpose of PRU 8.4 (Cross sector groups), PRU 8.5 (Third country groups), PRU 8 Ann 1R (Capital adequacy calculations for financial conglomerates) and PRU 8 Ann 2R (Prudential rules for third country groups) it is not an *ancillary banking services undertaking*.~~
- ancillary services undertaking* (1) ~~an *ancillary insurance services undertaking*, an *ancillary banking services undertaking* or an *ancillary investment services undertaking*~~ (in accordance with Article 4(21) of the *Banking Consolidation Directive* (Definitions) and subject to (2)) and in relation to an *undertaking* in a *consolidation group*, *sub-group* or another group of *persons*) an *undertaking* complying with the following conditions:
- (a) its principal activity consists of:
 - (i) owning or managing property; or
 - (ii) managing data-processing services; or
 - (iii) any other similar activity;
 - (b) the activity in (a) is ancillary to the principal activity of one or more *credit institutions* or *investment firms*; and

(c) those credit institutions or investment firms are also members of that consolidation group, subgroup or group.

(2) (for the purpose of GENPRU 1.3 (Valuation) and INSPRU 6.1 (Group Risk: Insurance Groups) an undertaking in (1) and an ancillary insurance services undertaking.

applicable sectoral consolidation rules

(in respect of a *financial sector* and in accordance with paragraph 6.940 of GENPRU 38 Ann 1R (Applicable sectoral consolidation rules)) the *FSA's sectoral rules* about capital adequacy and solvency on a consolidated basis applicable to that *financial sector* under the table in paragraph 6.1044 of GENPRU 38 Ann 1R.

applicable sectoral rules

(in respect of a *financial sector*) *applicable sectoral consolidation rules* for that *financial sector* and the *FSA's sectoral rules* about capital adequacy and solvency for: ~~applicable to that *financial sector* under the table in paragraph 6.28 of GENPRU 38 Ann 1R;~~

(a) the banking and investment services sector as set out in paragraph 6.2 of GENPRU 3 Ann 1R; or

(b) insurance undertakings;

which of those sets of *rules* apply for the purpose of a particular calculation depends on the nature of that calculation.

asset management company

~~(in accordance with Article 2(5) of the *Financial Groups Directive (Definitions)*)~~ a management company within the meaning of Article 1a(2) of the *UCITS Directive*, as well as an *undertaking* the registered office of which is outside the *EEA* and which would require authorisation in accordance with Article 5(1) of the *UCITS Directive* if it had its registered office within the *EEA*.

bank

(a) a *firm* with a *Part IV permission* which includes *accepting deposits*, and:

(i) which is a *credit institution*; or

(ii) whose *Part IV permission* includes a *requirement* that it comply with ~~*IPRU(BANK)*~~ the rules in *GENPRU* and *BIPRU* relating to banks;

but which is not a *building society*, a *friendly society* or a *credit union*;

(b) ...

<i>banking and investment group</i>	<p>a group of <i>persons</i> (at least one of which is an <i>EEA regulated entity</i> that is a <i>credit institution</i> or an <i>investment firm</i>) who:</p> <ul style="list-style-type: none"> (a) form a group in respect of which the consolidated capital adequacy requirements for the <i>banking sector</i> or the <i>investment services sector</i> under: <ul style="list-style-type: none"> (i) the <i>FSA's sectoral rules</i>; or (ii) the <i>sectoral rules</i> of another <i>competent authority</i>; apply; or (b) would form such a group if the scope of those <i>sectoral rules</i> were amended as described in paragraph 3.1 of <u>GENPRU 38</u> Ann 2R (removing restrictions relating to place of incorporation or head office of members of those <i>financial sectors</i>).
<i>Banking Consolidation Directive</i>	<p>the Council Directive of the <u>European Parliament and the Council of 14 June 2006</u> 20 March 2006 relating to the taking up and pursuit of the business of credit institutions (No 2000/12/2006/48/EC).</p>
<i>banking sector</i>	<p>a sector composed of one or more of the following entities:</p> <ul style="list-style-type: none"> (a) a <i>credit institution</i>; (b) a <i>financial institution</i>; and (c) an <i>ancillary banking services undertaking</i> that is <u>not an ancillary insurance services undertaking</u>.
<i>base capital resources requirement</i>	<p>an amount of <i>capital resources</i> that a firm an <i>insurer</i> must hold as set out in <u>GENPRU 2.1.2630R</u> (Table: Base capital resources requirement for an insurer) or a <i>BIPRU firm</i> must hold under <u>GENPRU 2.1.41R</u> (Base capital resources requirement for a <i>BIPRU firm</i>) and <u>GENPRU 2.1.48R</u> (Table: Base capital resources requirement for a <i>BIPRU firm</i>) or, as the case may be, <u>GENPRU 2.1.60R</u> (Calculation of the base capital resources requirement for banks authorised before 1993).</p>
<i>base currency</i>	<ul style="list-style-type: none"> (1) (in <i>COLL</i> and <i>CIS</i>) the currency specified: <ul style="list-style-type: none"> (a) ... (b) ... (2) (in <i>ELM</i>, <i>GENPRU</i> and <i>BIPRU</i>) (in relation to an <i>ELMI firm</i>) the currency in which that <i>ELMI's firm's</i> books of account are drawn up.

BCD credit institution a *credit institution* that has its registered office (or, if it has no registered office, its head office) in an *EEA State*, excluding an institution to which the *BCD* does not apply under article 2(3) of the *BCD* (see also *full BCD credit institution*).

Capital Adequacy Directive the ~~Council~~ Directive of the European Parliament and the Council of ~~15 March 1993~~ 14 June 2006 on capital adequacy of investment firms and credit institutions (No ~~93/6/EEC~~ 2006/49/EC).

capital resources

- (1) in relation to a *BIPRU firm* or an *insurer*, the *firm's* capital resources as calculated in accordance with the *capital resources table*, ~~PRU 2.2.12R~~ including, in relation to a *BIPRU firm*, as that calculation is adjusted under *BIPRU* 10.5 for the purposes of *BIPRU* 10 (Concentration risk requirements); or
- (2) (in relation to an *institution* that is an *EEA firm* and not a *BIPRU firm* and which is required to meet the capital resources requirements of the *CRD implementation measures* for its *EEA State* on an individual basis) capital resources calculated under those *CRD implementation measures*; or
- (3) (for the purposes of *GENPRU* and *BIPRU*, in relation to an *undertaking* not falling within (1) or (2) and subject to (4)), capital resources calculated in accordance with (1) on the assumption that:
 - (a) it is a *BIPRU firm* with a *Part IV permission*; and
 - (b) it carries on all its business in the *United Kingdom* and has obtained whatever *permissions* for doing so are required under the *Act*; or
- (4) (for the purposes of *GENPRU* and *BIPRU* and in relation to any *undertaking* not falling within (1) or (2) for which the methodology in (3) does not give an answer whose *capital resources* a *BIPRU firm* (the "relevant firm") is required to calculate under a *Handbook rule*) capital resources calculated under (1) on the assumption that it is a *BIPRU firm* of the same category as the relevant firm.

capital resources requirement an amount of capital resources that:

- (1) a *BIPRU firm* must hold as set out in the *main BIPRU firm Pillar 1 rules*; or
- (2) an *insurer* must hold as set out in ~~*PRU* 2.1.14R to *PRU* 2.1.20R~~ *GENPRU* 2.1.17R to *GENPRU* 2.1.23R.

<i>commodity</i>	<p>(1) <u>(except for the purpose of calculating <i>position risk requirements</i>) a physical asset (other than a financial instrument or cash) which is capable of delivery.</u></p> <p>(2) <u>(for the purpose of calculating <i>position risk requirements</i>) any of the following (but excluding gold):</u></p> <p style="margin-left: 2em;">(a) <u>a commodity within the meaning of paragraph (1); and</u></p> <p style="margin-left: 2em;">(b) <u>any:</u></p> <p style="margin-left: 4em;">(i) <u>physical or energy product; or</u></p> <p style="margin-left: 4em;">(ii) <u>of the items referred to in paragraph 10 of Section C of Annex I of the <i>MIFID</i> as an underlying with respect to the <i>derivatives</i> mentioned in that paragraph;</u></p> <p style="margin-left: 4em;"><u>which is, or can be, traded on a secondary market.</u></p>
<i>competent authority</i>	<p>(1) ...</p> <p>...</p> <p>(3) <u>(in relation to a group, and for the purposes of <i>PRU 8-1SYSC 12</i> (Group risk systems and controls requirement), <i>GENPRU 8.4</i> (Cross sector groups), <i>PRU 8.5</i> (Third country groups), <i>PRU 8 Ann 1R</i> (Capital adequacy calculations for financial conglomerates) and <i>PRU 8 Ann 2R</i>, <i>BIPRU</i> and <i>INSPRU</i>, any national authority ...</u></p>
<i>conglomerate capital resources</i>	<p>(in relation to a <i>financial conglomerate</i> with respect to which <i>GENPRU 3.1.298.4.29R</i> (Application of methods 1, 2 or 3 from Annex I of the <i>Financial Groups Directive</i>) applies) capital resources as defined in whichever of paragraphs 1.1, 2.1 or 3.1 of <i>GENPRU 3</i> Ann 1R (Capital adequacy calculations for financial conglomerates) applies with respect to that <i>financial conglomerate</i>.</p>
<i>conglomerate capital resources requirement</i>	<p>(in relation to a <i>financial conglomerate</i> with respect to which <i>GENPRU 3.1.298.4.29R</i> (Application of methods 1, 2 or 3 from Annex I of the <i>Financial Groups Directive</i>) applies) the capital resources requirement defined in whichever of paragraphs 1.3, 2.4 or 3.3 of <i>GENPRU 3</i> Ann 1R (Capital adequacy calculations for financial conglomerates) applies with respect to that <i>financial conglomerate</i>.</p>
<i>consolidation group</i>	<p>the following:</p> <p style="margin-left: 2em;">(a) <u>a <i>conventional group</i>; or</u></p>

- (b) *undertakings* linked by a *consolidation Article 12(1) relationship* or (for the purposes of *BIPRU*) an *Article 134 relationship*.

If a *parent undertaking* or *subsidiary undertaking* in a *conventional group* (the first person) has a *consolidation Article 12(1) relationship* or (for the purposes of *BIPRU*) an *Article 134 relationship* with another *person* (the second person), the second person (and any *subsidiary undertaking* of the second person) is also a member of the same *consolidation group*.

conventional group

~~for the purposes of PRU 8 (Group Risk))~~ a group of *undertakings* that consists of a *parent undertaking* and the rest of its *sub-group*.

core tier one capital

an item of capital that is stated in stage A of the *capital resources table* ~~table in PRU 2.2.14R~~ (*Core tier one capital*) to be core tier one capital.

counterparty

- (1) (in *UPRU*) ...;
- (2) (for the purposes of the *rules* relating to *insurers* in *GENPRU* and *BIPRU* ...
- (3) (for the purposes of the *rules* relating to *BIPRU firms* in *GENPRU* and *BIPRU* and in relation to an *exposure* of a *person* ('A')) the *counterparty* with respect to that *exposure* or, if the context requires, another *person* in respect of whom, under that *exposure*, A is exposed to credit risk or the risk of loss if that *person* fails to meet its obligations, such as the issuer of the underlying security in relation to a *derivative* held by A.

credit institution

~~(as defined in accordance with articles 14(1) and 107 of the BCD);~~

- (1) an *undertaking* whose business is to receive deposits or other repayable funds from the public and to grant credits for its own account; or
- (2) an electronic money institution within the meaning of the *E-Money Directive*;

but so that:

- (3) ~~(except for the purposes of *GENPRU*, *ELM* and *BIPRU*) excluding~~ an institution within (2) that does not have the right to benefit from the mutual recognition arrangements under *BCD* is excluded; and
- (4) for the purposes of *BIPRU* 10 (Concentration risk requirements) it means:

- (a) a credit institution as defined by (1) to (2) that has been authorised in an EEA State; or
- (b) any private or public undertaking which meets the definition in (1) – (2) and which has been authorised in a non-EEA state.

(see also *BCD credit institution, full credit institution, full BCD credit institution and Zone A credit institution.*)

EEA banking and investment group

...

- (c) it is otherwise required by *EEA prudential sectoral legislation* for the *banking sector* or the *investment services sector* (except Article 56a 143 of the *Banking Consolidation Directive* (Third-country parent undertakings)) to be subject to consolidated supervision by a *competent authority*.

EEA firm

...

- (b) a *credit institution* (as defined in article 14(1) of the *Banking Consolidation Directive*) which is authorised (within the meaning of article 4(2)) by its *Home State regulator*;
- (c) a *financial institution* (as defined in article 14(5) of the *Banking Consolidation Directive*) which is a subsidiary of the kind mentioned in article 19 24 and which fulfils the conditions in articles 18 23 and 1924;

...

exempt CAD firm

- (1) ~~(in accordance with Article 2(2) of the *Capital Adequacy Directive* (Definitions)) a firm that satisfies the following conditions: (except in SYSC) has the meaning set out BIPRU 1.1.16R (Types of investment firm: exempt CAD firm) which is in summary an *investment firm* that satisfies certain specified conditions.~~
- (2) (in SYSC) a firm in (1) whose head office (or, if it has a registered office, that office) is in the United Kingdom.
 - (a) ~~it is an *ISD investment firm*;~~
 - (b) ~~it is not an *insurer*, a *bank*, a *building society* or an *ELMI*;~~

- (e) ~~its *permission* is subject to a *limitation* or *requirement* preventing it from holding *client money* or *clients' assets* and for that reason it may not at any time place itself in debit with its *clients*; and~~
- (d) ~~the only *core investment service* for which it has *permission* is receiving and transmitting on behalf of investors orders in relation to one or more of the instruments listed in Section B of the Annex to the *ISD*.~~

exposure

- (1) (in relation to a *firm* but subject to (2) and (3)) the maximum loss which the *firm* might suffer if:
 - (a) a counterparty or a group of connected counterparties fail to meet their obligations; or
 - (b) it realises assets or off-balance sheet positions.
- (2) (in accordance with Article 77 of the *Banking Consolidation Directive* and for the purposes of the calculation of the *credit risk capital component* and the *counterparty risk capital component* (including *BIPRU 3* (Standardised credit risk), *BIPRU 4* (The IRB approach), *BIPRU 5* (Credit risk mitigation) and *BIPRU 9* (Securitisation)) an asset or off-balance sheet item.
- (3) (for the purposes of *BIPRU 10* (Concentration risk requirements)) has the meaning in *BIPRU 10.2* (Identification of exposures).

financial conglomerate definition decision tree

the decision tree in *GENPRU 38* Ann 4R.

financial institution

- (1) (in accordance with paragraph 5(c) of Schedule 3 to the *Act* (EEA Passport Rights: EEA firm) and article 14(5) of the *Banking Consolidation Directive* (Definitions), but not for the purposes of *ELM*, *GENPRU*, *BIPRU* and *INSPRU 8* (Group risk)), an undertaking, other than a *credit institution*, the principal activity of which is to acquire holdings or to carry on one or more of the listed activities listed in points 2 to 12 of Annex I to the *BCD*, which is a subsidiary of the kind mentioned in article 19 24 of the *BCD* and which fulfils the conditions in that articles 18 and 19 of the *BCD*.
- (2) for the purposes of *ELM*, *GENPRU*, *BIPRU* and *INSPRU 8* (Group risk) and in accordance with Articles 1(3) (Scope) and 14(5) (Definitions) and 2(2) (Scope) of the *Banking Consolidation Directive*) the following:

- (a) an *undertaking*, other than a *credit institution*, the principal activity of which is to acquire holdings or to carry on one or more of the *listed activities* listed in points 2 to 12 of Annex I to the *Banking Consolidation Directive* including the services and activities provided for in Sections A and B of Annex I of the MIFID when referring to the financial instruments provided for in Section C of Annex I of that Directive;
- (b) (for the purposes of consolidated requirements) those institutions permanently excluded by Article paragraph 2(3) of the Banking Consolidation Directive (Scope), with the exception of the central banks ~~central banks~~ of ~~Member EEA States~~, but so that, so far as this paragraph (b) applies for the purposes of *ELM*, it ~~only applies for the purposes of chapter 7 (Consolidated financial supervision) of ELM~~; and
- (c) ...
- financial instrument* (1) (other than for the purposes of BIPRU and GENPRU) as defined in Article 5 of the Prescribed Markets and Qualifying Investments Order and Article 1(3) of the Market Abuse Directive, and which consequently carries the same meaning in the Buy-back and Stabilisation Regulation);
- (a) ...
- ...
- (2) (for the purposes of BIPRU and GENPRU) an instrument listed in Section B of the Annex to the ISD.
- financial sector* (1) ~~one of the banking sector, the insurance sector or the investment services sector. (subject to (2))~~ one of the banking sector, the insurance sector or the investment services sector.
- (2) (for the purposes of the definition of financial conglomerate and for any other provision of GENPRU 3 that treats the banking sector and the investment services sector as one) one of the banking and investment services sector or the insurance sector.
- foreign currency* (in *ELM*, *GENPRU* and *BIPRU*) (in relation to an *ELMI firm*) any currency other than the *base currency*.

*FSA regulated EEA
financial conglomerate*

a *financial conglomerate* (other than a *third-country financial conglomerate*) that satisfies one of the following conditions:

- (a) ~~GENPRU 3.1.268-4.26R~~ or ~~GENPRU 3.1.298-4.29R~~ (Capital adequacy calculations for *financial conglomerates*) applies with respect to it; or
- (b) a *firm* that is a member of that *financial conglomerate* is subject to obligations imposed through its *Part IV permission* to ensure that that *financial conglomerate* meets levels of capital adequacy based or stated to be based on Annex I of the *Financial Groups Directive*.

group

- (1) (except in relation to an *ICVC* and except for the purposes of ~~PRU 8.1-SYSC 12~~ (Group risk systems and controls requirement) ...

...

- (3) (for the purposes of ~~PRU 8.1-SYSC 12~~ (Group risk systems and controls requirement) ...

immediate group

...

- (2) (in *ELM 7* and *BIPRU* and in relation to *any person*) has the same meaning as in paragraph (1), with the omission of (1)(e).

initial capital

- (1) (in *ELM*) ...

- (2) (in *UPRU*) ...

- ~~(2) (for the purposes of the definition of matched principal dealer, in accordance with Article 2(24) of the Capital Adequacy Directive (Definitions) and with respect to a firm) capital that is recognised for the purpose of the rules about capital adequacy to which that firm is subject but excluding, in accordance with items (1) and (2) of Article 34(2) of the Banking Consolidation Directive (General principles), anything that does not fall within the following classes of capital:~~

- ~~(a) capital within the meaning of Article 22 of the Bank Accounts Directive (Liabilities: Item 9-Subscribed capital), insofar as it has been paid up, plus share premium accounts but excluding cumulative preferential shares; or~~

(b) reserves within the meaning of Article 23 of the Bank Accounts Directive (Liabilities: Item 11—Reserves) and profits and losses brought forward as a result of the application of the final profit or loss. Interim profits can only be included before a formal decision has been taken only if these profits have been verified by persons responsible for the auditing of the accounts and if the amount thereof has been evaluated in accordance with the principles set out in the Bank Accounts Directive and is net of any foreseeable charge or dividend.

(3) (in the case of a BIPRU firm) capital resources included in stage A (Core tier one capital) of the capital resources table plus capital resources included in stage B of the capital resources table (Perpetual non-cumulative preference shares);

(4) (in the case of an institution that is an EEA firm) capital resources calculated in accordance with the CRD implementation measures of its Home State for Article 4 of the Capital Adequacy Directive (Definition of initial capital) or Article 9 of the Banking Consolidation Directive (Initial capital requirements); and

(5) (for the purposes of the definition of dealing on own account and in the case of an undertaking not falling within (3) or (4)) capital resources calculated in accordance with (3) and paragraphs (3) and (4) of the definition of capital resources.

In the case of a firm subject to the rules in chapter 10 of IPRU(INV), initial capital means initial capital as defined in the Glossary to that chapter.

innovative tier one capital an item of capital that is stated in ~~stage C of the table in GENPRU 2.2.14R~~ (Capital resources) to be innovative tier one capital.

innovative tier one capital resources the amount of *capital resources* at stage C of the *capital resources table* ~~table in PRU 2.2.14R~~ (Innovative tier one capital).

innovative tier one instrument a *potential tier one instrument* that is stated in ~~GENPRU 2.2.52R to PRU 2.2.69R~~ (Capital resources) to be an innovative instrument.

<i>insurance conglomerate</i>	<p>a <i>financial conglomerate</i> identified as an insurance conglomerate in the decision tree in paragraph 4.5 of PRU 8 Ann 1R (Decision tree for types of <i>financial conglomerate</i> and definition of <i>most important financial sector</i>) <u>a <i>financial conglomerate</i> that is identified in paragraph 4.3 of GENPRU 3 Ann 1R (Types of financial conglomerate) as an insurance conglomerate.</u></p>
<i>insurance holding company</i>	<p>(1)</p> <p>(2) For the purposes of:</p> <p style="padding-left: 40px;">(a) the definition of the <i>insurance sector</i>; and</p> <p style="padding-left: 40px;">(b) <u>ELM</u>; <u>and</u></p> <p style="padding-left: 40px;">(c) <u>the definition of <i>material insurance holding</i></u>;</p> <p style="padding-left: 80px;">paragraph (1)(b) of this definition does not apply.</p>
<i>insurance sector</i>	<p>a sector composed of one or more of the following entities:</p> <p style="padding-left: 40px;">(a) an <i>insurance undertaking</i>;</p> <p style="padding-left: 40px;">(b) an <i>insurance holding company</i>; and</p> <p style="padding-left: 40px;">(c) (in the circumstances described in <u>GENPRU 3.1.398-4.39R</u> (The financial sectors: Asset management companies)) an <i>asset management company</i>.</p>
<i>in the money</i>	<p>(1) (in <i>LR</i>) (in relation to securitised derivatives):</p> <p style="padding-left: 40px;">(a) ...</p> <p style="padding-left: 40px;">(b) ...</p> <p>(2) <u>(for the purposes of BIPRU 7 (Market risk) and in relation to an <i>option</i> or <i>warrant</i> the strike price of that <i>option</i> or <i>warrant</i> being less than the current market value of the underlying instrument (in the case of a call <i>option</i> or <i>warrant</i>) or vice versa (for a put <i>option</i>).</u></p>
<i>investment management firm</i>	<p>(1) <u>(except in SUP 16 and subject to BIPRU TP 1.3R (Revised definition of investment management firm for certain transitional purposes)), a <i>firm</i> whose <i>permitted activities</i> include <i>designated investment business</i>, which is not an <i>authorised professional firm</i>, <i>bank</i>, <u>BIPRU investment firm</u>, <i>ELMI</i>, <i>building society</i>, <i>credit union</i>, ...</u></p>

(2) (in SUP 16) as in (1) but excluding the words 'BIPRU investment firm'.

investment services sector a sector composed of one or more of the following entities:

- (a) an *investment firm*;
- (b) a *financial institution*; and
- (c) (in the circumstances described in GENPRU 3.1.398-4.39R (The financial sectors: Asset management companies)) an *asset management company*.

local (1) (except in BIPRU 1.1 (Application and purpose)) a firm which is a member of a futures and options exchange and whose permission includes a requirement that:

- (a) the *firm* will not conduct *designated investment business* other than:
 - (i) *dealing* for its own account on that *futures* or *options* exchange; or
 - (ii) *dealing* for the accounts of other members of the same *futures* and *options* exchange; or
 - (iii) making a price to other members of the same *futures* and *options* exchange; and
- (b) the performance of the *firm's* contracts must be guaranteed by and must be the responsibility of one or more of the clearing members of the same *futures* and *options* exchange.

(2) (in BIPRU 1.1 (Application and purpose) and in accordance with article 3(1)(p) of the *Capital Adequacy Directive* (Definitions)) an *undertaking* dealing for its own account on markets in financial-futures or options or other derivatives and on cash markets for the sole purpose of hedging *positions* on derivatives markets or which deals for the accounts of other members of those markets and which are guaranteed by clearing members of the same markets, where responsibility for ensuring the performance of contracts entered into by such an *undertaking* is assumed by clearing members of the same markets; for these purposes a clearing member means a member of the exchange or the clearing house which has a direct contractual relationship with the central counterparty (market guarantor).

lower tier two capital (1) (in *ELM*) ...

	(2) (in <i>BIPRU</i> , <i>GENPRU</i> and <i>INSPRU</i>) an item of capital that is specified in stage H of the <i>capital resources table</i> in PRU 2.2.14R (Lower tier two capital).
<i>lower tier two capital resources</i>	the sum calculated at stage H of the calculation in the <i>capital resources table</i> PRU 2.2.14R (Lower tier two capital).
<i>lower tier two instrument</i>	an item of capital that meets the conditions in GENPRU 2.2.10894R (Lower tier two capital) and is eligible to form part of a <i>firm's lower tier two capital resources</i> .
<i>material holdings</i>	(1) (in for the purposes of <i>ELM</i>) the a holdings and or positions set out in ELM <i>ELM</i> 2.4.17R (Material holdings). (2) (for the purposes of <i>GENPRU</i> and <i>BIPRU</i>) has the meaning in <i>GENPRU</i> 2.2.209R (Deductions from tiers one and two: Material holdings).
<i>mixed-activity holding company</i>	one of the following: (a) (in accordance with Article 4(22) 4(20) of the <i>Banking Consolidation Directive</i> (Definitions)) a <i>parent undertaking</i> , other than a <i>financial holding company</i> , a <i>credit institution</i> or a <i>mixed financial holding company</i> , the <i>subsidiary undertakings</i> of which include at least one <i>credit institution</i> ; or (b) (in accordance with Articles 7(3) 2(2) and 37(1) of the <i>Capital Adequacy Directive</i> (Supervision on a consolidated basis) and in relation to a <i>banking</i> and <i>investment group</i> without any <i>credit institutions</i> in it) a <i>parent undertaking</i> , other than a <i>financial holding company</i> , an <i>investment firm</i> or a <i>mixed financial holding company</i> , the <i>subsidiary undertakings</i> of which include at least one <i>investment firm</i> .
<i>mixed financial holding company</i>	(in accordance with Article 2(15) of the <i>Financial Groups Directive</i> (Definitions)) a <i>parent undertaking</i> , other than a <i>regulated entity</i> , which <u>meets the following conditions:</u> (a) <u>it, together with its <i>subsidiary undertakings</i>, at least one of which is an <i>EEA regulated entity</i>, and other entities, constitutes a <i>financial conglomerate</i>;</u> (b) <u>it has been notified by its <i>coordinator</i> that its group is a <i>financial conglomerate</i> in accordance with Article 4(2) of the <i>Financial Groups Directive</i>; and</u>

- (c) it has not been notified that its *coordinator* and other *relevant competent authorities* have agreed not to treat the group as a *financial conglomerate* in accordance with Article 3(3) of the *Financial Groups Directive*.

most important financial sector

(in relation to a *financial sector* in a *consolidation group* or a *financial conglomerate* and in accordance with GENPRU 3.18.4 (Cross sector groups)) the *financial sector* with the largest average referred to in the box titled Threshold Test 2 in the *financial conglomerate definition decision tree* (10% ratio of balance sheet size and solvency requirements) and so that ~~(a)~~ the *investment services sector* and the *banking sector* are treated as one for the purposes of the definition of *financial conglomerate* and for any other purpose that GENPRU 3.1 (Cross sector groups) says they are. ~~set out in PRU 8.4.7R (Definition of financial conglomerate: The financial sectors: General); and~~

- (b) ~~the definition is altered as set out in paragraph 4.4 and the decision tree in paragraph 4.5 of PRU 8 Ann 1R (Types of financial conglomerate and definition of most important financial sector) for the purposes set out in paragraph 4.4 of PRU 8 Ann 1R.~~

multilateral development bank

- (1) any of the following:

- (i) African Development Bank; ~~(AfDB)~~
- (ii) Asian Development Bank; ~~(ASB)~~
- (iii) Caribbean Development Bank; ~~(CDB)~~
- (iv) Council of Europe Development Bank;
- (v) European Bank for Reconstruction & Development; ~~(EBRD)~~
- (vi) European Investment Bank; ~~(EIB)~~
- (vii) European Investment Fund; ~~(EIF)~~
- (viii) Inter-American Development Bank; ~~(IADB)~~
- ~~Inter-American Investment Corporation (IAIC)~~
- (ix) International Bank for Reconstruction & Development ~~(IBRD)~~;
- (x) ~~including~~ International Financial Corporation; ~~(IFC)~~

(xi) Multilateral Investment Guarantee Agency; ~~(MIGA)~~ and

(xii) Nordic Investment Bank; ~~(NIB)~~

(2) for the purposes of the *standardised approach* to credit risk the following are considered to be a multilateral development bank:

(i) the Inter-American Investment Corporation;

(ii) the Black Sea Trade and Development Bank; and

(iii) the Central American Bank for Economic Integration

oil market participant

a *firm*:

(a) ...

(b) which is not an *authorised professional firm, bank, BIPRU investment firm, building society,* ...

option

the *investment*, specified in article 83 of the *Regulated Activities Order* (Options), which is an option to acquire or dispose of:

(a) ...

(b) ...

(c) ...

(d) an option to acquire or dispose of an option specified in (a), (b) or (c);

but so that for the purposes of calculating capital requirements for BIPRU firms and BIPRU 10 (Concentration risk requirements) it also includes any of the items listed in the table in BIPRU 7.6.18R (Option PRR: methods for different types of option) and any cash settled option.

overall financial sector

a sector composed of one or more the following types of entities:

(a) members of each of the *financial sectors*; and

(b) (except where GENPRU 3.18.4 (Cross sector groups) or GENPRU 38 Ann 1R (Capital adequacy calculations for financial conglomerates) provide otherwise) a *mixed financial holding company*.

- own funds* (1) own funds as described in articles ~~34~~56 to ~~39~~67 of the *Banking Consolidation Directive*.
- ...
- ownership share* (~~in ELM~~) in accordance with the definition of a "share" in section 422(6) of the *Act* (Controller):
- parent undertaking* ...
- (a) (in relation to whether an *undertaking*, other than an *incorporated friendly society*, is a *parent undertaking* and except for the purposes of ~~PRU 8.4 (Cross sector groups), PRU 8.5 (Third country groups), PRU 8 Ann 1R (Capital adequacy calculations for financial conglomerates) and PRU 8 Ann 2R (Prudential rules for third country groups described in (c))~~ an *undertaking* which has the following relationship to another *undertaking* ("S")):
- (i) ...
- (b) (in relation to whether an *incorporated friendly society* is a parent undertaking and except for the purposes of ~~PRU 8.4 (Cross sector groups), PRU 8.5 (Third country groups), PRU 8 Ann 1R (Capital adequacy calculations for financial conglomerates) and PRU 8 Ann 2R (Prudential rules for third country groups described in (c))~~ an *incorporated friendly society* which has the following relationship to a *body corporate* ("S")):
- (i) ...
- (c) (for the purposes of BIPRU, GENPRU and INSPRU as they apply on a consolidated basis, for the purposes of BIPRU 10 (Concentration risk requirements) and for the purposes of SYSC 12 (Group risk systems and controls requirement) ~~PRU 8.4 (Cross sector groups), PRU 8.5 (Third country groups), PRU 8 Ann 1R (Capital adequacy calculations for financial conglomerates) and PRU 8 Ann 2R (Prudential rules for third country groups)~~ and in relation to whether an *undertaking* is a parent undertaking) an *undertaking* which has the following relationship to another *undertaking* ("S")):
- (i) a relationship described in (a) other than (a)(vii); or

- (ii) it effectively exercises a dominant influence over S₂;

and so that ~~(e)(ii) applies also~~ (a)(v) does not apply for the purpose of BIPRU as it applies on a consolidated basis (including BIPRU 8 (Group risk - consolidation)) or BIPRU 10 -PRU 8.4 (Group risk systems and controls requirement).

participation

(for the purposes of *ELM*, *UPRU* and ~~*GENPRU-PRU 8 (Group risk)*~~ and for the purposes of *BIPRU* and *INSPRU* as they apply on a consolidated basis):

(a) ...

PD

- (1) (except in *GENPRU* and *BIPRU*) Prospectus Directive.
- (2) (in *GENPRU* and *BIPRU*) probability of default.

permanent share capital

an item of capital that is stated in *GENPRU 2.2.836R (Core tier one capital: permanent share capital)* to be permanent share capital.

personal investment firm

- (1) (except in *SUP 16* and subject to *BIPRU TP 1.3R (Revised definition of personal investment firm for certain transitional purposes)*) a firm whose permitted activities include designated investment business, which is not an authorised professional firm, bank, *BIPRU investment firm*, *ELMI*, building society, credit union, ...
- (2) (in *SUP 16*) as in (1) but excluding the words '*BIPRU investment firm*'.

potential tier one instrument

an item of capital that falls into *GENPRU 2.2.2762R (Tier one capital: General)*.

qualifying debt security

- (1) (for the purposes of ~~*ELM*~~ in *ELM*) a security falling into *ELM 3.3.9R (Liquid assets)*.
- (2) (for the purposes of *BIPRU*) a debt security that satisfies the conditions in *BIPRU 7.2.49R (Definition of a qualifying debt security)*.

recognised third country investment firm

~~(in *ELM*)~~ an *CAD investment firm* that satisfies the following conditions:

- (a) is subject to the prudential rules of one of the regulatory bodies in Appendix C in section 10 of chapter CS of *IPRU(BANK)*; and its head office is outside the *EEA*;

- (b) has its registered office (or, if it has no registered office, its head office) in the state in which that regulatory body is established; it is authorised by a *third country competent authority* in the state or territory in which the *CAD investment firm's* head office is located;
- (c) that *third country competent authority* is named in Part 2 of *BIPRU 8 Annex 6R (Non –EEA investment firm regulators' requirements deemed CRD- equivalent for individual risks)*; and
- (d) that *investment firm* is subject to and complies with prudential rules of or administered by that *third country competent authority* that are at least as stringent as those laid down in the *EEA prudential sectoral legislation for the investment services sector*.

regulated entity

one of the following:

- (a) a *credit institution*; or
- (b) a *regulated insurance entity*; or
- (c) an *investment firm*;

whether or not it is incorporated in, or has its head office in, an *EEA State*.

An *asset management company* is treated as a regulated entity for the purposes described in *GENPRU 3.1.128-4.39R* (The financial sectors: asset management companies).

sectoral rules

(in relation to a *financial sector*) rules and requirements relating to the prudential supervision of *regulated entities* applicable to *regulated entities* in that *financial sector* as follows:

- (a) (for the purposes of *GENPRU 3.1.128-4.12R* (Definition of financial conglomerate: Solvency requirement)) *EEA prudential sectoral legislation* for that *financial sector* together with as appropriate the rules and requirements in (c); or
- (b) (for the purpose of calculating *solo capital resources* and a *solo capital resources requirement*):

- (i) (to the extent provided for in paragraphs 6.5 to 6.6 of *GENPRU 3* of *PRU 8* Ann 1R) rules and requirements that are referred to in ~~those paragraphs~~ paragraph 6.6 of *PRU 8* Ann 1R (Solo capital resources requirement: Non-EEA firms subject to equivalent regimes); and
- (ii) the rules and requirements in (c); or
- (c) (for all other purposes) rules and requirements: of the *FSA*;
 - (i) ~~of the *FSA*~~; or
 - (ii) ~~of or administered by another competent authority~~;

and so that:

- (d) (in relation to prudential rules about consolidated supervision for any *financial sector*) those requirements include ones relating to the form and extent of consolidation;
- (e) (in relation to any *financial sector*) those requirements include ones relating to the eligibility of different types of capital;
- (f) (in relation to any *financial sector*) those requirements include both ones applying on a solo basis and ones applying on a consolidated basis;
- (g) (in relation to the *insurance sector*) references in this definition to consolidated supervision are to supplementary supervision, similar expressions being interpreted accordingly; and
- (h) references to the *FSA's sectoral rules* are to *sectoral rules* in the form of *rules*;

~~;~~ and

- (i) ~~(for the purpose of calculating solo capital resources and a solo capital resources requirement) the following undertakings are not subject to sectoral rules for the purposes of paragraphs 6.2, 6.3, 6.5 or 6.6 of *PRU 8* Ann 1R as the case may be and instead fall under paragraph 6.7 of *PRU 8* Ann 1R (Solo capital resources requirement: other members)~~;

- (i) ~~a *regulated entity* that is incorporated in, and has its head office in, one of the states or territories referred to in paragraph 6.5 of Part 6 of PRU 8 Ann 1R (Solo capital resources requirement: non-EEA firms subject to equivalent regimes), a *UK domestic firm* or an *EEA regulated entity* if it has an exemption from the *sectoral rules* referred to in paragraphs 6.2, 6.3 or 6.6 of PRU 8 Ann 1R as the case may be; and~~
- (ii) ~~a *regulated entity* that is incorporated in, and has its head office in, one of the states or territories referred to in paragraph 6.5 of Part 6 of PRU 8 Ann 1R if it is not subject to requirements that are equivalent to *EEA prudential sectoral legislation* applicable to its *financial sector*.~~

securities and futures firm (1) ~~(except in SUP 16 and subject to BIPRU TP 1.3R (Revised definition of securities and futures firm for certain transitional purposes)) a *firm* whose *permitted activities* include *designated investment business*, which is not an *authorised professional firm*, *bank*, *BIPRU investment firm*, *ELMI*, *building society*, *credit union*,
....~~

(2) ~~(in SUP 16) as in (1) but excluding the words '*BIPRU investment firm*'.~~

securitisation (1) ~~(subject to (2)) a process by which assets are sold to a bankruptcy-remote *special purpose vehicle* in return for immediate cash payment and that vehicle raises the immediate cash payment through the issue of debt securities in the form of tradable notes or commercial paper.~~

(2) ~~(in accordance with Article 4(36) of the *Banking Consolidation Directive* (Definitions) and in *BIPRU*) a transaction or scheme whereby the credit risk associated with an *exposure* or pool of *exposures* is *tranch*ed having the following characteristics:~~

- (a) ~~payments in the transaction or scheme are dependent upon the performance of the *exposure* or pool of *exposures*; and~~

- (b) the subordination of *tranches* determines the distribution of *losses* during the ongoing life of the transaction or scheme.

smallest financial sector

(in relation to a *financial sector* in a *consolidation group* or a *financial conglomerate* and in accordance with GENPRU 3.18.4 (Cross sector groups)) the *financial sector* with the smallest average referred to in the box titled Threshold Test 2 in the *financial conglomerate definition decision tree* (10% ratio of balance sheet size and solvency requirements), the *banking sector* and *investment services sector* being treated as one *financial sector* in the circumstances set out in GENPRU 3.18.4.

solo capital resources

- (1) (for the purposes of GENPRU 3 and INSPRU 6 ~~PRU 8~~ (Group risk) and in relation to a member of a *financial conglomerate* in the overall *financial sector*) capital resources that are or would be eligible as capital under the *sectoral rules* that apply for the purpose of calculating its *solo capital resources requirement*. Paragraph 6.89 of GENPRU 3 Ann 1R (Solo capital resources requirement: the insurance sector) applies for the purpose of this definition in the same way as it does for the definition of *solo capital resources requirement*.
- (2) for the purpose of BIPRU 10 (Concentration risk requirements) the definition in (1) is adjusted in accordance with BIPRU 10.8.13R (Calculation of capital resources for a UK integrated group) so that it means *capital resources* calculated in accordance with the *rules* applicable to the category of BIPRU firm identified by applying the procedure in BIPRU 8.6.6R to BIPRU 8.6.9R (Consolidated capital resources).

solo capital resources requirement

(for the purpose of PRU 8 (Group risk)) a capital resources requirement calculated on a solo basis as defined in paragraphs 6.2-6.9 of PRU 8 Ann 1R (Solo capital resources requirement: the insurance sector).

- (1) (for the purpose of GENPRU 3) a capital resources requirement calculated on a solo basis as defined in paragraph 6.2 to 6.7 of GENPRU 3 Ann 1R.
- (2) (for the purposes of INSPRU 6) a capital resources requirement calculated on a solo basis as defined in paragraph 6.2 to 6.7 of GENPRU 3 Ann 1R as it would apply if references to *financial conglomerate* in those paragraphs were replaced with references to *insurance group*.

- (3) (for the purposes of GENPRU 2.2.214R (Deductions from tiers one and two: Material holdings)) a capital resources requirement calculated on a solo basis as defined in paragraph 6.2 to 6.7 of GENPRU 3 Ann 1R as those paragraphs apply to the insurance sector.
- solvency deficit* (in GENPRU 38 Ann 1R (Capital adequacy calculations with respect to financial conglomerates) and in respect of a member of the overall financial sector) the amount (if any) by which its solo capital resources fall short of its solo capital resources requirement.
- specific risk* (1) (in SYSC) unique risk that is due to the individual nature of an asset and can potentially be diversified.
- (2) (in GENPRU and BIPRU and in accordance with paragraph 12 of Annex I of the Capital Adequacy Directive) the risk of a price change in an investment due to factors related to its issuer or, in the case of a derivative, the issuer of the underlying investment.
- sponsor* (1) (in LR) a person approved, under section 88 of the Act by the FSA, as a sponsor.
- (2) (in BIPRU), in accordance with Article 4(42) of the Banking Consolidation Directive (Definitions) and in relation to a securitisation within the meaning of paragraph (2) of the definition of securitisation) an undertaking other than an originator that establishes and manages an asset backed commercial paper programme or other securitisation scheme that purchases exposures from third party entities.
- step-up* (in relation to any item of capital) any change in the coupon rate on that item that results in an increase in the amount payable at any time, including a change already provided in the original terms governing those payments. A step-up:
- (1) (in relation to a tier one instrument) has the meaning set out in PRU 2.2.74R; and
- (2) (in relation to a tier two instrument) has the meaning set out in PRU 2.2.118R.
- (a) includes (in the case of a fixed rate) an increase in that coupon rate;
- (b) includes (in the case of a floating rate calculated by adding a fixed amount to a fluctuating amount) an increase in that fixed amount;

	(c) <u>includes (in the case of a floating rate) a change in the benchmark by reference to which the fluctuating element of the <i>coupon</i> is calculated that results in an increase in the absolute amount of the <i>coupon</i>; and</u>
	(d) <u>does not include (in the case of a floating rate) an increase in the absolute amount of the <i>coupon</i> caused by fluctuations in the fluctuating figure by reference to which the absolute amount of the <i>coupon</i> floats.</u>
<i>tier one capital</i>	(a) (in <i>ELM</i>) ... (b) (in <i>PRU BIPRU</i> , <i>GENPRU</i> and <i>INSPRU</i>) an item of capital that is specified in stages A (<u>Core tier one capital</u>), B (<u>Perpetual non-cumulative preference shares</u>) or C (<u>Innovative tier one capital</u>) of the <u>capital resources table</u> table in <i>PRU 2.2.14R</i> .
<i>tier one capital resources</i>	the sum calculated at stage F of the calculation in <u>the capital resources table</u> <i>PRU 2.2.14R</i> (Total tier one capital after deductions).
<i>tier one instrument</i>	an item of capital that falls into <i>GENPRU 2.2.2762R</i> (<u>Tier one capital: General</u>) and is eligible to form part of a <i>firm's tier one capital resources</i> .
<i>tier two capital</i>	(a) (in <i>ELM</i>) ... (b) (in <i>PRU BIPRU</i> , <i>GENPRU</i> and <i>INSPRU</i>) an item of capital that is specified in stages G (<u>Upper tier two capital</u>) or H (<u>Lower tier two capital</u>) of the <u>capital resources table</u> table in <i>PRU 2.2.14R</i> .
<i>tier two capital resources</i>	the sum calculated at stage I (<u>Total tier two capital</u>) of the calculation in <u>the capital resources table</u> <i>PRU 2.2.14R</i> .
<i>tier two instrument</i>	an item of capital <u>capital instrument</u> that meets the conditions in <i>GENPRU 2.2.10459R</i> (<u>General conditions for eligibility as tier two capital instruments</u>) or <i>GENPRU 2.2.10877R</i> (<u>Upper tier two capital: General</u>) and is eligible to form part of a <i>firm's tier two capital resources</i> .
<i>trading book</i>	(1) (in <i>UPRU</i>)

	(2)	<u>(in BIPRU and GENPRU and in relation to a BIPRU firm) has the meaning in BIPRU 1.2 (Definition of the trading book) which is in summary, all that firm's positions in CRD financial instruments and commodities held either with trading intent or in order to hedge other elements of the trading book, and which are either free of any restrictive covenants on their tradability or able to be hedged.</u>
	(3)	<u>(in BIPRU and GENPRU and in relation to a person other than a BIPRU firm) has the meaning in (2) with references to a firm replaced by ones to a person.</u>
<i>upper tier two capital</i>	(1)	(in ELM) ...
	(2)	<u>(in PRU BIPRU, GENPRU and INSPRU) an item of capital that is specified in stage G of the capital resources table (Upper tier two capital) table in PRU 2.2.14R.</u>
<i>upper tier two capital resources</i>		the sum calculated at stage G of the calculation in <u>the capital resources table (Upper tier two capital) PRU 2.2.14R.</u>
<i>upper tier two instrument</i>		an item of capital <u>capital instrument</u> that meets the conditions in <u>GENPRU 2.2.10+77R (Upper tier two capital: General)</u> and is eligible to form part of a <i>firm's upper tier two capital resources</i> .
<i>working day</i>	(1)	(in PR) ...
	(2)	<u>(in relation to an underwriter and for the purpose of BIPRU but not for the purpose of the definition of working day 0) the number of business days after working day 0 specified by the provision in question so that, for example, working day one means the business day following working day 0.</u>

Part 3A (Deletions taking effect on 31 December 2006)

Delete the following definitions from the Glossary; the text is not shown struck through.

LLD

minimum guarantee fund

Part 3B (Deletions taking effect on 1 January 2007)

Delete the following definitions from the Glossary; the text is not shown struck through.

ancillary banking services undertaking

ancillary investment services undertaking

arranger

bank consolidation rule

banking conglomerate

building society conglomerate

broker/manager

FSA consolidation rule

initial credit spread

investment services conglomerate

main investment services undertaking

matched principal broker

own account dealer

Annex B

Amendments to Threshold Conditions

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

Amend COND 2.4 as follows:

2.4 Threshold condition 4: Adequate resources

...

2.4.2 G (1) ...

(2) ...

(3) High level systems and control requirements are in SYSC. Detailed financial resources and systems requirements are in the relevant section of ~~IPRU or PRU~~ the Prudential Standards part of the Handbook, including specific provisions for particular types of *regulated activity*. ...

2.4.3 G (1) ...

(2) In particular, although it is the *firm* that is being assessed, the *FSA* may take into consideration the impact of other members of the *firm's group* on the adequacy of its resources. For example, the *FSA* may assess the consolidated solvency of the *group*. The *FSA's* approach to the consolidated supervision of a *firm* and its *group* is in the relevant part of ~~IPRU or PRU~~ the Prudential Standards part of the Handbook.

2.4.4 G (1) ...

(2) Relevant matters may include but are not limited to:

(a) whether there are any indications that the *firm* may have difficulties if the application is granted (see COND 2.4.6 G), at the time of the grant or in the future, in complying with any of the *FSA's* prudential *rules* (see the relevant part of ~~IPRU or PRU~~ the Prudential Standards part of the Handbook);

...

...

...

- 2.4.6 G (1) ...
- (2) As a result, the *FSA* would expect a *firm* which is applying for *Part IV permission*, or a substantial variation of that *permission*, to take adequate steps to satisfy itself and, if relevant, the *FSA* that:
- (a) it has a well constructed business plan or strategy plan for its product or service which demonstrates that it is ready, willing and organised to comply with the relevant requirements in ~~*IPRU, PRU*~~ the Prudential Standards part of the *Handbook* and *SYSC* that apply to the *regulated activity* it is seeking to carry on; ...
- ...
- ...
- ...

Annex C

Amendments to the Senior Management Arrangements, Systems and Controls

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

...

App 1.1.8 G Examples of how the *FSA* considers that SYSC 3 will apply in practice to an *incoming EEA firm* (see SYSC 1.1.4 R) are as follows:

(1) The ~~Integrated Prudential Sourcebook (*PRU*)~~ Prudential Standards part of the *Handbook* (with the exception of ~~PRU 7.6.33~~ *INS* PRU 1.5.33 R on the payment of financial penalties) and the Interim Prudential sourcebook (insurers) (*IPRU (INS)*) (~~with the exception of rules 3.6 and 3.7~~) do not apply to an *insurer* which is an *incoming EEA firm*. Similarly, SYSC 3 does not require such a *firm*:

(a) ...

(b) to establish systems and controls for compliance with that ~~Interim Prudential sourcebook or *PRU*~~ Prudential Standards part of the *Handbook* (SYSC 3.2.6 R); or

(c) ...

...

...

Annex D

Amendments to the Integrated Prudential sourcebook

In this Annex, new text is not underlined and deleted text is not shown struck-through.

Part 1: amendments taking effect on 31 December 2006

The following provisions are deleted. The text is not shown struck-through.

Provision in PRU	
1.2.17 G	Deleted
1.2.32 G (1)	Deleted
1.2.40 G	Deleted
1.2.43 G	Deleted
1.2.53 G	Deleted
1.3.2 G	Deleted
1.3.3 R	Deleted
1.3.5C R	Deleted
1.3.5D R	Deleted
2.2.42 G	Deleted
2.2.43 G	Deleted
2.2.44 G	Deleted
2.2.45 G	Deleted
2.2.46 G	Deleted
2.2.47 G	Deleted
2.2.48 G	Deleted
2.2.49 G	Deleted
2.2.53 R	Deleted
2.2.71 R	Deleted
2.2.74 R	Deleted
2.2.102 R	Deleted
2.2.118 R	Deleted

Part 2: amendments taking effect on 1 January 2007

1. So far as not redesignated by the following, the whole of the Integrated Prudential sourcebook is deleted:
 - (a) the General Prudential Sourcebook Instrument 2006;
 - (b) the Insurance Prudential Sourcebook Instrument 2006;
 - (c) the Prudential Sourcebook for Mortgage and Insurance Intermediaries Instrument 2006;
 - (d) the Senior Management Arrangements, Systems And Controls (Markets In Financial Instruments) Amendment Instrument 2006.

Annex E

Amendments to the Interim Prudential sourcebook for banks

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

Amend IPRU (BANK), Volume 1 as follows:

TRANS

~~Transitional provisions [Deleted]~~

Chapter GN, Section 1: The Interim Prudential Sourcebook For Banks: Notes

1. CONTENTS

Volume 1

GN	re Interim Prudential Sourcebook for Banks:
s 1	Contents
s 2	The Prudential Sourcebook for banks: Introductions
s 3	The FSA's requirements (rules)
s 4	Presentation and conventions

~~Adequacy of capital~~

General

CO	Capital Adequacy Overview
CB	Trading book/banking book division
CA	Definition of capital

Specific banking book treatments

BC	Credit risk in the banking book
BO	Proxies for market risk in banking book

Treatments common to banking and trading book

FX	Foreign exchange risk
CM	Commodities risk
DU	Common treatments for counterparty risk

Specific trading book treatments

N.B. The policy outlined in these chapters applies to CAD banks only

TI	Interest rate position risk
TE	Equity position risk

TC	Counterparty risk in the trading book
TL	Incremental capital for large exposures
TU	Securities underwriting
TO	Options position risk requirement
TS	CAD1 models
TV	VaR models

Volume 2

Other

LE	Large exposures
CD	Credit derivatives
SE	Securitisation and asset transfers

Adequate Liquidity

LM	Mismatch liquidity
LS	Sterling stock liquidity

Adequate records, systems and controls

AR	Accounting and Other Records and Internal systems and controls
ST	Foreign Exchange—risk based supervision
FR	Fraud

Controllers: the fit & proper requirement

CL	Comfort letters
----	-----------------

Other

VA	Valuation
NE	Collateral and netting
CS	Consolidated supervision
OS	Outsourcing
PN	Provisioning policy statements

Chapter GN, Section 2

2. THE PRUDENTIAL SOURCEBOOK FOR BANKS: APPLICATION AND PURPOSE

Application

1. From December 2004 the Financial Services Authority (the FSA) has begun the phased implementation for *banks* of its Integrated Prudential Sourcebook (*PRU*). This will eventually replace the set of sectoral prudential sourcebooks applied on an interim basis, including this one applying to *banks* (*IPRU (BANK)*).

With the implementation of the recast Capital Adequacy Directive and the Banking

Consolidation Directive in the UK from January 2007, the Integrated Prudential Sourcebook (PRU) and the Interim Prudential sourcebook for banks (IPRU (BANK)) have, so far as banks are concerned, been substantially substituted by the General Prudential Sourcebook (GENPRU), parts of the Senior Management Arrangements, Systems and Controls sourcebook (SYSC) and the Prudential Sourcebook for Banks, Building Societies and Investment Firms (BIPRU). The only remaining prudential standards in IPRU (BANK) are those that relate to liquidity. Over the transition period until all the provisions of IPRU (BANK) have been revoked, the FSA's detailed prudential standards (and some related notification requirements) applying to banks authorised under the Act are set out in a combination of PRU, GENPRU, BIPRU, SYSC and IPRU (BANK). Where a chapter of IPRU (BANK) has been substantively affected by the implementation of PRU, the introductory section of that chapter has been amended to indicate in broad terms how the chapter's provisions relate to those in PRU. Banks are responsible for ensuring that they meet all the prudential standards applying to them in both PRU, GENPRU, BIPRU, SYSC and IPRU (BANK) during the transitional period.

2. ~~IPRU (BANK) sets out material relevant to all banks (see definition in section 3.5 of Chapter GN). However, most of the material applies only to UK banks. The only parts of IPRU (BANK) which apply applies to EEA banks and overseas banks are the rules and guidance on liquidity (Rule 3.3.15 and in Chapter LM) and fraud (Chapter FR). The rules and guidance in Chapter LS apply only to UK banks.~~

Purpose

3. [Deleted]
4. [Deleted]
5. [Deleted]

Powers and general approach

6. [Deleted]
7. [Deleted]
8. [Deleted]
9. [Deleted]
10. [Deleted]
11. [Deleted]

Chapter GN, Section 3: The FSA's prudential rules for banks

3.1 Introduction

- 3.1.1 G The rules (except ~~IPRU (BANK) 3.3.15R~~) in this section are made under sections 138 and 149 of the Act. Those sections and section 156 are specified for the purposes of section 153(2). ~~IPRU (BANK) 3.3.15R (which is a designated pre-commencement provision) is treated as having effect under section 138.~~

...

3.2 Application

3.2.1 R The *rules* (including *evidential provisions*) in this section apply as follows:

<u>Rule/Evidential Provision</u>		<u>Application</u>
R 3.3.15 - R 3.5.1 -	Adequate liquidity definitions	All <i>banks</i> except <i>EEA banks</i> whose notification to the <i>FSA</i> of their intention to provide services in the <i>UK</i> covers only services provided on a cross-border basis and not services provided through a <i>branch</i>.
R 3.3.1 - R 3.3.9 - R 3.3.11 - R 3.3.13 - R 3.3.19 - E 3.3.23 - R 3.4.1 - R 3.4.3 - R 3.4.5 - E 3.4.9 - R 3.4.12 - R 3.6.1 -	two individuals to direct business <i>initial capital</i> <i>euro 5 million</i> capital adequate capital large exposures: systems & controls internal audit function large <i>exposures</i> policy statement liquidity policy statement provisioning policy statement policy statement procedures submission of policy statements policy statements: transitional	All <i>UK banks</i> except <i>UK branches of EEA banks</i> or <i>overseas banks</i>
R 3.3.12 - R 3.3.21 - E 3.3.25 - R 3.4.7 -	<i>euro 5 million</i> or <i>relevant amount</i> notification of large <i>exposures</i> audit committee trading book policy statement	<i>UK banks</i> only

3.3 ~~Prudential rules [Deleted]~~

3.4 Policy Statement Rules

~~Large Exposure Policy Statement~~

3.4.1 R ~~[Deleted]~~

3.4.2 G ~~[Deleted]~~

Liquidity Policy Statement

3.4.3 R (1) A *UK bank* and in the case of an *EEA bank* or *overseas bank*, its branch in the UK must set out its policy on the management of its liquidity in a

written statement.

(2) The policy in the statement must be such that compliance with it would enable the *bank* to maintain adequate liquidity in conformity with ~~IPRU (BANK) 3.3.15R~~ GENPRU 1.2.26R.

...

~~Provisioning policy statement~~

3.4.5 R ~~[Deleted]~~

3.4.6 G ~~[Deleted]~~

~~Trading book policy statement~~

3.4.7 R ~~[Deleted]~~

3.4.8 G ~~[Deleted]~~

Policy statement procedures

3.4.9 E (1) A *bank's* policy statements required under ~~IPRU (BANK) 3.4.1R, 3.4.3R, 3.4.5R and 3.4.7R~~ should be approved by its board or, where appropriate, by a person or body of persons to whom the board has delegated this function (the "delegate").

...

...

3.4.12 R ~~[Deleted]~~

...

3.4.14 G ~~[Deleted]~~

3.5 R Definitions

Amend the following definition in the table in *IPRU (BANK) 3.5.1R* as shown:

bank ~~(1) a firm with a Part IV permission which includes accepting deposits, and:~~
~~(a) which is a credit institution; or~~
~~(b) whose Part IV permission includes a requirement that it comply with IPRU (BANK); but which is not a building society, friendly society or credit union; and~~
~~(2) an EEA bank.~~

See definition in the Glossary.

credit ~~An undertaking whose business is to receive deposits or other repayable funds~~

institution ~~from the public and to grant credits for its own account or an electronic money institution within the meaning of article 1(3)(a) of Directive 2000/46/EC (the E-Money Directive) that has the right to benefit from the mutual recognition arrangements under Directive 2000/12/EC (the Banking Consolidation Directive).~~

See definition in the Glossary.

Delete the following definitions from the table in *IPRU (BANK) 3.5.1R*; the text is not shown struck through:

associated undertaking
building society
commencement
euro 5 million
exposure
financial holding company
financial institution
FSMA
group
initial capital
mixed-activity holding company
mixed financial holding company
notification rules
own funds
parent undertaking
Part IV permission
participating interest
participation
PRU
relevant amount
subsidiary undertaking
SUP

3.6 ~~TRANSITIONAL RULE [Deleted]~~

Chapter GN, Section 4: Presentation and Conventions

...

4.2 Understanding the presentation

...

- (a) The dates of latest issue of each section of each chapter can be checked ~~by phoning the Policy Department of the FSA's Financial Supervision Banking Directorate [020 7676 0484/0394],~~ or via the FSA's internet site (at www.fsa.gov.uk).

...

...

- CO ~~CAPITAL ADEQUACY OVERVIEW~~ [Chapter deleted]
- CB ~~THE BANKING BOOK/TRADING BOOK DIVISION~~ [Chapter deleted]
- CA ~~DEFINITION OF CAPITAL~~ [Chapter deleted]
- BC ~~CREDIT RISK IN THE BANKING BOOK~~ [Chapter deleted]
- BO ~~PROXIES FOR MARKET RISK IN THE BANKING BOOK~~ [Chapter deleted]
- FX ~~FOREIGN EXCHANGE RISK~~ [Chapter deleted]
- CM ~~COMMODITY POSITION RISK~~ [Chapter deleted]
- DU ~~COUNTERPARTY RISK TREATMENTS COMMON TO THE BANKING AND THE TRADING BOOK~~ [Chapter deleted]
- TI ~~INTEREST RATE POSITION RISK~~ [Chapter deleted]
- TE ~~EQUITY POSITION RISK~~ [Chapter deleted]
- TC ~~COUNTERPARTY RISK IN THE TRADING BOOK~~ [Chapter deleted]
- TL ~~INCREMENTAL CAPITAL FOR LARGE EXPOSURES~~ [Chapter deleted]
- TU ~~SECURITIES UNDERWRITING~~ [Chapter deleted]
- TO ~~OPTIONS PRR~~ [Chapter deleted]
- TS ~~CAD1 MODELS~~ [Chapter deleted]
- TV ~~Use Of A Value At Risk Model~~ [Chapter deleted]
- LE ~~LARGE EXPOSURES~~ [Chapter deleted]

Amend IPRU (BANK), Volume 2 as follows:

CD ~~CREDIT DERIVATIVES~~ [Chapter deleted]

SE ~~SECURITISATION AND ASSET TRANSFERS~~ [Chapter deleted]

Chapter LM: Mismatch Liquidity

Chapter LM, Section 1: Introduction

1.1 Legal resources

1 (a) ...
(b) ...

See ch
GN
s. 3

(c) The rules requiring a bank to maintain adequate liquidity appropriate to the nature and scale of its business, and to set out its policy on liquidity risk management in a written statement.

See ch
GN
s. 3

~~(e) All UK banks authorised for the purposes of the Act are required to meet these requirements except EEA banks. An EEA bank or overseas bank with a branch in the UK is also subject to rule 3.3.15 which requires its UK those requirements in relation to that branch to maintain adequate liquidity.~~

2 As part of the ~~phased~~ implementation of the ~~Integrated Prudential Sourcebook (PRU)~~ recast Capital Adequacy Directive and the Banking Consolidation Directive in the UK from January 2007, provisions in ~~PRU 1.2 and PRU 5.1~~ relating to a firm's systems and controls for liquidity risk have been introduced, ~~superseding and leading to the revocation or amendment of~~ material formerly in this chapter in SYSC 11 and provisions concerning stress testing and scenario analysis have been introduced in GENPRU 1.2.30R. The relevant rules implement part of Article 22 and Annex V of the Banking Consolidation Directive. This chapter and chapter LS sets out the FSA's framework for monitoring the liquidity of banks authorised for the purposes of the Act to determine whether the above requirements are met.

...

1.2 Application

4 This chapter applies to banks in the manner set out in 1.1. In respect of EEA banks that have a branch in the UK but do not have a UK deposit-taking permission, only Sections 1, 2, 3, 4.2, 9.1 and 10 of the chapter apply. In respect of all EEA banks and overseas banks with a branch in the UK, the chapter (or applicable sections of it) only applies in relation to the liquidity of those branches and not the bank as a whole.

(a) For UK-incorporated banks, the present reporting form (LR), is completed on a solo basis. Where a bank already reports for capital and large exposure

purposes on a solo-consolidated basis with the agreement of the supervisor, the Form LR should be submitted on a solo-consolidated basis rather than a solo basis.

- (i) Definitions of solo supervision and solo-consolidated supervision can be found elsewhere in the IPRU (BANK) Handbook.

...

Chapter LM, Section 3: Main Features Of The Liquidity Policy

This section summarises the main features of the liquidity policy. It does not cover every feature and should be read in conjunction with the sections that follow, and other parts of the Handbook referred to below. Certain of the provisions referred to implement Article 22 and Annex V of the Banking Consolidation Directive.

3.1 Main prudential policies applying to banks

See ~~GN~~
s3 GENPRU

1 A bank must maintain adequate liquidity at all times.

1.2

See s10

2 A bank must formulate a statement of its liquidity management policy. It should agree with the FSA standards for adherence to this policy, i.e. mismatch guidelines and the procedures for the notification of breaches of those guidelines. (The rule requiring a liquidity policy statement is GN 3.4.3R. SYSC 11 requires a bank to have policies for liquidity risk management.)

See s9

3 A bank should have adequate systems for monitoring liquidity on a daily basis. (See SYSC 11).

3A A bank should carry out stress testing and scenario analysis in relation to liquidity risk. (See GENPRU 1.2.26R and associated guidance, and SYSC 11).

3B A bank should have a contingency funding plan. (see SYSC 11)

...

Chapter LM, Section 4: The framework for measuring liquidity

...

4.2 'Global concession' policy

6. The FSA ~~is required to~~ supervises the liquidity of all banks operating in the United Kingdom except in the case of EEA banks and overseas banks it is only required to supervise the liquidity of their UK branches.

...

Chapter LM, Section 6: Stock of marketable assets

...

6.3 Inclusion of marketable assets in the maturity ladder

6.3.1 General

...

7 ...

See ch
BC s3

(d) ~~The definition of Zone A/Zone B countries given in the chapter on credit risk in the banking book~~ The meaning of Zone A country is as defined in the glossary of defined terms used in the Handbook.

"Zone B" comprises all countries not in Zone A countries.

6.3.2 The standard "matrix" approach

8 The discount factors applied to different types of marketable assets in the FSA's mismatch calculations are given in the table below:

...

Other securities denominated in freely tradable currencies (usually Zone A)

Non-governmental debt securities ~~which are classified as~~ 5%
qualifying by the FSA in its implementation of the CAD falling within the definition of qualifying debt security, and which have six or fewer months to residual maturity.

Non-governmental debt securities ~~which are classified as~~ 10%
qualifying by the FSA in its implementation of the CAD falling within the definition of qualifying debt security, and which have five or fewer years residual maturity.

Non-governmental debt securities ~~which are classified as~~ 15%
qualifying by the FSA in its implementation of the CAD falling within the definition of qualifying debt security, and which have more than five years residual maturity.

Equities which (in the FSA's implementation of the CAD) qualify 20%
for a specific risk weight no higher than 42%

...

(a) ...

See ch
BC s3

(b) Qualifying debt security means qualifying for inclusion in the capital adequacy calculation at specific risk weightings is defined in the glossary of defined terms used in the Handbook.

(c) ~~The definition of Zone A/Zone B countries is given in the chapter on credit risk in the banking book~~ 6.3.1.7(d) above.

...

See ch
BC s3

(g) Zone B equities, which (in the FSA's implementation of the CAD) qualify for a specific risk weight (no higher than 42%) can be considered to be marketable and are discounted at 40%.

...

Chapter LM, Section 8: Factors considered in setting mismatch guidelines

...

8.3 Home country lending

4 A branch which lends a considerable proportion of its own balance sheet back to its home country risks becoming illiquid if, for any reason, the home country is unable to meet its debt service obligations. Partly for this reason the FSA assesses whether to place limits on home country lending for branches.

See
chLE 9

(a) ~~For details on home country exposure limits see the chapter on large exposures~~

Chapter LM, Section 9: Monitoring liquidity

...

9.1.2 Systems for monitoring liquidity

2 In order to be considered to be conducting its business in a prudent manner a bank must maintain adequate systems. A bank should therefore have in place systems which enable it to monitor its liquidity profile on a frequent and timely basis.

See
SYSC 11

(a) What in detail will be considered adequate systems depend on the nature of business conducted by the bank. But every bank should have systems in place that enables it to calculate its liquidity position on a daily basis.

Chapter LM, Section 10: Policy statements

...

4 The policy statement should consider the management of liquidity in both normal and abnormal circumstances. In particular, it should include details of the bank's contingency funding plan maintained as required by ~~PRU 5.1.86E~~ SYSC 11.1.24E.

...

Chapter LS: Sterling stock liquidity

Chapter LS, Section 1: Introduction

1.1 Legal resources

1. ...
(a) ...
(b) ...
(c) ...

See ch
GN(3)

All UK banks authorised for the purposes of the Act are required to meet these requirements ~~except EEA banks~~. An EEA bank or overseas bank with a branch in

the UK is also subject to ~~rule 3.3.15 which requires its UK~~ those requirements in relation to that branch to maintain adequate liquidity.

- 2 As part of the ~~phased implementation of the Integrated Prudential Sourcebook (PRU) recast Capital Adequacy Directive and the Banking Consolidation Directive in the UK from January 2007, provisions in PRU 1.2 and PRU 5.1 relating to a firm's systems and controls for liquidity risk have been introduced, superseding and leading to the revocation or amendment of~~ material formerly in this chapter in SYSC 11 and provisions concerning stress testing and scenario analysis are introduced in GENPRU 1.2.30R. The relevant rules implement part of Article 22 and Annex V of the Banking Consolidation Directive. This chapter and chapter LM sets out the FSA's framework for monitoring the liquidity of banks authorised for the purposes of the Act to determine whether the above requirements are met.

...

...

Chapter LS, Section 4: The measurement of sterling stock liquidity

...

4.4 Definitions relevant to both components

4.4.1 *The stock of sterling liquid assets*

9 The stock of *sterling liquid assets* consists of:

(a) ...

...

(i) [Deleted]

a) [Deleted]

i) [Deleted]

(j) [Deleted]

a) [Deleted]

b) [Deleted]

...

...

AR ~~ACCOUNTING AND OTHER RECORDS AND INTERNAL CONTROL SYSTEMS~~ [Chapter deleted]

ST ~~FOREIGN EXCHANGE RISK BASED SUPERVISION~~ [Chapter deleted]

FR ~~FRAUD~~ [Chapter deleted]

- CL ~~COMFORT LETTERS~~ [Chapter deleted]
- VA ~~VALUATION~~ [Chapter deleted]
- NE ~~COLLATERAL AND NETTING~~ [Chapter deleted]
- CS ~~CONSOLIDATED SUPERVISION~~ [Chapter deleted]
- OS ~~OUTSOURCING~~ [Chapter deleted]
- PN ~~PROVISIONING POLICY STATEMENTS~~ [Chapter deleted]

Annex F

Amendments to the Interim Prudential sourcebook for Building Societies

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

Amend IPRU(BSOC), Volume 1 as follows:

Contents List

TP TRANSITIONAL PROVISIONS

X. INTRODUCTORY CHAPTER

~~VOLUME 1: PRUDENTIAL STANDARDS~~

~~1. SOLVENCY~~

~~2. ISSUED CAPITAL~~

~~3. BOARDS AND MANAGEMENT~~

4. FINANCIAL RISK MANAGEMENT

5. LIQUIDITY

~~6. LENDING~~

~~7. LARGE EXPOSURES~~

~~8. MORTGAGE INDEMNITY INSURANCE~~

~~9. SYSTEMS~~

~~10. SECURITISATION~~

~~11. -OUTSOURCING~~

~~[Volume deleted]~~ ~~VOLUME 2: CONSTITUTIONAL GUIDANCE~~

To be inserted after the Contents List

Transitional Provisions

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
1	<i>IPRU(BSOC)</i> 4 and <i>IPRU(BSOC)</i> 5	R	<p>A society to which <i>SYSC</i> 4 to <i>SYSC</i> 10 do not apply must, in the material in column (2), treat:</p> <p>(a) the references generally to <i>SYSC</i> 4, <i>SYSC</i> 5, <i>SYSC</i> 6 or <i>SYSC</i> 7 as references generally to <i>SYSC</i> 3.2; and</p> <p>(b) the references to specific rules in <i>SYSC</i> 4, <i>SYSC</i> 5, <i>SYSC</i> 6 or <i>SYSC</i> 7 as references to the rules in <i>SYSC</i> 3.2.23R to <i>SYSC</i> 3.2.37R that correspond to those rules.</p>	1 January 2007 – 31 October 2007	1 January 2007

Volume 1, Introductory Chapter X

X.1 ~~Introduction~~ [Deleted]

X.2 Application

X.2.1 R The Interim Prudential Sourcebook for building societies applies to all firms with permission from the Financial Services Authority (the "FSA") to take deposits which are also building societies as defined in the Building Societies Act 1986 ("the 1986 Act") and, in this sourcebook, "society" and "societies" are construed accordingly.

X.3 ~~Content of this sourcebook~~ [Deleted]

X.4 ~~The Purpose of the Interim Prudential Sourcebook for Building Societies~~ [Deleted]

X.5 ~~Principal Purpose of a building society and funding and lending limits~~ [Deleted]

X.6 ~~The continuing 1986 Act~~ [Deleted]

X.7 ~~Frequently used terms~~ [Deleted]

X.8 ~~Schedule of Transitional Provisions~~ [Deleted]

1. ~~SOLVENCY~~ [Chapter deleted]

2. ~~ISSUED CAPITAL~~ [Chapter deleted]

3. ~~BOARDS AND MANAGEMENT~~ [Chapter deleted]

Chapter 4 FINANCIAL RISK MANAGEMENT

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4.6 ~~Management Responsibilities~~ 12

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4A. Supervisory Approach Categories 21

4B. ~~Credit Derivatives~~ 29

4.1 Introduction

4.1.1 G This chapter ~~replaces PN 1998/4, issued by the Commission, and contains rules and guidance for societies on financial risk management, a key part of compliance with Principle 3 ("a firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems which supplements the high level requirements in the Senior Management Arrangements, Systems and Controls sourcebook (SYSC)).~~

4.1.1A G As part of the implementation of the Capital Adequacy Directive (CAD), the Banking Consolidation Directive (BCD) and the Markets in Financial Instruments Directive (MiFID), provisions relating to a firm's organisational and risk systems and controls have been introduced in SYSC 4, SYSC 5, SYSC 6 and SYSC 7. Whilst some of the material in SYSC applies to all societies, some applies only to societies that are subject to MiFID. The guidance in this chapter generally explains the application of the high level requirements in SYSC 4, SYSC 5, SYSC 6 and SYSC 7 (even if there may not be a specific cross reference) in the context of financial risk management.

...

4.1.3 G Rules and guidance on interest rate risk in the banking book are contained in chapter 2.3 of the Prudential sourcebook for Banks, Building Societies and Investment Firms (BIPRU). Under these requirements a society should evaluate the effect of a standard interest rate shock specified by the FSA in that chapter. The result should be taken account of in the ICAAP (as defined in the Handbook Glossary).

4.1.4 G Societies with a trading book will also be subject to a market risk capital requirement calculated in accordance with BIPRU 7. This is unlikely to be applicable to any societies apart from those on the "Trading" approach – see 4A.6 below. A society with foreign currency exposures will however be subject to the foreign exchange capital requirements in BIPRU 7 whether or not it has a trading book.

4.2 RulesGeneral

4.2.1 RG In meeting the requirements of SYSC 4.1.1R and SYSC 7.1.2R in the context of financial risk management, Aa society mustshould have an adequate system for managing and containing financial risks to the net worth of its business, and risks to its net income, whether arising from fluctuations in interest or exchange rates or from other factors.

4.2.2 G The arrangements, processes and mechanisms required in SYSC 7.1.3R Societies should haveinclude systems and procedures for identifying, monitoring and controlling all material maturity mismatch, interest rate, foreign exchange and similar (e.g. index related) risks, and for reporting exposures to senior management and the board of the society on a regular, and timely, basis. Societies should also have interest margin management systems in place to estimate the expected profitability of new mortgage and savings products, and to project forward the cumulative effect of mortgage incentives and loyalty schemes.

4.2.3 G Societies should have credit limits in place for all counterparties both for placing liquidity and for transacting derivative contracts (further guidance also in Chapter 5 (Liquidity)) and in ~~PRU 5.4~~the General Prudential sourcebook (GENPRU) 1.2 and SYSC 11 – stress testing and scenario analysis, and contingency funding plans).

4.2.4 G [Deleted]

4.2.5 RG A society must maintain, and submit to the FSA, In meeting the requirements in SYSC 7.1.4R in the context of financial risk management, the board of a society should approve and periodically review a board-approved policy statement on financial risk management.

4.2.6 R [Deleted]

4.2.7 G [Deleted]

...

4.3 Financial risks

...

Key risk categories

4.3.7 G The key financial risks which, ~~in order to comply with Rule~~ as envisaged in 4.2.1G, societies should manage and control, are:

(1) ...

...

4.3.8 G Societies' financial risk management policies should also cover:

(1) ...

...

(3) [Deleted]

- (4) Operational risk in treasury and related activities: including failure of internal controls or procedures, and the risk arising from errors in legal documentation.
- (5) [Deleted]

...

4.5 Supervisory approach

...

4.5.5 G ~~To comply with rule~~ As explained in 4.2.1G, a society's system for financial risk management ~~must~~ should be adequate. The policy statement ~~required~~ envisaged under rule in 4.2.5G ~~must~~ should be appropriate for the society's business needs and the complexity of its existing and proposed treasury activities. The FSA has devised five models, described as supervisory approaches, of increasing sophistication, to assist societies ~~to comply with these rules~~. The approaches are described as "administered", "matched", "extended", "comprehensive" and "trading". A society that conducts its treasury activities in accordance with the most suitable (for it) of these five models, can readily demonstrate that it complies with ~~rule~~ the SYSC requirements referred to in 4.2.1G and 4.2.5G in the context of financial risk management. But these models are neither mandatory nor exhaustive. Guidance on the characteristics of each approach is set out in Annex 4A.

...

4.5.7 G Whilst the "approach" benchmarks have no legal significance, the process of moving between approaches provides a useful opportunity for the FSA to review a society's progress, and to satisfy itself that policies, limits and systems are appropriate for the treasury activities planned, ~~and that therefore compliance with rule 4.2.1 is adequately established~~.

...

4.6 Management responsibilities

4.6.1 G [Deleted]

4.7 Risk management systems

4.7.1 G ~~In order to demonstrate compliance with rule 4.2.1~~ The guidance in this section amplifies SYSC 7.1.2R and SYSC 7.1.3R specifically in the context of treasury management. a society should have in place information systems that are capable of:

- (1) ...
- (2) assessing the potential impact of interest rate (and if applicable, currency exchange rate) changes on its earnings and economic value (including the effect of any standard interest rate shock as specified by the FSA in BIPRU 2.3);
- (3) reporting accurately, and promptly, on risk positions – to management, to the board and, if requested, to the FSA - including generating the information necessary to carry out its ICAAP and reporting the results of stress testing for interest rate risk in the banking book;

...

...

Control limits

4.7.3 G Control limits confine structural risk positions within levels considered by board and management to be prudent, given the size, complexity and capital needs of the society's business. Where applicable, limits should also be applied to individual instrument types, asset/liability portfolios, and to separate business activities or subsidiaries. ~~The size of the limits set will be a factor in the FSA's assessment of the overall risk profile of the society, and thus in the threshold solvency ratio which is set for it.~~

...

Stress testing

4.7.7 G The risk measurement systems put in place should evaluate the impact, on income or economic value as appropriate, of abnormal market conditions. The amount and type of such stress testing required will depend upon the sophistication of treasury operations undertaken, and the level of risk taken, but where required should be regular and systematic. Boards and management should, periodically, review the extent of such stress testing to ensure that any "worst case" scenarios remain valid. Contingency plans should be in place to deal with the consequences should such scenarios become reality. Rules and guidance on stress testing, ~~and scenario analysis and contingency funding plans specifically for liquidity risk~~ are in PRUGENPRU 1.2 and PRU 5.4~~BIPRU 2.2~~. Material on this subject specifically relating to liquidity risk, including liquidity contingency plans, is in SYSC 11. Requirements for stress testing for interest rate risk in the banking book are set out in BIPRU 2.3

Board information reporting

4.7.8 G The FSA attaches considerable importance to the quality, timeliness, and frequency of the management information which the board uses ~~to inform itself of the society's risk positions and to satisfy itself that treasury activities are being undertaken in accordance with its policies and guidelines. Information obtained by the board should not be confined to the current position, but~~ should include regular and systematic stress testing, as described above, which should be taken into account when policies and limits are established or reviewed.

4.8 Counterparty Risk

...

4.8.5A G The guidance in this section complements the high level rules and guidance on credit and counterparty risk in SYSC 7.1.9R to SYSC 7.1.11R.

...

Committed facilities

4.8.8 G A society with high levels of maturing funding, or vulnerability to withdrawal of individual deposits, should consider arranging committed facilities (or ~~to~~ maintain higher than average levels of liquidity). In arranging committed facilities, a society should consider:

(1) ...

...

...

4.9 Operational risk

General

4.9.1 G [Deleted]

Segregation of duties

4.9.2 G [Deleted]

4.9.3 G [Deleted]

Reporting lines

4.9.4 G [Deleted]

4.9.5 G [Deleted]

Remuneration policy

4.9.6 G [Deleted]

IT Security

4.9.7 G Reliance on computerised dealing, information, treasury management and risk assessment systems renders societies particularly vulnerable to software or hardware failure. ~~In accordance with Chapter 9 systems, b~~Boards of societies should:

(1) [Deleted]

(2) ...

...

4.10 Independent review and controls

Internal audit

4.10.1 G The guidance in this section amplifies SYSC 6.2.1R in the context of treasury management. Each board should ensure that its society's internal audit department (if it has one) has the skills and resources available to undertake an audit of the treasury function. Internal audit should evaluate, on a continuing basis, the adequacy and integrity of the society's controls over maturity mismatch, over the level of structural risk taken and should assess the effectiveness of treasury management procedures.

4.10.2 G Societies with complex treasuries or lacking internal auditors with treasury expertise may outsource treasury audit to an audit firm with the appropriate expertise and experience. The work of outsourced internal audit should be fully integrated into the

society's overall audit procedures and plans, with appropriate reporting lines into the audit committee. However, in order to avoid conflicts of interest, internal audit should not be contracted out to the society's own external auditors – even if the function were to be performed by a completely different branch of the audit firm (~~see also Chapter 11 on Outsourcing~~).

External audit

4.10.3 G [Deleted]

Chapter 4, Annex 4A

...

4A.2 "Administered" approach

...

4A.2.2 G Societies adopting this approach:

(1) should not offer fixed rate products (defined as repricing more than one year and one day later than the current date) on either side ~~on~~ of the balance sheet;

(2) ...

...

...

4A.5 "Comprehensive" approach

...

4A.5.5 G Risk positions could reflect an interest view, subject to sensitivity limits set by board/ALCO and incorporating basic risk assessment/control. Foreign exchange mismatch (i.e. exchange rate exposure) is expected to be limited to less than 2% of own funds (~~within Capital Adequacy Directive de minimis levels~~).

4A.6 "Trading" approach

...

4A.6.3 G [Deleted]

Chapter 4, Annex 4B

ANNEX 4B [Deleted]

Chapter 5 LIQUIDITY

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...

...

5.1 Introduction

5.1.1 G This chapter now sets out the FSA's quantitative regime for building societies' prudential liquidity, and further guidance specific to building societies on the management of their liquidity in accordance with the five approaches to financial risk management set out in Chapter 4. This chapter complements ~~PRU 5.1 (which contains rules and guidance for a wider range of firms on systems and controls appropriate for liquidity risk)~~. Only certain provisions of PRU 5.1 apply to building societies, by virtue of PRU 5.1.3R and PRU 5.1.4R. Similarly it also complements PRU GENPRU 1.2 and BIPRU 2.2 (which contain rules and guidance for systems and controls relating to adequacy of financial resources generally) and SYSC 11 (which sets out the high level requirements for liquidity that apply to deposit takers and own account dealers, as well as insurers). The chapter outlines the factors the FSA will take into account in assessing whether a society meets the rules set out in ~~section 5.2 and PRU GENPRU 1.2 and the guidance in PRU 5.1~~SYSC 11 so far as liquidity risk is concerned. A list of types of asset suitable for inclusion in prudential liquidity for societies on each of the approaches to financial risk management is set out in Annex 5A. "Prudential liquidity" has the meaning set out in paragraph 5.3.4G.

5.1.1A G As part of the implementation of the Capital Adequacy Directive (CAD), the Banking Consolidation Directive (BCD) and the Markets in Financial Instruments Directive (MiFID), provisions relating to a firm's organisational and risk systems and controls have been introduced in SYSC 4, SYSC 5, SYSC 6 and SYSC 7. Whilst some of the material in SYSC applies to all societies, some applies only to societies that are subject to MiFID. The guidance in this chapter generally explains the application of the high level requirements in SYSC 4, SYSC 5, SYSC 6 and SYSC 7 (even if there is no specific cross reference) in the context of managing liquidity.

5.1.2 G Some material on liquidity systems and controls, previously in this chapter and superseded by ~~PRU 5.1~~SYSC 11, has been deleted, but the original numbering has been retained: where an entire section has been deleted this is noted alongside the original section number. The new material in ~~PRU 5.1~~SYSC 11 covers requirements for stress testing and scenario analysis, as well as contingency funding plans and their documentation.

5.2 Rules

5.2.4 E (1) ...

(2) Contravention of 5.2.4(1) may be relied upon as tending to establish contravention of ~~PRU 1.2.22R~~GENPRU 1.2.26R.

...

5.2.8 G Guidance on the content of a liquidity policy statement is set out in 5.6.2 to 5.6.4 and in Annex 5B. ~~Societies will also find guidance on the requirements (set out at PRU 1.2.26R, PRU 1.2.27R, PRU 1.2.31R, PRU 1.2.33R, PRU 1.2.35R, PRU 1.2.37R and PRU 1.2.38R) for stress testing and scenario analysis at PRU 5.1.58 to PRU 5.1.62. Further guidance on the requirements (set out at PRU 1.2.22R, PRU 1.2.35R and PRU 1.2.37R) on contingency funding plans and documentation is provided at PRU 5.1.8G — PRU 5.1.9G).~~ Societies may, for convenience, wish to combine their liquidity policy statement with their documentation meeting these general requirements with their liquidity policy statement for

contingency funding plans and documentation referred to in paragraph 5.1.1 and the other material in GENPRU, BIPRU and SYSC referred to in section 5.1. However if they do so, but societies need to be clear on how any combined document meets the separate requirements.

...

5.4 Short-term Liquidity

...

5.4.3 G The following liquid assets may be counted as short-term liquidity:

- (1) cash, current account balances, and Treasury, Local Authority and eligible bank bills;
- (2) deposits with relevant authorities (as defined in Annex ~~4E5A~~), banks and building societies with not more than 8 days' notice, or within 8 days of maturity;

...

...

5.5.1 Supervisory Approach to Liquidity

5.5.1 G Societies should adopt a risk-averse approach to the management of liquid assets. Societies should ensure that treasury systems and controls are adequate for the scale of activity undertaken and that treasury personnel have appropriate expertise and competence, including dealing, settlement and accounting skills. Chapter 4 suggests that dealings in certain categories of liquid assets should be confined to societies on an advanced approach to financial risk management.

...

5.6 Board and Management Responsibilities

...

5.6.2 G Rule 5.2.7 requires each society to have a liquidity policy statement. This should be approved by the society's board and be consistent with the society's strategic plan and its financial risk management policy statement. Societies should also have regard to the rules and guidance in PRUGENPRU 1.2, SYSC 4, SYSC 5, SYSC 7 and PRU 5.1 SYSC 11, ~~set out in more detail at PRU 5.2.8G.~~

...

5.6.4 G A liquidity policy statement should be a working document and personnel in the treasury and settlement areas should be familiar with its contents, as should members of ALCO or Finance Committee. When aspects of the policy or limits become out of date, the policy document should be amended ~~and the revised copy must be sent to the FSA (see rule 5.2.9).~~

5.6.5 G Boards should establish the objectives for liquidity including meeting obligations as they fall due (including any unexpected adverse cash flow), smoothing out the effect of maturity mismatches and the maintenance of public confidence. The need to earn a return may also be recognised as an objective, although this should be secondary to the security of the assets. Societies should also have regard to the rules and guidance in ~~PRUGENPRU 1.2~~ and ~~PRU 5.1 SYSC 11~~, set out in more detail at ~~PRU 5.2.8G~~.

5.6.6 G ~~[Deleted]~~

5.6.7 G ~~[Deleted]~~

5.6.8 G ~~[Deleted]~~

...

5.8 ~~Outsourcing of Liquidity Management and Brokers' Advice~~

5.8.1 G ~~[Deleted]~~

...

Chapter 5, Annex 5A: Prudential liquidity

5A.1 G ...

...

1.3 Loans to:

(1) ...

(2) any relevant authority ("relevant authority" is defined in ~~Annex 1F~~ section 49 of the Local Government Act 2000, as may be amended from time to time)

...

6 ~~LENDING~~ ~~[Chapter deleted]~~

7 ~~LARGE EXPOSURES~~ ~~[Chapter deleted]~~

8 ~~MORTGAGE INDEMNITY INSURANCE~~ ~~[Chapter deleted]~~

9 ~~SYSTEMS~~ ~~[Chapter deleted]~~

10 ~~Securitisation~~ ~~[Chapter deleted]~~

11 ~~Outsourcing~~ ~~[Chapter deleted]~~

Amend IPRU(BSOC), Volume 2 as follows:

~~[Volume deleted]~~ ~~VOLUME 2 : CONSTITUTIONAL GUIDANCE~~

Annex G

Amendments to the Interim Prudential sourcebook for Insurers

Amend IPRU(INS) Chapter 1 as follows. Underlining indicates new text and striking through indicates deleted text.

Chapter 1

APPLICATION RULE

Application

Insurers

- 1.1 ...
- The Society of Lloyd's
- 1.2 No provisions of *IPRU(INS)* apply to the *Society of Lloyd's* of Lloyd's, or ~~members~~ members of the *Society of Lloyd's* of Lloyd's except rules 9.37 and 9.38, and Part VII of Chapter 9.

Insert the following text in Volume 1, Chapter 9 as a new Part VII (Lloyd's of London). The text is redesignated and restated text. Amendments to the redesignated text are not shown:

Part VII

LLOYD'S OF LONDON

Application

- 9.47 PART VII of *IPRU(INS)* chapter 9 applies to the *Society* and to *managing agents*.

Requirement to report to the FSA

- 9.48 (1) The *Society* must report to the *FSA* within 6 months of the end of each *financial year* on its financial situation and solvency and on the whole of the *insurance business* carried on by *members*.
- (2) The report in *IPRU(INS)* 9.48 (1) must be prepared in accordance with GENPRU 1.3.4 R and this chapter.
- (3) The report in *IPRU(INS)* 9.48 (1) must include:

- (a) the *Lloyd's Return* which comprises a completed set of the forms set out in *IPRU(INS)* Appendix 9.11, together with any statements, notes, reports or certificates required by this chapter; and
 - (b) a copy of the *syndicate* accounts for each *syndicate* that is required by *byelaw* to prepare accounts for the *financial year*.
- (4) With the exception of the statements required to be annexed to the *Lloyd's Return* by *IPRU(INS)* 9.49 (6), the *Lloyd's Return* must be examined and reported on by the auditors appointed to audit the affairs of the *Society*.
 - (5) The *Society* must provide a printed copy of the *Lloyd's Return* to the *FSA*, with Form 9 signed by three signatories who are senior officers of the *Society* each duly authorised by the *Council* to sign the *Lloyd's Return* on behalf of the *Society*.
 - (6) If the *FSA* notifies the *Society* that any part of the *Lloyd's Return* is not in conformity with this chapter, the *Society* must promptly make any appropriate corrections or adjustments and if necessary re-submit the *Lloyd's Return* (or relevant part of it).

Content and form of the Lloyd's Return

- 9.49 (1) In preparing the *Lloyd's Return*, the *Society* must:
- (a) complete the forms in *IPRU(INS)* Appendix 9.11, following the requirements of and making the disclosures required under Appendices 9.1, 9.2, 9.3 and 9.4 of *IPRU(INS)* as if in the documents referred to in those Appendices references to an *insurer* were references to the *Society* and *members*, and adapting the requirements in those Appendices where necessary;
 - (b) complete the forms in *IPRU(INS)* Appendix 9.11 using standard accounting *classes* as set out in *IPRU(INS)* Appendix 9.16 where the forms require reporting by accounting class;
 - (c) report treaty reinsurance general business falling in accounting *classes* 9 to 10 as set out in *IPRU(INS)* Appendix 9.16 in Forms 28 and 29 in *IPRU (INS)* Appendix 9.11 by reference to the categories in the underlying accounting classes; and
 - (d) complete forms 13, 14, 40-60 in *IPRU(INS)* Appendix 9.11 for each *long-term insurance business syndicate*.
- (2) (a) Where a reinsurance contract in *IPRU(INS)* 9.49 (1)(c) covers more than one underlying accounting class as set out in *IPRU(INS)* Appendix 9.16 it must be apportioned between accounting classes in the way that best reflects its underlying composition.
 - (b) However, where the apportionment in (a) cannot be made with reasonable accuracy or without disproportionate effort, then the contract must be allocated to the accounting class as set out in *IPRU*

- (INS) Appendix 9.16 that most closely reflects its underlying composition.
- (c) Whether apportioned under (a) or allocated under (b), a consistent approach must be taken to reporting:
 - (i) the progress of a treaty in subsequent years; and
 - (ii) substantially similar *insurance business* in subsequent years.
 - (d) Where a different policy is subsequently followed a suitable explanatory note must be provided.
- (3) If, during the financial year in question, the *Society* has agreed to, or carried out, a material connected party transaction, it must provide a brief description of that transaction by way of a supplementary note to the *Lloyd's Return*.
- (4) The description to be provided under *IPRU(INS) 9.49 (3)* must state:
- (a) the names of the transacting parties;
 - (b) a description of the connection between the parties;
 - (c) a description of the transaction;
 - (d) the amounts involved;
 - (e) any other elements of the transaction needed for an understanding of its effect or potential effect upon the financial position of the *Society*; and
 - (f) amounts written off in the period in respect of debts due to or from transacting parties which are connected parties.
- (5) Transactions with the same connected party may be disclosed on an aggregated basis unless separate disclosure is needed for a proper understanding of the effect of the transactions upon the financial position of the *Society*.
- (6) The *Society* must annex to the *Lloyd's Return* a copy of each statement completed by a *managing agent* under *IPRU(INS) 9.60 (7)*.
- (7) For the purposes of the *Lloyd's Return* and *IPRU(INS) 9.49 (6)*, the *Society* must, for each statement annexed, identify the *syndicate* to which the *contract of insurance* or 'financing arrangement' relates.

Risk groups for general insurance business

- 9.50 (1) The *Society* must for the purposes of reporting under this chapter:
- (a) classify the direct and facultative *general insurance business* of *members* according to appropriate risk groups; and

- (b) where the risks are material, complete a separate Form 34 in *IPRU(INS)* Appendix 9.11 for each group.
- (2) The *Society* must not include:
- (a) policies falling within *classes* 14, 15, 16, 17 or 18 within the same risk group as policies falling within any other *class*, except that policies falling within *class* 14 may be included in the same risk group as policies falling within *class* 15; or
 - (b) policies in respect of private motor car risks, within the same risk group as policies in respect of other risks falling within accounting class 2 as set out in *IPRU(INS)* Appendix 9.16; or
 - (c) policies in respect of comprehensive private motor car risks, within the same risk group as policies in respect of non-comprehensive private motor car risks; or
 - (d) policies transferred to *members* by way of a transfer under section 111 of the Act (Sanction of the court for business transfer schemes), within the same risk group as other policies.
- (3) The *Society* must give the *FSA* notice of proposed changes to the definition or classification of the risk groups in *IPRU(INS)* 9.50 (1), sufficient to allow the *FSA* properly to assess the implications of the proposals.

Major treaty reinsurers

- 9.51 (1) The *Society* must, in connection with the *general insurance business* carried on by *members*, include in the *Lloyd's Return* a statement of major treaty reinsurers.
- (2) A major treaty reinsurer is any insurance company to which in the *financial year* in question or any of the five preceding *financial years*:
- (a) in the case of proportional reinsurance, 2% or more of the gross premiums receivable in respect of *general insurance business* of the *members* in aggregate has been ceded; or
 - (b) in the case of non-proportional reinsurance, 5% or more of the gross premiums receivable in respect of *general insurance business* has been ceded.
- (3) The statement required under *IPRU(INS)* 9.51 (1) must include:
- (a) the full name of each major treaty reinsurer;
 - (b) the amount of the reinsurance premiums payable in the *financial year* to each such reinsurer;
 - (c) whether and if so how the reinsurer was connected to any *member* or any *managing agent*;

- (d) the amount of any debt of each such reinsurer included at line 75 of Form 13 in *IPRU(INS)* Appendix 9.11;
- (e) the amount of any deposit received from each such reinsurer under reinsurance treaties included at line 31 of Form 15 in *IPRU(INS)* Appendix 9.11; and
- (f) the reinsurers' share of *technical provisions* shown on Form 13 in *IPRU(INS)* Appendix 9.11 except that in respect of claims incurred but not reported, such recoveries need only be included to the extent that they are in respect of specific occurrences for which provisions have been allocated;

or, as the case may be, a statement that having aggregated the reinsurance ceded by *members* no reinsurer is a major treaty reinsurer.

- (4) The requirements of *IPRU(INS)* 9.51 (1), *IPRU(INS)* 9.52 (1) and *IPRU(INS)* 9.53 (1) may be satisfied by giving a fair view and making use of an appropriate degree of approximation. The *Society* may employ any reasonable methods to establish the information required.

Major facultative reinsurers

- 9.52 (1) The *Society* must, in connection with the *general insurance business* carried on by *members*, include in the *Lloyd's Return* a statement of major facultative reinsurers.
- (2) A major facultative reinsurer is an insurance company to which or with respect to which:
 - (a) 0.5% or more of the gross premiums *receivable* in respect of *general insurance business* of the *members* in aggregate has been ceded; or
 - (b) the addition of the amounts in items (d) and (e) of *IPRU(INS)* 9.51 (3) produces an amount exceeding 1% of the aggregate gross assets of *members*.
- (3) The statement required under *IPRU(INS)* 9.52 (1) must include the matters listed in *IPRU(INS)* 9.51 (3), with appropriate amendments.

Major reinsurance cedants

- 9.53 (1) The *Society* must, in connection with the *general insurance business* carried on by *members*, include in the *Lloyd's Return* a statement of major reinsurance cedants.
- (2) A major reinsurance cedant is an insurance company which in the *financial year* in question or any of the three preceding *financial years*:
 - (a) cedes an amount which exceeds 5% of the gross premiums *receivable* by *members* in respect of *general insurance business* accepted under reinsurance treaties; and

- (b) cedes an amount which exceeds 2% of the gross premiums *receivable* by *members* in respect of *general insurance business*.
- (3) The statement required under *IPRU(INS) 9.53 (1)* must include the matters listed in *IPRU(INS) 9.51 (3)*, with appropriate amendments.

Derivative contracts

- 9.54 (1) The *Society* must annex a statement to the *Lloyd's Return* comprising a brief description of:
- (a) any *byelaws* and guidelines issued by the *Society* governing the use of *derivative* contracts;
 - (b) any provision in those guidelines governing the use of contracts under which *members* have a right or obligation to acquire or dispose of assets which was not, at the time when the contract was entered into, reasonably likely to be exercised and the circumstances in which, pursuant to that provision, such contracts may be used;
 - (c) the extent to which *members* were during the *financial year* a party to any contracts of the kind described in (b);
 - (d) the extent to which any of the amounts recorded in Form 13 would be changed if assets which *members* had a right or obligation to acquire or dispose of under *derivative* contracts outstanding at the end of the *financial year* (being, in the case of *options*, only those *options* which it would have been prudent to assume would be exercised) had been acquired or disposed of;
 - (e) the difference between (d) and the amount which would result under (d) if such *options* had been exercised and this were reflected in Form 13 to the maximum extent;
 - (f) how different the information provided pursuant to (d) and (e) would have been if, instead of applying to contracts outstanding at the end of the *financial year*, (d) and (e) had applied to *derivative* contracts outstanding at such other time during the *financial year* as would have changed the amounts in Form 13 to the maximum extent;
 - (g) the maximum loss which would be incurred by *members* on the failure by any one other person to fulfil its obligations under *derivative* contracts outstanding at the end of the *financial year*, both under existing market conditions and in the event of other foreseeable market conditions, together with an assessment of whether such maximum loss would have been materially different at any other time during the *financial year*;
 - (h) the circumstances surrounding the use of any *derivative* contract held at any time during the *financial year* which did not fulfil the criteria in *INSPRU 4.2.5 R*; and

- (i) the total value of any fixed consideration received by *members* (whether in cash or otherwise) during the *financial year* in return for granting rights under *derivative* contracts and a summary of contracts under which such rights have been granted.
- (2) For the purposes of *IPRU(INS) 9.54 (1)*, if *members* are a party to:
- (a) a *contract for differences*; or
 - (b) any other contract which is to be, or may be, settled in cash they must be treated as having a right or obligation to acquire or dispose of the assets underlying the contract.

General insurance business ceded

- 9.55 (1) The *Society* must annex to the *Lloyd's Return* a statement:
- (a) of each major treaty reinsurer and major facultative reinsurer; and
 - (b) for each of the realistic disaster scenarios set by the *Society* when fulfilling its obligations under *INSPRU* and *GENPRU* to monitor aggregation of risk within the Lloyd's market of the contribution it is assumed each such reinsurer would provide in the event of that disaster occurring.

The Society

- 9.56 (1) The *Society* must annex to the *Lloyd's Return* a statement naming each individual who has served:
- (a) on the *Council*;
 - (b) as Chairman of the *Council*; and
 - (c) as Chief Executive Officer of the *Society*;

at any time during the *financial year*, including in each case the dates of commencement or end of service (as the case may be) of any individual who has not served for the entire year.

Capacity controlled

- 9.57 (1) The *Society* must annex to the *Lloyd's Return* a statement identifying any *members*, *members' agents* or *managing agents* that control a significant share of the underwriting capacity of the *Society*.
- (2) To control a significant share means:
- (a) in relation to a *managing agent*, managing, directing through one or more Members' Agent Pooling Arrangements or owning, whether directly or in conjunction with *connected persons*, capacity which in aggregate is greater than 5% of the total underwriting capacity of the *Society*;

- (b) in relation to a *members' agent*, directing through one or more Members' Agent Pooling Arrangements or owing, whether directly or in conjunction with *connected persons*, underwriting capacity which in aggregate is greater than 2.5% of the total underwriting capacity of the *Society*; and
- (c) in relation to a member, owning, whether directly or in conjunction with *connected persons*, underwriting capacity which, in aggregate, is greater than 2.5% of the total underwriting capacity of the *Society*.

Certificates and audit report

9.58 (1) Certificates

The *Society* must annex to the *Lloyd's Return*:

- (a) a certificate from the *Council*, including the statements required by *IPRU (INS)* Appendix 9.12;
- (b) a statement from the *Lloyd's actuary*, including the statements required by *IPRU (INS)* Appendix 9.13;
- (c) a certificate from the *syndicate actuary* of each *syndicate* which carries on *long-term insurance business*, including the statements required by *IPRU (INS)* Appendix 9.14, and;
- (d) an abstract from the *syndicate actuary* of each *syndicate* which carries on *long-term insurance business* of the *actuary's* report made under *SUP* 4.6.14G.

(2) Audit report

The *Society* must ensure that the *Lloyd's Return* and every document annexed to or provided with it has been examined by the *Society's* auditors and must provide with the *Lloyd's Return* an audit certificate in respect of that examination.

- (3) The certificate in *IPRU(INS)* 9.58 (2) must be in the form set out in *IPRU(INS)* Appendix 9.15.

Public disclosure

9.59 (1) The *Society* must provide within a period not exceeding 30 days:

- (a) on demand to any *member* or policyholder a copy of the *Lloyd's Return* and the *global account* most recently submitted to the *FSA*; and
- (b) if specifically requested by a *member* or policyholder, a copy of any *syndicate* account submitted to the *FSA*.

Syndicate-level reporting

- 9.60 (1) Each *managing agent* must:
- (a) prepare a return for each *financial year* in respect of the *insurance business* carried on through each *syndicate* managed by it; and
 - (b) provide the return in (a) to the *Society* as soon as practicable after the end of the financial year but in any event in time to enable the *Society* to report to the *FSA* in accordance with *IPRU(INS)* 9.48 (1).
- (2) The *Society* must:
- (a) issue instructions to *managing agents* setting out the form and content of the return under *IPRU(INS)* 9.60 (1); and
 - (b) issue the instructions in (a) as soon as practicable but in any event in time to enable *managing agents* to comply with *IPRU(INS)* 9.60 (1).
- (3) A *managing agent* must annex to each return which it prepares under *IPRU(INS)* 9.60 (1), a certificate signed by the persons referred to in *IPRU(INS)* 9.60 (4), including the statements required by *IPRU(INS)* Appendix 9.17.
- (4) The certificate in *IPRU(INS)* 9.60 (3) must be signed by:
- (a) where there are more than two *directors* of the *managing agent*, at least two of those *directors* and, where there are not more than two *directors*, all the *directors*; and
 - (b) a *chief executive*, if any, of the *managing agent* or (if there is no *chief executive*) the secretary.
- (5) A *managing agent* must ensure for each *syndicate* managed by it that the return required under *IPRU(INS)* 9.60 (1) is examined and reported on by the *syndicate* auditor.
- (6) A *managing agent* must annex to each return required under *IPRU(INS)* 9.60 (1) an audit certificate provided by the *syndicate* auditor including the statements required by *IPRU(INS)* Appendix 9.18.
- (7) A *managing agent* must annex to each return which it prepares under *IPRU(INS)* 9.60 (1) a statement of the information required by *IPRU(INS)* rule 9.32A, as if in that *rule* references to:
- (a) ‘*insurer*’ were to the *members* carrying on *insurance business* through the relevant *syndicate*;
 - (b) the ‘*return*’ were to the return required to be prepared by it in respect of the business carried on through the relevant *syndicate* under *IPRU(INS)* 9.60 (1)
 - (c) the ‘*insurer’s* balance sheet’ were to the *syndicate* balance sheet;

- (d) the ‘*insurer’s capital resources*’ were to the *capital resources* managed by or at the direction of the *managing agent* in respect of the *insurance business* carried on through the relevant *syndicate*; and
- (e) the ‘*insurer’s total technical provisions*’ were to the *technical provisions* in respect of the *insurance business* carried on through the relevant *syndicate*.

The Central Fund

- 9.61 (1) The *Society* must give the *FSA* a report on the *Central Fund* as at the end of each calendar quarter.
- (2) The report referred to in *IPRU(INS) 9.61 (1)* must reach the *FSA* within two weeks of the end of each calendar quarter and must include information on:
- (a) the net market value of the *Central Fund*;
 - (b) payments made from the *Central Fund* in that quarter;
 - (c) the types of investment in which the *Central Fund* is held;
 - (d) the commencement or cessation of, or any changes in the terms of, any insurance policy taken out to protect the *Central Fund*; and
 - (e) any claim made, or circumstances notified that are likely to lead to a claim, under any insurance policy taken out to protect the *Central Fund*.

Information about the capacity transfer market

- 9.62 (1) The *Society* must give the *FSA* a report as at the end of each calendar quarter in which any capacity is transferred.
- (2) The report referred to in *INSPRU 8.4.3 R* must reach the *FSA* within one month of the end of the relevant calendar quarter and must include information on:
- (a) the total capacity in *syndicates* transferred during the quarter, analysed by *syndicate* and method of transfer;
 - (b) the number, and nature, of all investigations by the *Society* into conduct in the *capacity transfer market* undertaken or continued during the quarter; and
 - (c) the number, and nature, of all complaints received during the quarter about the operation of the *capacity transfer market*.

Guidance

- 9.63 (1) *IPRU(INS)* Chapter 9 Part VII requires the *Society* to report on the *insurance business* carried on by *members* and on the assets and liabilities of *members* and the *Society*, and requires reports from the *Society* on the *Central Fund* and the *capacity transfer market*. It also requires *managing agents* to report on the *insurance business* carried on through each *syndicate* they manage. Reporting at syndicate level is required to enable the *Society* to prepare the *Lloyd's Return*. The statements required to be annexed to the return by *IPRU(INS)* 9.60 (7) should not be included in the audit under *IPRU(INS)* 9.49 (6).
- (2) The *Lloyd's Return* is made annually and contains the statement required from the *Society* that *capital resources* at least equal to the *capital resources requirements* for *general insurance business* and *long-term insurance business* under *GENPRU 2* have been maintained at all times throughout the *financial year*.
- (3) For *general insurance business*, the *capital resources requirement* for the *Society* is the higher of the aggregate of the *members' capital resources requirements* for *general insurance business*, calculated in accordance with *GENPRU 2.3.5 R*, and the *Society GICR*. For *long-term business*, the *capital resources requirement* for the *Society* is the aggregate of the *members' capital resources requirements*, calculated in accordance with *GENPRU 2.3.7 R*. The *Society* is required to ensure that each *member's capital resources requirement* is covered by that *member's capital resources*, or, where there is a shortfall in the *member's capital resources*, by the *Society's own capital resources*. For *general insurance business*, the *Society* must ensure that the *Society GICR* is covered by the aggregate *capital resources* supporting the *insurance business* of all the *members*.
- (4) Where appropriate, the *Society* is also required to modify prudential reporting to make it more like that of an *insurer*. This is to aid comparisons between *Lloyd's* and *insurers*.
- 9.64 The *Society* should make the report referred to in *IPRU(INS)* 9.48 (1), including amendments and corrections, and amalgamated *syndicate* accounts available at its head office for inspection by policyholders and potential policyholders and *members*.
- 9.65 (1) In assessing what are appropriate risk groups for reporting purposes the *Society* should ensure where possible that:
- (a) each risk group should include only risks from within a single accounting class and in relation to a single country;
 - (b) policies are not included in the same risk group where, having regard to the patterns of risk, *claims* incurrence and settlement patterns, it is necessary to group them separately for the purposes of applying statistical methods in calculating the provision for *claims* outstanding in accordance with generally accepted accounting practice; and
 - (c) claims-made policies are not included in the same risk group as policies which are not claims-made policies, except:

- (i) where this is not possible without disproportionate expense; and
 - (ii) where the policies within the risk group do not exhibit materially different characteristics.
 - (2) Subject to *IPRU(INS) 9.50 (2)(a)* and *IPRU(INS) 9.50 (2)(b)* and *IPRU(INS) 9.65 (1)(c)*, the *Society* may in respect of any accounting class include all *insurance business* carried on by *members* in any country in any *financial year* as a single risk group.
 - (3) Notwithstanding the provisions of *IPRU(INS) 9.50 (2)(a)* and *IPRU(INS) 9.50 (2)(b)* and *IPRU(INS) 9.65 (1)(c)*, the *Society* may classify all *insurance business* carried on by *members* in any country in respect of any accounting class in any financial year as a single risk group, as long as gross premiums written for that year in respect of that *insurance business* are less than 5% of the world-wide gross premiums written for all accounting *classes* for that year.
 - (4) The requirements to report a separate risk group in *IPRU(INS) 9.50 (2)(a)* do not apply where, in the case of any *financial year*, the gross premiums receivable for that year in respect of that risk group would be less than £1million.
- 9.66 The *Society* should be treated as if it were a major treaty reinsurer when *inter-syndicate reinsurance* in aggregate exceeds the amounts set out in *IPRU(INS) 9.51 (2)*
- 9.67 The *Society* should be treated as if it were a major facultative reinsurer when *inter-syndicate reinsurance* in aggregate exceeds the amounts set out in *IPRU(INS) 9.52 (2)*.
- 9.68 The *Society* should be treated as if it were a major reinsurance cedant when *inter-syndicate cessions* in aggregate exceed the amounts set out in *IPRU(INS) 9.53 (2)*.
- 9.69 In relation to required disclosures of *derivative* contracts in *IPRU(INS) 9.54 (1)*, references to a *derivative* contract and related expressions should be taken to include:
- (1) any *derivative* contract entered into by a *managing agent* on behalf of a *member* as part of that *member's insurance business*; and
 - (2) any *derivative* contract entered into by the *Society*.
- 9.70 Contracts that are *quasi-derivative contracts* should be treated as *derivative* contracts.
- 9.71 The requirements of *IPRU(INS) 9.55(1)* may be satisfied by giving a fair view and may make use of an appropriate degree of approximation. The *Society* may employ any reasonable methods to establish the information required. The *Society* may also include such explanation as it considers to be necessary to allow a reasonable interpretation to be put on this statement.

- 9.72 (1) Because of the significance of the *Central Fund* in the protection of policyholders, the *Society* should notify the *FSA* under *IPRU(INS)* 9.61 (2)(e) of all matters relevant to any actual or potential claim. These include but are not limited to the facts on which that claim is based, the circumstances under which those facts arose and any relevant response to the claim from any *insurer* or reinsurer concerned.
- (2) The report referred to in *IPRU(INS)* 9.61 (1) must be submitted in writing in accordance with *SUP* 16.3.7 to *SUP* 16.3.10 (see *SUP* 16.3.6).

Appendix 9.11

Reporting forms

1. This appendix consists only of one or more forms or templates. Forms and templates are to be found through the 'Forms' link under Useful Links section at www.fsahandbook.info or on the Handbook CD-ROM.

Appendix 9.12 (rule IPRU (INS) 9.58 (1)(a))

Certificate by the Council

1	Subject to 5, the certificate required by <i>IPRU (INS) 9.58 (1)</i> must state:	
	(a)	in relation to Forms 9 to 17, 20 to 42, the supplementary notes to the forms and the statements required under <i>IPRU (INS) 9.51 (1)</i> , <i>IPRU (INS) 9.52 (1)</i> and <i>IPRU (INS) 9.53 (1)</i> , <i>IPRU (INS) 9.54 (1)</i> , <i>IPRU (INS) 9.57 (1)</i> , that:
	(i)	the <i>Lloyd's Return</i> has been prepared in accordance with <i>IPRU (INS) Chapter 9 Part VII</i> , <i>INSPRU</i> and <i>GENPRU</i> ;
	(ii)	proper accounting records have been maintained and adequate information has been obtained by the <i>Society</i> ; and
	(iii)	an appropriate system of control has been established and maintained by the <i>Society</i> over its transactions and records;
	(b)	that, as applicable, the assets held by <i>members</i> throughout the <i>financial year</i> in question enabled the <i>Society</i> to comply with <i>INSPRU 1.1.30R</i> (Localisation (UK firms only)) and <i>INSPRU 1.1.34R</i> (Matching of assets and liabilities); and
	(c)	in relation to the statement required by <i>IPRU (INS) 9.58 (1)(b)</i> to be made by the <i>Lloyd's actuary</i> , that:
	(i)	for the purpose of preparing the statement, proper accounts and records have been maintained; and
	(ii)	the information given has been ascertained in conformity with <i>IPRU (INS) 9.58 (1)</i> .
2	Subject to 5, the certificate required by <i>IPRU (INS) 9.58 (1) (a)</i> must state that <i>capital resources</i> at least equal to the <i>capital resources requirements</i> under <i>GENPRU 2</i> , have been maintained at all times during the <i>financial year</i> in question.	
3	Subject to 5, the certificate required by <i>IPRU (INS) 9.58 (1)(a)</i> must also state in relation to the <i>long-term insurance business</i> carried on by <i>members</i> :	
	(a)	that the requirements of <i>INSPRU 1.5.18R</i> to <i>INSPRU 1.5.33R</i> have been fully complied with and in particular that, subject to the provisions of <i>INSPRU 1.5.27R</i> assets attributable to <i>long-term insurance business</i> , the income arising, the proceeds of any realisation of such assets and any other income or proceeds allocated to the <i>long-term insurance fund</i> or <i>funds</i> have not been applied otherwise than for the purpose of the <i>long-term insurance business</i> ;
	(b)	that all guarantees given by a <i>member</i> of the performance by a related <i>insurer</i> which would fall to be met by any <i>long-term insurance fund</i> have been disclosed in the <i>Lloyd's Return</i> , and that the fund or funds on which each of those guarantees would fall has been identified in it;

	(c)	that the return in respect of <i>long-term insurance business</i> is not distorted by agreements between the <i>members</i> concerned or by any arrangements which could affect the apportionment of expenses and income; and
4	Subject to 5, where the <i>Council</i> is satisfied that:	
	(a)	the systems of control established and maintained by <i>managing agents</i> complied, at the end of the <i>financial year</i> in question, with any relevant guidance and it is reasonable to believe that those systems continued so to comply and will continue to so comply; or
	(b)	the <i>Lloyd's Return</i> has been prepared in accordance with any relevant guidance; this must be so stated, by listing that guidance, in the certificate required by <i>IPRU (INS) 9.58 (1)(a)</i> .
5	Where, in the opinion of those signing the certificate, the circumstances are such that any of the statements required by 1 to 4 cannot truthfully be made, the relevant statements must be omitted.	
6	Where, by virtue of 5, any statements have been omitted from the certificate this fact must be stated in a note.	

Appendix 9.13 (rule IPRU (INS) 9.58 (1)(b))

Statement by the Lloyd's actuary

1	The statement required by <i>IPRU (INS) 9.58 (1)(b)</i> must be prepared and signed by the <i>Lloyd's actuary</i> , and must:		
	(a)	state whether, for every <i>syndicate year</i> in which members carry on <i>general insurance business</i> either:	
		(i)	the <i>syndicate actuary</i> has provided an unqualified opinion, which:
			(1) is in a form conforming to guidance from the <i>actuarial bodies</i> ; and
			(2) confirms that the <i>technical provisions</i> set by the <i>managing agent</i> are at least equal to the <i>syndicate actuary's</i> best estimate; or
		(ii)	the <i>Lloyd's actuary</i> has set the <i>technical provisions</i> (both gross and net of reinsurance recoveries); and
	(b)	describe any source of uncertainty in the liabilities covered by the <i>technical provisions</i> , which in his opinion is material to the <i>Society</i> as a whole:	
		(i)	which any <i>syndicate actuary</i> mentions in his opinion; or
		(ii)	which affects any <i>syndicate year</i> for which the <i>Lloyd's actuary</i> has set the <i>technical provisions</i> .
2	If the <i>Lloyd's actuary</i> has set the <i>technical provisions</i> for any <i>syndicate year</i> , the statement must include an opinion covering those <i>technical provisions</i> , which:		
	(a)	confirms that they are at least equal to his best estimate; and	
	(b)	is in a form conforming to guidance for <i>syndicate actuaries</i> from the <i>actuarial bodies</i> , modified to show:	
		(i)	that he is retained by the <i>Society</i> and not the <i>managing agent</i> ;
		(ii)	that he, and not the <i>managing agent</i> , set the <i>technical provisions</i> ; and
		(iii)	separately, the <i>technical provisions</i> of each <i>syndicate year</i> covered.
3	If the <i>Lloyd's actuary</i> considers it necessary, such qualification, amplification or explanation as may be appropriate must be added to the statement.		

Appendix 9.14 (rule IPRU (INS) 9.58 (1))

Certificate by syndicate actuary

1	The certificate required by <i>IPRU (INS) 9.58 (1)(c)</i> to be signed by the <i>syndicate actuary</i> appointed to a <i>syndicate</i> in which <i>members</i> carry on <i>long-term insurance business</i> must state:	
	(a)	whether in his opinion, proper records have been kept by the <i>managing agent</i> adequate for the purpose of the valuation of the liabilities of the <i>syndicate</i> ;
	(b)	whether the sum of the <i>mathematical reserves</i> and the deposits received from reinsurers as shown in Form 14 constitute proper provision at the end of the <i>financial year</i> for the <i>long-term insurance liabilities</i> where these liabilities:
	(i)	include any increase in liabilities arising from a distribution of surplus as a result of an investigation as at the end of the <i>financial year</i> into the financial condition of the <i>long-term insurance business</i> ; and
	(ii)	include all liabilities arising from <i>deposit back arrangements</i> ;
		but exclude liabilities which had fallen due before the end of the <i>financial year</i> , other than those arising from deposit back arrangements;
	(c)	whether the liabilities have been valued in accordance with <i>INSPRU</i> and <i>GENPRU</i> in the context of assets valued in accordance with <i>GENPRU</i> , as shown in Form 14;
	(d)	by way of a list, the professional guidance that has been complied with;
	(e)	whether in his opinion, premiums for contracts entered into during the <i>financial year</i> and the income earned on them are sufficient on reasonable actuarial assumptions, taking into account other financial resources of the <i>members</i> and the <i>Society</i> that are available for the purpose, to enable the <i>members</i> to meet their commitments and, in particular, to establish adequate <i>mathematical reserves</i> ; and
	(f)	whether the amounts in Form 60 are accurate.
2	If the <i>syndicate actuary</i> considers it necessary, such qualification, amplification or explanation as may be appropriate must be added to the certificate.	

Appendix 9.15 (rule IPRU (INS) 9.58 (3))

Auditors' report

1	The certificate required by <i>IPRU (INS) 9.58 (2)</i> must, in addition to any statement required by section 237(2) and (3) of the Companies Act, state:	
	(a)	that in the auditors' opinion, Forms 9 to 17, 20 to 42, the supplementary notes to the forms and the statements required under <i>IPRU (INS) 9.51 (1)</i> , <i>IPRU (INS) 9.52 (1)</i> , <i>IPRU (INS) 9.53 (1)</i> and <i>IPRU (INS) 9.54 (1)</i> have been properly prepared in accordance with <i>IPRU (INS) Chapter 9 Part VI</i> , <i>INSPRU</i> and <i>GENPRU</i> ;
	(b)	that according to the information and explanations that the auditors have received:
	(i)	in their opinion, the certificate required to be signed in accordance with <i>IPRU (INS) 9.58 (1)(a)</i> , otherwise than in relation to statements to which paragraph 1(c) of this table relates, has been properly prepared in accordance with <i>IPRU (INS) Chapter 9 Part VII</i> , <i>INSPRU</i> and <i>GENPRU</i> ; and
	(ii)	subject to paragraph 1(c), it was or was not unreasonable for the persons giving the certificate to have made the statements in it (other than statements to which paragraph 1(c) relates); and
	(c)	the extent to which, in giving their opinion, the auditors have relied:
	(i)	in respect of financial information supplied to the <i>Society</i> by <i>managing agents</i> on behalf of <i>syndicates</i> , on work carried out by <i>syndicate auditors</i> ; and
	(ii)	in respect of <i>long-term insurance business</i> carried on by <i>members</i> , on the certificates of the <i>syndicate actuaries</i> given in accordance with the requirements of <i>IPRU (INS) Chapter 9 Part VII</i> , <i>INSPRU</i> and <i>GENPRU</i> with respect to the amounts in Form 60.
2	The audit opinion required by 1(b)(i) does not extend to cover the statements required under:	
	(a)	<i>IPRU (INS) 9.55 (1)</i> and ; and <i>IPRU (INS) 9.57 (1)</i>
	(b)	<i>IPRU (INS) Appendix 9.12 1(d)</i> , but only in so far as it relates to relevant guidance which either states that compliance with the guidance need not be audited or which relates to controls with respect to money laundering.
3	To the extent that the information and explanations they have received do not allow the auditors to express an opinion on whether it was or was not unreasonable for the <i>Council</i> to have made the statement required by <i>IPRU (INS) Appendix 9.12 1(a)(iii)</i> the auditors must add to their report such qualification, amplification or explanation as may be appropriate.	

- | | |
|---|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 4 | Where the auditors refer in their report or in any note attached to their report to any uncertainty, the report must state whether, in the auditors' opinion, that uncertainty is material to determining whether the <i>Society</i> is able to meet the solvency requirements of <i>IPRU (INS)</i> Chapter 9 Part VII, <i>INSPRU</i> and <i>GENPRU</i> . |
|---|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|

Appendix 9.16 (rule IPRU (INS) 9.49 (1)(b))

Accounting classes

1	For the purposes of <i>IPRU (INS)</i> Chapter 9 Part VII, the accounting classes for <i>general insurance business</i> are those set out in the following table:
---	------------------------------------------------------------------------------------------------------------------------------------------------------------------

Accounting class	Description	Corresponding classes of <i>general insurance business</i>
1	Accident and health	1 (other than 1(p) and 2
2	Motor	1(p), 3 and 10
3	Aviation	1(p), 5 and 11
4	Marine	1(p), 6 and 2
5	Transport	7
6	Property	4, 8, and 9
7	Third-party liability	13
8	Miscellaneous and pecuniary loss	14, 15, 16, 17 and 18
9	Non-proportional treaty	
10	Proportional treaty	
11	Marine, aviation and transport treaty	

Appendix 9.17 (rule IPRU (INS) 9.60 (3))

1	The certificate in <i>IPRU(INS) 9.60 (3)</i> must state that:	
	(a)	the return has been properly prepared in accordance with the instructions referred to in <i>IPRU(INS) 9.60 (2)</i> ;
	(b)	proper accounting records have been maintained and adequate information has been obtained by the <i>managing agent</i> ;
	(c)	an appropriate system of control has been established and maintained by the <i>managing agent</i> over the <i>syndicate's</i> transactions and records;
	(d)	in relation to the statement by the <i>syndicate actuary</i> of a <i>syndicate</i> carrying on <i>long-term insurance business</i> required by <i>IPRU(INS) 9.58 (1)(c)</i> :
		(i) proper accounts and records have been maintained for the purpose of preparing the statement; and
		(ii) the information given has been ascertained in conformity with <i>IPRU(INS) Appendix 9.14</i> .

Appendix 9.18 (rule IPRU (INS) 9.60 (7))

1	The certificate in <i>IPRU(INS) 9.60 (7)</i> must state:	
	(a)	that in the auditors' opinion, the return has been properly prepared in accordance with the instructions referred to in <i>IPRU(INS) 9.60 (2)</i> ;
	(b)	that according to the information and explanations that the auditors have received:
	(i)	in their opinion, the certificate required to be signed in accordance with <i>IPRU(INS) 9.60 (3)</i> (other than statements to which paragraph 1(c) relates) has been properly prepared in accordance with the instructions; and
	(ii)	it was or was not unreasonable for the <i>persons</i> giving the certificate to have made the statements in it (other than statements to which paragraph 1(c) relates);
	(c)	the extent to which, in giving their opinion, the auditors have relied, in respect of <i>long-term insurance business</i> , on the work of the <i>syndicate actuary</i> .
2	The audit opinion required by paragraph 1 does not extend to cover information on major treaty reinsurers or major facultative reinsurers.	
3	To the extent that the information and explanations they have received do not allow the auditors to express an opinion as to whether it was or was not unreasonable for the persons giving the certificate required to be signed in accordance with <i>IPRU(INS) 9.60 (3)</i> to have made the statements therein, the auditors must add to their report such qualification, amplification or explanation as may be appropriate.	

Annex H

Amendments to the Interim Prudential sourcebook for Investment Businesses

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

Amend IPRU(INV) as follows:

Contents

Chapter

1 ...

...

7 UCITS Management Firms

...

Transitional provisions

1. Table Transitional provisions applying to IPRU(INV)

(1)	(2)	(3)	(4)	(5)	(6)
	Material to which the transitional provision applies		Transitional provision	Transitional provision: dates in force	Handbook provision: coming into force
1.	IPRU (INV) Chapter 7	R	[Deleted: material moved to UPRU]	[Deleted: material moved to UPRU]	[Deleted: material moved to UPRU]
2.	<i>The provisions of IPRU(INV) added by the Interim Prudential Sourcebook for Investment firms (Market Risk)</i>	R	[Deleted]	[Deleted]	[Deleted]

	<i>Instrument 2004</i>				
--	----------------------------	--	--	--	--

1 Chapter 1: Application and General Provisions

1.1 Purpose

1.1.1 G ~~Before 1 January 2007, the Interim Prudential Sourcebook for Investment Businesses (*IPRU (INV)*) sets out the detailed financial resources and prudential standards which the *FSA* applies to certain *firms* on an interim basis pending the introduction of a single prudential sourcebook applying to all *firms* regulated by the *FSA* – (the Integrated Prudential Sourcebook) was the part of the *Handbook* that dealt with capital requirements for *investment firms* subject to the position risk requirements of the previous version of the *Capital Adequacy Directive*. Now however, *investment firms* which are subject to the risk-based capital requirements of the *Capital Adequacy Directive* are subject to the General Prudential sourcebook (*GENPRU*) and the Prudential sourcebook for Banks, Building Societies and Investment Firms (*BIPRU*). However the *FSA* has not yet removed the parts of *IPRU (INV)* that deal with requirements for *firms* subject to risk-based capital requirements of the previous version of the *Capital Adequacy Directive*. Consequently, many provisions of *IPRU (INV)* will not apply to any *firm*. The *FSA* intends to remove these provisions in due course.~~

...

1.1.3A G This sourcebook does not apply to *BIPRU investment firms* except as provided in chapter TP of *BIPRU* applying parts of *IPRU (INV)* to certain *BIPRU investment firms* on a transitional basis.

...

1.1.6 G The *Supervision manual* sets out provisions relating to the periodic reporting and notification of financial information to the *FSA* or to the auditing of accounts. However, this sourcebook contains a few additional notification requirements (*notification rules*) arising out of EU Directives.

1.2 APPLICATION

1.2.1 ...

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

(a) ...

...

(g) the *Society of Lloyd's* (in relation to *underwriting agents*); and

(h) ~~a UCITS management company; and~~

(i) ...

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

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

(3) ...

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

- (a) ...
- ...
- (g) a *UCITS qualifier*; or
- (h) a *UCITS management company*.

...

1.2.5 R Table

This table belongs to IPRU (INV) 1.2.34R

...	...
<i>UCITS management company</i>	Chapters 1 and 7
...	...

...

3 Chapter 3: Financial resources for Securities and Futures Firms which are not Investment Firms

...

3-166(3) R ...

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

...

Models approach

3-169A G ...

G The *FSA* will grant a modification or waiver permitting the use of a VaR model only where a number of qualitative and quantitative standards are met. In assessing the VaR model the *FSA* will have regard to the matters set out in ~~Chapter TV of IPRU (BANK)~~ *BIPRU 7.10*.

...

~~Consolidated Supervision~~

~~Scope of test~~

3-190(1) R [Deleted]

3-190(2) R [Deleted]

G [Deleted]

3-190(3) R [Deleted]

3-190(4) R [Deleted]

G [Deleted]

~~Constituents of a group~~

3-191(1) R [Deleted]

3-192(2) G [Deleted]

G [Deleted]

~~Exemptions~~

3-192(3) R [Deleted]

~~Group financial resources~~

3-192(4) R [Deleted]

G [Deleted]

~~Group financial resources requirement~~

3-193(1) R [Deleted]

3-193(2) R [Deleted]

3-193(3) R [Deleted]

3-193(4) R [Deleted]

G [Deleted]

3-193(5) G [Deleted]

~~Intra-group offsets and netting~~

3-194 R [Deleted]

~~Exemption from consolidated supervision~~

3-195 R [Deleted]

...

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

Delete the following definitions from Appendix 1; the text is not shown struck through:

bank

credit institution

EEA parent

5 CHAPTER 5: FINANCIAL RESOURCES

5.1.1 APPLICATION

...

...				
Consolidated supervision rules				
5.7.1(1)(b) to 5.7.5(2)	Yes, but only for <i>€AD firms</i>	No	No	No
...				
Consolidated supervision rules				
5.7.1(1)(b) to 5.7.5(2)	No	No	Yes, but only for <i>€AD firms</i>	
...				

...

TRANSITIONAL ARRANGEMENTS

...

...	
PART II <i>OWN FUNDS TRANSITIONAL PROVISIONS</i>	
1	<u>[Deleted]</u>

- | | | |
|---|-----|-----------|
| 2 | (a) | [Deleted] |
| | (b) | [Deleted] |
| | (c) | [Deleted] |
| | (d) | [Deleted] |
| 3 | | [Deleted] |
| 4 | | [Deleted] |

...

5.7 CONSOLIDATED SUPERVISION

5.7.1 [Deleted]

5.7.2 [Deleted]

5.7.3 [Deleted]

5.7.4 [Deleted]

5.7.5 [Deleted]

APPENDIX 1 (INTERPRETATION)

GLOSSARY OF TERMS FOR CHAPTER 5 (FORMER IMRO FIRMS)

Amend the following definitions in Appendix 1 as shown:

- category b body* means:
- (a) ...
 - ...
 - (e) an *investment firm* or *credit institution* authorised in any other country, which applies a financial supervision regime at least equivalent to the ~~Capital Adequacy Directive (No. 93/6/EEC)~~ Capital Adequacy Directive.
- exempt exposure* means:
- (a) ...
 - ...
 - (g) to a *connected company* provided that the *group* is supervised on a consolidated basis in accordance with the ~~Second Consolidated Supervision Directive~~ Banking Consolidation Directive and the consolidation requirements of the ~~Capital Adequacy Directive (No. 93/6/EEC)~~ Capital

Adequacy Directive; or

- financial resources requirement* (a) ~~(in relation to a UCITS management company)~~ has the meaning given in rule 7.2.1R(2) and (3);
- (b) ~~(in relation to a firm other than one in (a))~~ has the meaning given in rule 5.2.3(1)(a) to (c) (Determination of requirement).
- liquid capital* (a) ~~(in relation to a UCITS management company)~~ means capital calculated in accordance with Table 7.3.1R composed of the specified items set out in that Table;
- (b) ~~(in relation to a firm other than one in (a))~~ has the meaning given in rule 5.2.2(1) (Calculation of own funds and liquid capital).
- otc derivative* means interest rate and foreign exchange contracts covered by Annex III to the previous version of the Banking Consolidation Directive (i.e. Directive (2000/12/EC)) and off balance sheet contracts based on equities which are not traded on a *recognised* or *designated investment exchange* or other exchange where they are subject to daily margin requirements, excluding any foreign exchange contract with an original maturity of 14 calendar days or less.
- own funds* (a) ~~(in relation to a UCITS management company)~~ has the meaning given in Table 7.3.1R composed of the specified items set out in that Table;
- (b) ~~(in relation to a firm other than one in (a))~~ has the meaning given in rule 5.2.2(1) (Calculation of own funds and liquid capital).
- recognised third country investment firm* means an *investment firm* which is authorised in a country other than a *member state* and which is subject to and complies with prudential rules equivalent to the requirements of the ~~Capital Adequacy Directive (No. 93/6/EEC)~~ Capital Adequacy Directive.

Delete the following definitions from Appendix 1; the text is not shown as struck through:

CAD Article 3 exempting criteria

CAD firm

consolidated supervision

contingent liability

credit institution

EEA firm

financial institution

group financial resources

group financial resources requirement

listed activity

7. [Deleted:material moved to UPRU]UCITS MANAGEMENT COMPANIES

10 Chapter 10: Financial resources for Securities and Futures Firms which are Investment Firms

...

10-32(6) R A *firm* which is subject to the waiver from consolidated supervision in accordance with rule ~~10-204~~14.1.4 R is exempt from (5) above.

...

10-60 FIRMS TO WHICH RULES 10-61 TO ~~10-204~~10-196 APPLY

Category A, B and C firms

10-60(1) R Rules 10-61 to ~~10-204~~10-196 apply to a *category A, B or C firm*

...

10-61(7) R A *firm* must deduct the full value of its *material holdings in credit or financial institutions*, in accordance with Table 10-61(1)B, unless:

- (a) the *firm* has been granted a waiver from rules ~~10-200 to 10-203~~ IPRU(INV) 14, in which case it must:
 - (i) deduct in full from *original own funds* those *material holdings in credit or financial institutions* which would have been included in the scope of consolidation in accordance with rule ~~10-200(3)~~14.2.1R if the waiver had not been granted; and

...

...

10-62(2) R A *firm* must calculate its *financial resources* in accordance with Table 10-62(2)(2)A below, unless:

(a) it has been granted a waiver from rules ~~10-200 to 10-203~~ IPRU(INV) 14, in which case it must calculate *financial*

resources in accordance with Table 10-62(2)B; or

...

...

10-63 (12) R

...

G

...

G

In respect of (b) above, a *firm* which has been granted a waiver from ~~rules 10-200 to 10-203~~ IPRU(INV) 14 may use the items of capital listed in "E" in Table 10-62(2)B to cover the items in line "F" before it uses *original own funds* to cover the items in line "F".

G

...

...

10-65 (12) R

The liquidity adjustment for a *material holding* in either a *credit* or *financial institution* is:

(a)

...

(b)

for a *firm* which has been granted a waiver from ~~rules 10-200 to 10-203~~ IPRU(INV) 14: 100%, unless it is:

(i)

a *material holding* in a *credit* or *financial institution* which would have been included in the scope of consolidation in accordance with rule ~~10-200(3)~~ 14.2.1 R if the waiver had not been granted, in which case it must be deducted in full from *original own funds*; or

...

...

10-190 (1) R

A *firm* must comply with rules 10-190 to 10-195 on both a solo and consolidated basis, except that a *firm* with a waiver from consolidated supervision in accordance with rule ~~10-204~~ 14.1.4 R or which is exempt under rule ~~10-200(2)~~ 14.1.2 R, must comply with rules 10-190 to 10-195 on a solo basis only and also with rule 10-196.

...

10-192 (1) R

A *firm* may exclude the following from its *LER* calculation and the limits set out in rule 10-193:

(a)

...

...

- (g) if the *firm* first notifies the *FSA* in writing, *exposures* to the *firm's parent, subsidiaries* and other *subsidiaries of its parent*, provided that these entities are subject to consolidated supervision in accordance with ~~rules 10-200 to 10-203~~IPRU (INV) 14;

...

- 10-196 R A *firm* which is exempt from consolidated supervision in accordance with rule ~~10-204~~14.1.4 R must either:
- (a) have in place an *ACMP* which enables the *firm* to monitor its *exposures* on a groups wide basis; or
- (b) report to the *FSA* all group *large exposures* at the end of each quarter.

Consolidated Supervision

10-200 ~~[Deleted]~~

~~GROUP FINANCIAL RESOURCES~~

10-201 R ~~[Deleted]~~

10-202 ~~[Deleted]~~

~~INTRA-GROUP OFFSETS AND NETTING~~

10-203 R ~~[Deleted]~~

~~EXEMPTION FROM CONSOLIDATED SUPERVISION~~

10-204 R ~~[Deleted]~~

APPENDIX 1 – GLOSSARY OF TERMS FOR IPRU(INV) 10

Amend the following definition in Appendix 1 as shown:

listed activities ~~means a listed activity within the meaning of the *BCD*, i.e. one or more of the following activities—~~

- (a) ~~lending;~~

- ~~(b) financial leasing;~~
- ~~(c) money transmission services;~~
- ~~(d) issuing and administering means of payment;~~
- ~~(e) guarantees and commitments;~~
- ~~(f) trading for own account or for the account of customers in money market instruments (cheques, bill, CDs, etc);~~
- ~~(g) foreign exchange;~~
- ~~(h) financial *futures* and *options*;~~
- ~~(i) exchange and interest rate instruments; or~~
- ~~(j) transferable *securities*;~~
- ~~(k) *participation* in share issues and the provision of services related to such issues;~~
- ~~(l) corporate finance advice;~~
- ~~(m) moneybroking;~~
- ~~(n) portfolio management and advice; or~~
- ~~(o) safekeeping and administrative of securities;~~

has the meaning set out in the Handbook *Glossary* for *listed activity*.

Delete the following definitions from Appendix 1; the text is not shown struck through:

credit institution

EEA parent

financial institution

oil

oil collective investment scheme

oil investment

oil market investment activities

oil market participant

Chapter 10, Appendix 4: Interest rate PRR

...

DEFINITION OF A QUALIFYING DEBT SECURITY

46 R A debt *security* is a *qualifying debt security* if:

(1) ...

...

(4) it is a mortgage backed *security* relating to residential real estate of the type referred to in BIPRU 3.4.94R(1)(d)(i) which meets the ~~criteria in 7e of section 3.2.5 of chapter BC of IPRU (BANK)~~requirements about legal certainty referred to in BIPRU 3.4.62R.

...

...

Chapter 10, Appendix 10: Use of CAD 1 Model

...

5. G ~~As explained in SUP 8.3.1G, waivers permitting the use of models in the calculation of PRR will not be granted if that would be contrary to the CAD, and any waiver which is granted will only be granted on terms that are compatible with the CAD. The FSA considers it unlikely that it will deviate from this even where the firm making the waiver application is not subject to CAD. Accordingly, It is generally the case that only waivers permitting the use of models that the FSA is likely to grant are CAD1 and VaR models in accordance with the policy in this appendix.~~

...

Chapter 10, Appendix 11: Use of Value at Risk Model

...

2. G The models described in this appendix are described as VaR models in order to distinguish them from the kinds of model originally contemplated by the ~~Capital Adequacy Directive (CAD) previous version of the Capital Adequacy Directive (i.e. Directive 93/6/EEC).~~ (These are covered in Appendix 10 and referred to as "CAD 1 models"). A VaR model is a risk management model which uses a statistical measure to predict profit and loss movement ranges with a confidence interval. ~~The standards described in this appendix, and which will be applied by the~~

~~FSA, are based on and implement Annex VIII of the CAD.~~

...

12. G ~~As explained in SUP 8.3.1G, waivers permitting the use of models in the calculation of PRR will not be granted if that would be contrary to the CAD, and any waiver which is granted will only be granted on terms that are compatible with the CAD. The FSA considers it unlikely that it will deviate from this approach even where the firm making the waiver application is not subject to CAD. Accordingly, It is generally the case that the only waivers permitting the use of models that the FSA is likely to grant are CAD1 and VaR models in accordance with the policy in this appendix.~~

...

Chapter 10, Appendix 63: Guidance on Credit Derivatives

...

REGULATORY CAPITAL TREATMENT

~~... Furthermore, the FSA is constrained by the requirements of the Capital Adequacy Directive, and the associated pieces of legislation; it is possible that what seems a common sense approach could be illegal.~~

...

Offset for capital adequacy purposes

The ~~Capital Adequacy Directive allows the competent authorities to~~FSA recognises certain offsets for general market risk, but requires that the specific risk charge is applied to gross positions.

...

Risk assessment models

~~In the light of the forthcoming CADII package of directives, f~~Firms may also wish to consider whether to approach the FSA for permission to use an appropriate risk assessment model as the basis for calculating regulatory capital requirements.

...

Netting

A firm may net long and short positions in the same equity, debt and derivative instruments (under ~~Chapter 10 rule 10-8323R of appendix 5~~ for equities based instruments and ~~rule 10-10237R of appendix 4~~ for interest rate based products) before the specific risk charge is applied to the resultant net long or short position. Instruments are considered to be the same where the issuer is the same, they have equivalent ranking in liquidation, and the currency, coupon and maturity are the same. These netting criteria are taken from Annex 1 (Position Risk) of the ~~Capital Adequacy Directive ("CAD 1")~~previous version of the *Capital Adequacy*

Directive (Directive 93/6/EEC).

...

13 Chapter 13: Financial Resource Requirements for Personal Investment Firms

...

~~Alternative to Financial Resources Test 1~~

13.3.3 R ~~[Deleted]~~

13.3.3A R ~~[Deleted]~~

13.3.3B R ~~[Deleted]~~

...

13.7 ~~[Deleted] Consolidated Supervision of Group Companies~~

...

APPENDIX 13(1): Defined terms for Chapter 13

Delete the following definitions from Appendix 13(1); the text is not shown struck through:

bank

credit institution

EEA firm

financial institution

listed activity

14 Chapter 14: Consolidated supervision for investment business

14.1 Application

14.1.1 R Subject to rule 14.1.2, *consolidated supervision* and this chapter apply to a *firm* which is a member of a group if it is:

- (1) ~~a securities and futures firm, subject to the financial rules in Chapter 3, which is a broad scope firm but not a venture capital firm~~ it is:

- (a) a securities and futures firm, subject to the financial rules in Chapter 3, which is a broad scope firm but not a venture capital firm;
 - (b) a securities and futures firm, subject to the financial rules in Chapter 10, unless the firm is a category D firm; or
 - (c) a category A personal investment firm, subject to the financial rules in Chapter 13; and
- (2) ~~it is not a BIPRU firm. an investment management firm, which is a CAD investment firm subject to the financial rules in Chapter 5;~~
 - (3) ~~a UCITS investment firm, subject to the financial rules in chapter 7;~~
 - (4) ~~a securities and futures firm, subject to the financial rules in Chapter 10, unless the firm is a category D firm; or~~
 - (5) ~~a category A personal investment firm, subject to the financial rules in Chapter 13.~~

Cases where consolidated supervision under this chapter will not apply

- 14.1.2 R A firm is not subject to consolidated supervision under the rules in this Chapter where any of the following conditions are fulfilled:
- (1) the firm is included in the supervision on a consolidated basis of the group of which it is a member by a competent authority other than the FSA;
 - (2) the firm is a member of a UK consolidation group already included in the supervision on a consolidated basis of the group of which it is a member by the FSA under IPRU(BANK) or IPRU(BSOC) BIPRU 8.
- 14.1.3 G
- (1) ~~The rules in this chapter apply even if the firm is subject to the rules in PRU 8.4 (the financial conglomerates rules) or PRU 8.3 (the insurance group rules), if the firm is part of an investment sub-group. Financial conglomerates are subject to the Financial Groups Directive (2002/87/EC). Insurance groups are subject to the Insurance Groups Directive (98/78/EC). Neither directive allows a waiver of consolidation of a Capital Adequacy Directive group. So if there is an investment sub-group within an insurance group, the rules in this chapter apply, regardless of the application of a group capital assessment to the wider group. [Deleted]~~
 - (2) ~~Where firms authorised in two or more member states have as their parent the same financial holding company, supervision on a consolidated basis will be exercised by the competent authority of the firms authorised in the member state in which the financial holding company was set up. If no firm has been authorised in the Member State in which the financial holding company was set up, the competent authorities of the Member States concerned will seek to reach agreement as to who amongst them will exercise supervision~~

~~on a consolidated basis. In the absence of such an agreement, supervision on a consolidated basis will be exercised by the competent authority that granted authorisation to the firms with the greatest balance sheet total (measured on the basis of total assets). If that figure is the same for more than two authorised firms, supervision on a consolidated basis will be exercised by the competent authority which first gave the authorisation.~~[Deleted]

- (3) Where there is more than one authorised *firm* in the group, subject to the rules of this chapter, one consolidated supervision return may be submitted on behalf of all the *firms* in the group in accordance with SUP 16.3.25G.

Exemption from consolidated supervision

14.1.4 R A *firm* need not meet the requirements in rules 14.3.1 and 14.3.2 if:

- (1) ...
- (2) ...
- (3) each member of the group which is a *CAD investment firm*:
 - (a) ~~deducts any material holdings in credit and financial institutions from its financial resources;~~
 - (b) ~~complies with its solo applicable financial resources requirement and the large exposures requirements; and~~
 - (c) ~~has systems and controls to monitor and control the sources of capital and funding of all other financial institutions within the group;~~[Deleted]
- (4) ...
- (5) ...
- (6) ...
- (7) ...

...

14.1.6 G (1) The Capital Adequacy Directive (articles 7(4) to 7(6)) provides that a *competent authority* such as the *FSA* may waive *consolidated supervision* provided certain conditions are met. The conditions in *rule* 14.1.4 are mainly derived from the Capital Adequacy Directive.[Deleted]

- (2) ...

...

...

14.2 Scope of consolidation

...

- 14.2.4 G (1) *A firm's parent is a financial holding company if it is either a financial institution or a securities and futures firm that is subject to the financial rules in Chapter 3 and that is a broad scope firm (but not a venture capital firm) and if its subsidiary undertakings carry out mainly listed activities, activities of a credit institution or activities undertaken by a Chapter 3 broad scope firm. For this purpose the FSA interprets the phrases 'mainly' or 'main business' to mean where the balance of business is over 40% of the relevant group or sub-group's balance sheet (measured on the basis of total assets) or profit and loss statement (measured on the basis of gross income). In addition, if the firm's parent has significant holdings in insurance undertakings or reinsurance undertakings, it is a mixed financial holding company, and the firm is subject to the rules in GENPRU 3.1 PRU 8.4 instead of the rules in this chapter. This is because a parent cannot be a financial holding company and a mixed financial holding company at the same time. GENPRU 3.1 PRU 8.4 sets out what constitutes significant insurance holdings (broadly more than 10% of the financial sector activities of the group). A firm's parent is a financial holding company and not regarded as a mixed financial holding company unless:*
- (a) the parent has been notified by its coordinator that the group it heads is a financial conglomerate (in accordance with Article 4(2) of the Financial Groups Directive); and
 - (b) it has not been notified that the coordinator and the relevant competent authorities have agreed not to treat the group as a financial conglomerate in accordance with Article 3(3) of the Financial Groups Directive.
- (2) *A firm with an ultimate non-EEA parent may also be subject to the provisions in GENPRU 3.2 PRU 8.5.*

...

14.4 Group financial resources

...

- 14.4.2 R (1) *If more than one firm in the group is subject to the rules of this chapter, group financial resources are defined according to the relevant rules applicable to the main firm in the group to which this chapter applies, with Tier 1 minority interests being allowed as Group Tier 1 capital and Tier 2 minority interests being allowed as Group Tier 2 capital.*
- (2) ...
- 14.4.3 R *Financial resources will be defined based upon the main firm in the group to*

which this chapter applies as follows:

- (1) ...
- (2) ~~if an *investment management firm*, Table 5.2.2(1)R but excluding any illiquid assets or qualifying property adjustments required by that Table;~~
- (3) ~~if a *UCITS investment firm*, Table 7.3.1R but excluding any illiquid assets or qualifying property adjustments required by that Table;~~
- (4) ...
- (5) ...

...

14.5 Group financial resources requirement

...

14.5.2 R Financial resources requirements for individual entities in the group are:

- (1) for *firms* regulated by the *FSA*, their regulatory capital requirement under *FSA* rules;
- (2) for entities regulated by an *EEA regulator* ~~or one of the regulators listed in IPRU(INV) 10 App 59 or IPRU(BANK) CS Appendix D~~ and which is subject to the local regulatory capital requirement of that regulator, that local regulatory capital requirement; ~~and~~
- (2A) for entities that are *recognised third country credit institutions* or *recognised third country investment firms* and which is subject to the local regulatory capital requirement of that regulator, that local regulatory capital requirement;
- (2B) for entities not in (2A) that are regulated by a *third country competent authority* named in the table in *BIPRU 8 Annex 3R* and which is subject to the local regulatory capital requirement of that regulator, that local regulatory capital requirement; and
- (3) for other entities in the group, a notional financial resources requirement calculated as if the entity were regulated by the *FSA*.

...

14.5.4 G A *firm* may apply for a *waiver* of rule 14.5.1R, to permit a line-by-line approach to determine its *group financial resources requirement*. ~~Any *waiver* application should demonstrate (where relevant) that the constraints for intra-group offsets under the Capital Adequacy Directive (article 7) are met.~~ A *firm* should also demonstrate that calculating its requirement in this way does not result in a distortion of the *group financial resources requirement*.

...

APPENDIX 14(1) (INTERPRETATION)

Amend the following definitions as shown:

<i>CAD Article 53 exempting criteria</i>	the following criteria in respect of the <i>firm's</i> dealing positions: - such positions arise only as a result of the <i>firm's</i> failure to match investors orders precisely; - the total market value of all such positions is subject to a ceiling of 15% of the <i>firm's</i> initial capital; and - such positions are incidental and provisional in nature and strictly limited to the time required to carry out the transaction in question.
<i>CAD investment firm</i>	a <i>firm</i> subject to the requirements of the <i>Capital Adequacy Directive (CAD) (93/6/EEC)</i> excluding a person to whom the <i>CAD</i> does not apply under Article 3.1(b)2.2 of that Directive.
<i>financial holding company</i>	an <i>undertaking</i> that satisfies the following conditions: (a) ... (b) ... one of which at least is a <i>credit institution</i> , a <i>firm</i> falling within <i>IPRU(INV) rule 14.1.1(1)</i> or an <i>investment firm</i> ; and (c) it is not a <i>mixed financial holding company</i> within the meaning of PRU 8.4
<i>parent</i>	any parent <i>undertaking</i> as defined in section 258 of the Companies Act 1985 or paragraph 14 of Financial Reporting Standard No 2 and any <i>undertaking</i> which effectively exercises a dominant influence over another <i>undertaking</i> .

Delete the following definition from Appendix 14(1); the text is not shown struck through:

UCITS investment firm

Annex I

Amendments to the Insurance: Conduct of Business sourcebook

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

Part 1: consequential amendments taking effect 31 December 2006

Amend ICOB 1 Ann 2G as follows:

Summary of Handbook provisions for insurance intermediaries

...

	Module	Application
...
Business Standards	<p style="text-align: center;">...</p> <p style="text-align: center;">Prudential sourcebook</p> <p style="text-align: center;"><u>GENPRU</u></p> <p style="text-align: center;">...</p> <p style="text-align: center;">PRU<u>INSPRU</u></p>	<p style="text-align: center;">...</p> <p style="text-align: center;"><u>Applies in respect of (1) where the insurance intermediary is also an insurer</u></p> <p style="text-align: center;">Applies in respect of (1) where the insurance intermediary is also an insurer</p>
...

...

Part 2: consequential amendments taking effect 1 January 2007

Amend ICOB 1 Ann 2G as follows:

Summary of Handbook provisions for insurance intermediaries

...

	Module	Application
...
Business Standards	Interim Prudential sourcebooks	

	<i>IPRU(INV)</i>	Applies in respect of (1) where the <i>insurance intermediary</i> is also an <i>investment firm</i> (<u>other than a <i>BIPRU investment firm</i></u>)

	Prudential sourcebook	
	<i>GENPRU</i>	Applies in respect of (1) where the <i>insurance intermediary</i> is also a <u><i>BIPRU firm</i></u> or an insurer .
	<u><i>BIPRU</i></u>	<u>Applies in respect of (1) where the <i>insurance intermediary</i> is also a <i>BIPRU firm</i>.</u>
	PRU 9.1 – PRU 9.3 <u><i>MIPRU 1 – MIPRU 4</i></u>	Applies in respect of (1).
	<i>INSPRU</i>	...
	PRU 9.4 <u><i>MIPRU 5</i></u>	Applies in respect of (1) where the <i>insurance intermediary</i> is also an <i>insurer</i> or a <i>mortgage lender</i> .
...

Annex J

Amendments to the Mortgages: Conduct of Business sourcebook

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

Part 1: consequential amendments taking effect 31 December 2006

Summary of the application of the Handbook to firms carrying on regulated mortgage activities and firms that communicate or approve qualifying credit promotions

Table: This table belongs to MCOB 1.4.1G

Module	Application
...	...
Business Standards	Interim Prudential sourcebooks,
	...
	<u>GENPRU</u>
	<u>Applies to every mortgage administrator, mortgage adviser, mortgage arranger and mortgage lender where they are also insurers;</u>
	<u>INSPRU</u>
	<u>Applies to every mortgage administrator, mortgage adviser, mortgage arranger and mortgage lender where they are also insurers.</u>
	...

...

Part 2: consequential amendments taking effect 1 January 2006

Amend MCOB 1 Annex 4G as follows:

Summary of the application of the Handbook to firms carrying on regulated mortgage activities and firms that communicate or approve qualifying credit promotions

Table: This table belongs to MCOB 1.4.1G

Module	Application
...	...
Business Standards	Interim Prudential sourcebooks,
...	...
...	<p>IPRU(INV) Applies to every <i>mortgage administrator, mortgage adviser, mortgage arranger and mortgage lender</i> where they are also <i>investment firms (other than <u>BIPRU investment firms</u>)</i>;</p>
...	<p><i>GENPRU</i> Applies to every <i>mortgage administrator, mortgage adviser, mortgage arranger and mortgage lender</i> where they are also <i><u>BIPRU firms or insurers</u></i>;</p>
...	<p><u><i>BIPRU</i></u> Applies to every <i>mortgage administrator, mortgage adviser, mortgage arranger and mortgage lender</i> where they are also <i><u>BIPRU firms</u></i>;</p>
...	<p><i>INSPRU</i> Applies to every <i>mortgage administrator, mortgage adviser, mortgage arranger and mortgage lender</i> where they are also <i>insurers</i>.</p>
...	...

...

Annex K

Amendments to the Market Conduct sourcebook

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

Amend MAR 3.3.3G as follows:

- 3.3.2 G MAR 3 is not the only chapter of the *Handbook* that applies to *firms* doing *inter-professional business*. *Firms* should always consider what other parts of the *Handbook* may apply to them. A table listing the applicable *Principles* is set out in MAR 3 Annex 2. The table also sets out the key provisions of *COB* and *CASS* that may also apply to *firms* doing *inter-professional business*, but it should not be read as an exhaustive list. *Firms* should also consider the other provisions of the *Handbook*, especially but not exclusively ~~*IPRU* and *PRU*~~ the Prudential Standards part of the *Handbook*.

Annex L

Amendments to the Supervision manual

For the convenience of readers this Annex is in four parts.

Part 1: amendments relating to the Society of Lloyd's

Amend SUP 15.1.1R as follows. New text is underlined and deleted text is shown struck-through:

Who?

15.1.1 R This chapter applies to every *firm* except that:

- (1) only *SUP 15.10* applies to an *ICVC* or a *UCITS qualifier*; ~~and~~
- (2) *SUP 15.3.22D to SUP 15.3.25D* apply only to the *Society*.

Insert the following text after SUP 15.3.21R. The text is redesignated and restated and amendments to the text are not shown:

Lloyd's of London

15.3.22 D *SUP 15.3.23D to SUP 15.3.25D* are given in relation to the exercise of the powers of the *Society* and of the *Council* generally, with a view to achieving the objective of enabling the *FSA* to:

- (1) comply with its general duty under section 314 of the *Act* (Authority's general duty);
- (2) determine whether *underwriting agents*, or *approved persons* acting for them or on their behalf, are complying with the requirements imposed on them by or under the *Act*;
- (3) enforce the provisions of the *Act*, or requirements made under the *Act*, by enabling the *FSA* to consider, where appropriate, whether it should use its powers, for example, to:
 - (a) vary or cancel the *permission* of an *underwriting agent*, under section 45 of the *Act* (Variation etc on the Authority's own initiative);
 - (b) withdraw approval from an *approved person* acting for or on behalf of an *underwriting agent*, under section 63 of the *Act* (Withdrawal of approval) (see *ENF 7*);
 - (c) prohibit an individual acting for or on behalf of an

underwriting agent from involvement in *regulated activities*, under section 56 of the *Act* (Prohibition orders) (see *ENF 8*);

- (d) require an *underwriting agent* to make restitution, under section 384 of the *Act* (Power of Authority to require restitution) (see *ENF 9*);
- (e) discipline an *underwriting agent*, or an *approved person* acting for it or on its behalf, for a breach of a requirement made under the *Act*, including the *Principles*, *Statements of Principle* and *rules* (see *ENF 11*, *ENF 12* and *ENF 13*);
- (f) apply to court for an *injunction*, restitution order or *insolvency order* (see *ENF 6*, *ENF 9* and *ENF 10*); and
- (g) prosecute any criminal offence that the *FSA* has power to prosecute under the *Act* (see *ENF 15*).

15.3.23 D The *Society* must immediately inform the *FSA* in writing if it becomes aware that any matter likely to be of material concern to the *FSA* may have arisen in relation to:

- (1) the *regulated activities* for which the *Society* has *permission*; or
- (2) *underwriting agents*; or
- (3) *approved persons* or individuals acting for or on behalf of *underwriting agents*.

15.3.24 D The *Society* must inform the *FSA* if it commences investigations or disciplinary proceedings relating to apparent breaches:

- (1) of the *Act* or requirements made under the *Act*, including the *threshold conditions* or the *Principles* or other *rules*, by an *underwriting agent*; or
- (2) of the *Statements of Principle* by an individual or other *person* who carries out *controlled functions* for or on behalf of an *underwriting agent*.

15.3.25 D The *Society* must inform the *FSA* if it commences investigations or disciplinary proceedings which do not fall within the scope of *SUP 15.3.24D* but which:

- (1) involve an *underwriting agent*, or an *approved person* who carries out *controlled functions* for it or on its behalf; or
- (2) may indicate that an individual acting for or on behalf of an *underwriting agent* may not be a fit and proper *person* to perform functions in relation to *regulated activities*.

Insert a new section SUP App 2.16 (Regulatory intervention points for Lloyd's) as follows. The text is redesignated and restated and amendments to the text are not shown:

App 2.16 Regulatory intervention points for Lloyd's
Application

App 2.16.1 R The *rules and guidance* in SUP App 2 apply to the *Society*:

- (1) with the modifications set out in SUP App 2.16.2R to SUP App 2.16.5G; but
- (2) except SUP App 2.8.1G to SUP App 2.8.5G, SUP App 2.9.1R, SUP App 2.10.1R, SUP App 2.12.1R(2)(a), SUP App 2.12.2G and SUP App 2.12.7R.

Interpretation

App 2.16.2 R For the purpose of SUP App 2.16 and the application of SUP App 2 to the *Society*:

- (1) "capital resources", as the context requires:
 - (a) in relation to the *Society's* own capital resources, means its own *capital resources* calculated in accordance with the *capital resources table*;
 - (b) in relation to a *member's* capital resources, means the *member's capital resources* calculated in accordance with GENPRU 2.3.22R;
 - (c) in relation to the aggregate *capital resources* of the *Society* and the *members* supporting the *insurance business* of the *members*, means the aggregate of the *capital resources* in (1)(a) and (b) but excluding the *Society's callable contributions*;
- (2) "guarantee fund":
 - (a) in relation to the *general insurance business* carried on by *members*, means the amount of capital resources required in order to comply with GENPRU 2.2.26R, GENPRU 2.3.17R and GENPRU 2.3.26R; and the "member's share of the guarantee fund" for *general insurance business* means the result of the calculation set out in GENPRU 2.3.27R;
 - (b) in relation to the *long-term insurance business* carried on by *members*, means the amount of capital resources required in order to comply with GENPRU 2.2.25R and GENPRU 2.3.17R; and the "member's share of the guarantee fund" for *long-term insurance business* means the result of the calculation set out in GENPRU 2.3.25R;

- (3) "required margin of solvency":
- (a) in relation to the *general insurance business* carried on by *members*, means the higher of the *Society GICR* and the *general insurance capital requirement* for the *members* in aggregate; and
 - (b) in relation to the *long-term insurance business* carried on by *members*, means the *long-term insurance capital requirement* for the *members* in aggregate.

Capital resources below guarantee fund

- App 2.16.3 R For the purposes of *SUP App 2.4.1R* and *SUP App 2.4.2G*, *capital resources* will have fallen below the guarantee fund if the *Society's* own capital resources are such that they are no longer sufficient to meet the aggregate of, for each *member*, the amount, if any, by which the *member's* capital resources fall short of the *member's* share of the guarantee fund.

Capital resources below required margin of solvency

- App 2.16.4 R For the purposes of *SUP App 2.5.1R* to *SUP App 2.5.3G*, capital resources will be such that they no longer equal or exceed the required solvency margin if the *Society's* own capital resources are insufficient to meet the aggregate of, for each *member*, the amount, if any, by which the *member's* capital resources fall short of the *member's* share of the required solvency margin.

Capital resources below capital resources requirement

- App 2.16.5 R For the purposes of *SUP App 2.6.1G*, capital resources will have fallen below the *capital resources requirement* if the *Society's* own capital resources are insufficient to meet the aggregate of, for each *member*, the amount, if any, by which the *member's* capital resources fall short of the *member's* share of the *capital resources requirement* for the *members* in aggregate.

Capital resources below the level of individual capital guidance

- App 2.16.6 G For the purposes of *SUP App 2.7.1G* to *SUP App 2.7.5G*, capital resources will have fallen below the level of *individual capital guidance* if the *Society's* own capital resources have fallen below the level advised in *individual capital guidance* given to the *Society* in respect of those capital resources.

Amend SUP Schedule 2 (Notification Requirements) by inserting the following new text at the appropriate place in the table. New text is underlined.

Handbook reference	Matter to be notified	Contents of notification	Trigger event	Time allowed
<u>SUP 15.3.23D</u>	<u>Any matter likely to be of material concern in relation to the FSA which may have arisen in relation to:</u> <u>(1) the regulated activities for which the Society has permission; or</u> <u>(2) underwriting agents; or</u> <u>(3) approved persons or individuals acting for or on behalf of underwriting agents..</u>	<u>Details of the matters arisen.</u>	<u>The Society becomes aware</u>	<u>Immediately</u>
<u>SUP 15.3</u>	<u>Commencement, continuation and cessation of relevant investigations and disciplinary proceedings</u>	<u>Commencement, continuation and cessation of relevant investigations and disciplinary proceedings listed in SUP 15.3.24D and 15.3.25D</u>	<u>Commencement of proceedings</u>	<u>Not specified</u>

Part 2: amendments relating to implementation of Article 35(5) of the Directive of the European Parliament and of the Council of 14 June 2006 on the capital adequacy of investment firms and credit institutions (No 2006/49/EC)

Insert the following new rule SUP 15.8.9R. The text is all new and is not underlined:

15.8.9	R	A <i>BIPRU firm</i> must report to the <i>FSA</i> immediately any case in which its counterparty in a <i>repurchase agreement</i> or <i>reverse repurchase agreement</i> or <i>securities or commodities lending or borrowing transaction</i> defaults on its obligations.
--------	---	----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------

Amend SUP Schedule 2 (Notification Requirements) by inserting the following new text at the appropriate place in the table. New text is underlined.

Handbook reference	Matter to be notified	Contents of notification	Trigger event	Time allowed
<u>SUP 15.8.9R</u>	<u>Default by counterparty on its obligations in a transaction of a type specified in SUP 15.8.9R.</u>	<u>The fact of the default.</u>	<u>Default by counterparty on its obligations in a repurchase agreement or reverse repurchase agreement or securities or commodities lending or borrowing transaction.</u>	<u>Immediately</u>

Part 3: consequential amendments taking effect on 31 December 2006

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

Amend SUP 3.1 as follows:

...

3.1.9 G Material elsewhere in the Handbook

A firm which is a bank, building society, friendly society or other insurer, investment management firm, personal investment firm, securities and futures firm, the Society of Lloyd's or a Lloyd's managing agent in respect of each syndicate managed by it, should see the ~~Interim Prudential sourcebooks~~ Standards part of the Handbook for further provisions on auditors as set out in SUP 3.1.10 G. For the categorisations employed in SUP 3.1.2 R and SUP 3.1.10 G see SUP App 1.

3.1.10 G Other relevant sections of the Handbook (see SUP 3.1.9 G)

<i>Bank</i>	<i>IPRU(BANK)</i>
<i>Building society</i>	<i>IPRU(BSOC)</i>
<i>Friendly society</i>	<i>IPRU(FSOC)</i>
<i>Insurer (other than a friendly society)</i>	<i>IPRU(INS)</i>
<i>Investment management firm, personal investment firm, securities and futures firm, UCITS management company</i>	<i>IPRU(INV)</i>
<i>Society of Lloyd's</i>	<i>LLD</i>
<i>Bank</i>	<i>IPRU(BANK)</i>
<i>Building society</i>	<i>IPRU(BSOC)</i>
<i>Friendly society</i>	<i>IPRU(FSOC)</i>
<i>Insurer (other than a friendly society)</i>	<i>IPRU(INS)</i>
<i>Investment management firm, personal investment firm, securities and futures firm</i>	<i>IPRU(INV)</i>
<i>Society of Lloyd's and Lloyd's managing agents</i>	<i>LLD <u>IPRU(INS)</u></i>

...

Amend SUP 8.2 as follows:

...

8.2.7	G	Rules that can be waived (see SUP 8.2.6 G)	
		Rules	... Chapters of the Handbook where such rules appear (Note 1)
		...	
		Insurance business rules	... <u>PRUINSPRU</u>
		...	

...

Amend SUP 9.3 as follows:

...

9.3.2	G	...	
		(1)	...
		...	
		(5)	in relation to the maintenance of adequate financial resources, the <i>FSA</i> may give a <i>firm</i> individual <i>guidance</i> on the amount or type of financial resources the <i>FSA</i> considers appropriate, for example on individual capital ratios for <i>banks</i> and <i>building societies</i> ; further <i>guidance</i> on how and when the <i>FSA</i> may give individual <i>guidance</i> on financial resources is contained in the Interim Prudential sourcebooks and in <u>PRU</u> the Prudential Standards part of the <i>Handbook</i> :
		(a)	...
		...	
		(d)	for an insurer: PRU 2.3.13 and PRU 2.3.24 <u>INSPRU 7</u>

...

Amend SUP 13A Ann 1G as follows:

13A	Annex 1G	Application of the Handbook to Incoming EEA Firms	
	(1) ...	(2) ...	(3) ...
	...		
	<u>PRU</u>	...	...
	<u>INSPRU</u>	Otherwise, PRU <u>INSPRU</u> does not apply unless the <i>firm</i> is an <i>insurer</i> to	

which ~~PRU 7.6.33~~INSPRU 1.5.33R applies.

...

Amend SUP App 1.3.1G as follows:

App 1.3.1	G	Table Prudential categories and sub-categories used in the Interim Prudential sourcebooks and the Supervision manual		
		Prudential categories (Note 1)	Applicable prudential requirements (Note 2)	Prudential sub-categories
	
		<i>Insurer*</i>	<i>IPRU(INS)</i> or <i>IPRU(FSOC)</i> <u>and</u> <u><i>INSPRU</i></u>	...
	
		<i>Society of Lloyd's*</i>	LLD <u><i>INSPRU</i></u> and <u><i>IPRU(INS)</i></u>	

Note 2 = Only the requirements in the ~~Interim~~ Prudential sourcebooks, ~~LLD~~, and CRED are listed in the column. Requirements in other parts of the *Handbook* will also apply.

Amend SUP App 2.1 to 2.14 as follows:

2 Insurers: Regulatory intervention points

2.1 Application

2.1.1 R ~~This appendix applies~~ SUP App 2.1 to 2.15 apply to an *insurer* unless it is:

- (1) a *Swiss general insurer*; or
- (2) an *EEA-deposit insurer*; or
- (3) an *incoming EEA firm*; or
- (4) an *incoming Treaty firm*.

2.1.2 G ~~This appendix applies~~ SUP App 2.1 to 2.15 apply to every *friendly society* as a *friendly society* is an *insurer*.

2.1.3 R SUP App 2.16 applies to the *Society*.

2.2 Interpretation

2.2.1 R For the purpose of *SUP* App 2.1 to 2.14:

(1) “capital resources”:

(a) ...;

(b) in relation to a *participating insurance undertaking*, means P+T, where P and T have the meanings given by ~~PRU 8.3.45R(3)(a)~~ INSPRU 6.1.45R(3)(a) and (e) respectively, as calculated in accordance with ~~PRU 8.3.43R~~ INSPRU 6.1.43R; and

(c) in relation to any other *firm*, means the *firm’s capital resources* as calculated in accordance with GENPRU 2.2.12R;

(2) “guarantee fund”:

(a) ...;

(b) in relation to a *participating insurance undertaking*, means the amount of capital resources which that *firm* must hold to comply with ~~PRU 8.3.45R(2)~~ INSPRU 6.1.45R(2);

(c) in relation to a *firm* which is not covered by (a) or (b), carrying on *general insurance business*, means the amount of capital resources which that *firm* must hold to comply with ~~PRU 2.2.18R~~ GENPRU 2.2.34R; and

(d) in relation to a *firm* which is not covered by (a) or (b), carrying on *long-term insurance business*, means the amount of capital resources which that *firm* must hold to comply with ~~PRU 2.2.17R~~ GENPRU 2.2.33R;

(3) ...

(4) “required margin of solvency”:

(a) ...;

(b) in relation to a *participating insurance undertaking*, means R-S-U, where R, S and U have the meanings given by ~~PRU 8.3.45R~~ INSPRU 6.1.45R (3)(c), (d) and (f) respectively;

...

2.2.2 G The calculation of each of the *base capital resources requirement*, the *long-term insurance capital requirement* and the *general insurance capital requirement* is set out in GENPRU 2.1. The calculation of each of the “guarantee fund” and “required margin of solvency” for *non-directive friendly societies* is set out in chapter 4 of *IPRU(FSOC)*.

2.3 Purpose

- 2.3.1 G ...
- 2.3.2 G The *rules* in ~~this appendix~~ SUP App 2.1 to 2.14 require a *firm* to submit reports and information to the *FSA* when:
- ...
- 2.3.3 G The *FSA* may also ask a *firm* to submit reports and information to it when the *firm's* capital resources fall below the level advised in ~~individual capital~~ individual capital guidance given to the *firm*.
- ...
- 2.3.7 G *Principle 4* of the *FSA's* Principles for Businesses provides that *firms* should hold adequate financial resources, while ~~PRU 1.2.22R~~ GENPRU 1.2.26R requires a *firm* to maintain overall financial resources which are adequate to ensure that there is no significant risk that it cannot meet its liabilities as they fall due. In considering these requirements, a *firm* may decide to maintain capital resources above the level advised in ~~individual capital~~ individual capital guidance given by the *FSA*, or, if no ~~individual capital~~ individual capital guidance has been given, above its *capital resources requirement*. The amount of any such additional capital resources held is at the discretion of the *firm*. However, the extent to which a *firm* matches these additional capital resources to the volatility of its capital base, in conjunction with the strength of its systems and controls environment, is likely to affect the frequency with which it is subject to intervention under this appendix.
- ...
- 2.5 Capital resources below required margin of solvency
- 2.5.1 R Unless *SUP App 2.5.3R* applies:
- (1) if a *firm's* capital resources are such that they no longer equal or exceed its required margin of solvency; or
 - (2) if a *firm* no longer complies with ~~PRU 2.2.16R~~ GENPRU 2.2.32R and ~~PRU 2.2.24R~~ GENPRU 2.2.28R, or ~~PRU 8.3.45R~~ INSPRU 6.1.45R(1)(a) and ~~PRU 8.3.45R~~ INSPRU 6.1.45R(1)(b), as applicable;
- it must, within 28 days of becoming aware of this event, submit to the *FSA* a plan for the restoration of a sound financial position, including:
- (3) a *scheme of operations*; and
 - (4) an explanation of how, if at all, and by when:
 - (a) it expects its capital resources to be restored to the required margin of solvency; or
 - (b) as the case may be, it expects to comply with ~~PRU 2.2.16R~~ GENPRU 2.2.32R and ~~PRU 2.2.24R~~ GENPRU 2.2.28R, or *PRU*

~~8.3.45R INSPRU 6.1.45R(1)(a)~~ and ~~PRU 8.3.45R INSPRU 6.1.45R(1)(b)~~, as applicable.

2.5.2 G

2.5.3 R If a *firm*:

- (1) falls into *SUP* App 2.5.1R(1) or (2); and
- (2) it has previously submitted either a run-off plan in accordance with *SUP* App 2.8.1R or a *scheme of operations* in accordance with *SUP* App 2.5.1R;

it must, within 28 days of becoming aware that it falls into *SUP* App 2.5.1R(1) or (2):

- (3) notify the *FSA*; and
- (4) submit a plan for restoration which:
 - (a) explains why the *firm's* capital resources have fallen below its required margin of solvency or, as the case may be, it no longer complies with ~~PRU 2.2.16R GENPRU 2.2.32R~~ or ~~PRU 2.2.24R GENPRU 2.2.28R~~, or ~~PRU 8.3.45R INSPRU 6.1.45R(1)(a)~~ and ~~PRU 8.3.45R INSPRU 6.1.45R(1)(b)~~, as applicable; and
 - (b) demonstrates how, if at all, and by when, the *firm* will restore it or, as the case may be, resume compliance with ~~PRU 2.2.16R GENPRU 2.2.32R~~ and ~~PRU 2.2.24R GENPRU 2.2.28R~~, or ~~PRU 8.3.45R INSPRU 6.1.45R(1)(a)~~ and ~~PRU 8.3.45R INSPRU 6.1.45R(1)(b)~~, as applicable.

2.6 Capital resources below capital resources requirement

...

2.7 Capital resources below the level of individual capital guidance

2.7.1 G Unless any of *SUP* App 2.4.1R, 2.5.1R, 2.5.3R or 2.6.1R applies, if a *firm's* circumstances change, such that its capital resources have fallen, or are expected to fall, below the level advised in ~~individual capital~~ *individual capital guidance* given to the *firm* by the *FSA*, then, consistent with *PRIN* 2.1.1R *Principle 11* (Relations with regulators), a *firm* should inform the *FSA* of this fact as soon as practicable, explaining why capital resources have fallen, or are expected to fall, below the level advised in ~~individual capital~~ *individual capital guidance*, and:

- (1) what action the *firm* intends to take to increase its capital resources; or
- (2) what modification the *firm* considers should be made to the ~~individual capital~~ *individual capital guidance* which it has been given.

- 2.7.2 G ...
- 2.7.3 G In relation to a *firm* carrying on *with-profits insurance business*, if it intends either (a) to remedy a fall in the level of capital resources advised in its ~~individual capital~~ *individual capital guidance*, or (b) to prevent a fall in the level advised in that *guidance*, for example, in either case, by taking management action to de-risk a *with-profits fund* or by reducing non-contractual benefits for *policyholders*, it should explain to the *FSA* how such proposed actions are consistent with the *firm's* obligations under *PRIN 2.1 Principle 6* (Customers' interests).
- 2.7.4 G If a *firm's* capital resources fall below the level advised in ~~individual capital~~ *individual capital guidance* given to the *firm* and, at the same time, any one or more of *SUP App 2.4.1R*, *2.5.1R*, *2.5.3R* or *2.6.1R* applies, the *firm* should first comply with those *rules*. Those *rules* are concerned with circumstances where capital resources are likely to have fallen to levels much lower than the level advised in ~~individual capital~~ *individual capital guidance* and are, in some cases, requirements imposed by the *Insurance Directives*.
- 2.7.5 G If a *firm* has not accepted ~~individual capital~~ *individual capital guidance* given by the *FSA* it should, nevertheless, inform the *FSA* as soon as practicable if its capital resources have fallen below the level suggested by that ~~individual capital~~ *individual capital guidance*. In such circumstances, the *FSA* may ask the *firm* for further explanation as to why it does not consider the ~~individual capital~~ *individual capital guidance* to be appropriate. The *FSA* may also consider using its powers under section 45 of the *Act* to, on its own initiative, vary a *firm's Part IV permission*, so as to require it to hold such capital as the *FSA* considers is necessary for the *firm* to comply with ~~PRU 1.2.22R~~ GENPRU 1.2.26R.

...

2.12 Content of a scheme of operations

...

- 2.12.5 G In relation to *firms* covered by ~~this appendix~~ *SUP App 2.1 to 2.14*, *IPRU(FSOC) 4.1* sets out the *rules* relating to capital resources for *non-directive friendly societies* and *GENPRU 2.1, 2.2* and ~~8.3~~ *INSPRU 6.1* set out the *rules* relating to capital resources for every other *firm* ...
- 2.12.6 G To reflect its obligations under ~~PRU 2.1.10R~~ GENPRU 2.1.14R or *IPRU(FSOC) 4.1(2)* (as applicable), in order to comply with *SUP App 2.12.1R*, a *firm* which carries on both long-term insurance business and general insurance business should submit separate information for each type of insurance business.

...

Amend SUP Sch 4 (Powers exercised) as follows:

The following powers and related provisions in the *Act* have been exercised by the *FSA* to make the *rules* in *SUP*:

(1) ...

...

(14) ...

(14A) Section 318(1) (Exercise of powers through Council)

(15) ...

...

Part 4: consequential amendments taking effect on 1 January 2007

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

Amend SUP 3.1 as follows:

3.1.2	R	Table Applicable sections (see SUP 3.1.1R)			
		(1)	Category of firm	(2) Sections applicable to the firm	(3) Sections applicable to its auditor
		(1)	...	...	...
	
		(7B)	<i>UCITS management company <u>firm</u></i>	<i>SUP 3.1 – 3.7</i>	<i>SUP 3.1, SUP 3.2, SUP 3.8 – SUP 3.10</i>
		(7C)	<i><u>BIPRU investment firm</u></i>	<i><u>SUP 3.1 – 3.7</u></i>	<i><u>SUP 3.1, SUP 3.2, SUP 3.8 – SUP 3.10</u></i>
	
3.1.9	G	Material elsewhere in the Handbook			
		<p><i>A firm which is a bank, building society, friendly society or other insurer, investment management firm, personal investment firm, or a securities and futures firm, the Society of Lloyd's or a Lloyd's managing agent in respect of each syndicate managed by it, should see the Prudential Standards part of the Handbook for further provisions on auditors as set out in SUP 3.1.10 G. For the categorisations employed in SUP 3.1.2 R and SUP 3.1.10 G see SUP App 1.</i></p>			
3.1.10	G	Other relevant sections of the Handbook (see SUP 3.1.9 G)			
			<i>Bank</i>		<i>IPRU(BANK)</i>
			<i>Building society</i>		<i>IPRU(BSOC)</i>
			...		
			<i><u>Investment management firm, personal investment firm, securities and futures firm (other than BIPRU investment firms)</u></i>		<i>IPRU(INV)</i>

Amend SUP 3.10 as follows:

3.10.5 R Table Client assets report

Whether in the auditor's opinion

- (1) ...
 - (2) ...
 - (3) in the case of *investment management firm, personal investment firm, a UCITS ~~management company~~ firm, or securities and futures firm or BIPRU investment firm*, when a *subsidiary* of the *firm* is a *nominee company* in whose name *custody assets* of the *firm* are registered, that *nominee company* has maintained throughout the year systems for the custody, identification and control of *custody assets* which:
 - (a) ...
 - (b) ...
- ...

Amend SUP 8.2 as follows:

...

8.2.7 G Rules that can be waived (see SUP 8.2.6 G)

Rules	...	Chapters of the Handbook where such rules appear (Note 1)
...		
Continued rules	...	IPRU(Bank) 3.3.15R (in chapter GN) <i>IPRU(INV)</i> (the continued provisions) <i>SUP</i> (parts of <i>SUP</i> 16 Ann 10)
...		

...

Amend SUP 9.3 as follows:

9.3.2 G ...

- (1) ...
- ...
- (5) in relation to the maintenance of adequate financial resources, the *FSA* may give a *firm* *individual guidance* on the amount or type of financial resources the *FSA* considers appropriate, for example ~~on individual capital ratios~~ *individual capital guidance* for ~~banks~~ *BIPRU*

firms and building societiesinsurers; further *guidance* on how and when the *FSA* may give ~~individual~~individual capital *guidance* on financial resources is contained in the Prudential Standards part of the *Handbook*:

- (a) for a ~~bank~~BIPRU firm: ~~IPRU(BANK) CO4~~ GENPRU 1.2 and BIPRU 2.2;
- (b) for an ~~building society~~: ~~IPRU(BSOC) 1.5 and IPRU(BSOC) Ann 1J~~ insurer: GENPRU 1.2 and INSPRU 7.1;

...

...

Amend SUP 10.12 as follows:

- 10.12.3 G In accordance with section 60 of the *Act* (Applications for approval), applications must be submitted by, or on behalf of, the *firm* itself, not by the *candidate*. Usually this will be the *firm* that is employing the *candidate* to perform the *controlled function*. Where a *firm* has outsourced the performance of a *controlled function*, the details of the outsourcing determine where responsibility lies and whom the *FSA* anticipates will submit *approved persons* forms. SUP 10.12.4 G describes some common situations. The *firm* which is outsourcing is referred to as "A" and the *person* to whom the performance of the function has been outsourced, or which makes the *arrangement* for the function to be performed, is referred to as "B". In each situation, A must take reasonable care to ensure that, in accordance with section 59(2) of the *Act*, no *person* performs a *controlled function* under an *arrangement* entered into by its contractor in relation to the carrying on by A of a *regulated activity*, without approval from the *FSA*. See also SYSC 3.2.4 G and if applicable ~~IPRU (BANK) OS, IPRU (BSOC) OS,~~ and for *insurers* SYSC 13.9.

Amend SUP 13A Ann 1G as follows:

13A	Annex 1G	Application of the Handbook to Incoming EEA Firms
	(1) ...	(2) ...
		(3) ...
	...	
	<i>GEN</i>	...
	<u><i>GENPRU</i></u>	<u><i>GENPRU</i> applies only to the <i>firm's branch in the United Kingdom in relation to liquidity risk only (GENPRU 1.2.3R and GENPRU 1.2.21G).</i></u>
	<u><i>BIPRU</i></u>	<u><i>BIPRU</i> does not apply as <i>EEA firms</i> are subject to the prudential</u>
		<u><i>Does not apply if the <i>firm</i> has permission only for cross border services and does not carry on regulated activities in the United Kingdom.</i></u>
		<u><i>Does not apply if the <i>firm</i> has permission only for cross</i></u>

	<u>standards of their home state regulator (BIPRU 1.1.7R and BIPRU 1.1.9G).</u>	<u>border services and does not carry on regulated activities in the United Kingdom.</u>
<u>PRU</u> <u>MIPRU</u>	<u>MIPRU 1 (Application and general provisions) does not apply unless the firm has a top-up permission.</u>	As column (2)
	PRU 9.1 <u>MIPRU 2 (Responsibility for insurance mediation activity) does not apply unless the firm has a top-up permission.</u>	
	PRU 9.2 <u>MIPRU 3 (Requirement to hold professional indemnity insurance) requirements for insurance and mortgage mediation activity and mortgage lending and administration) does not apply unless the firm has a top-up permission.</u>	
	PRU 9.3 <u>MIPRU 4 (Requirement to hold capital resources) for insurance and mortgage mediation activity and mortgage lending and administration) does not apply unless the firm has a top-up permission.</u>	
	See PRU 9.3.2G <u>MIPRU 4.1.2G</u> for more detailed <i>guidance</i> .	
	PRU 9.4 <u>MIPRU 5 (Insurance undertakings and mortgage lenders using insurance or mortgage mediation services) does not apply unless the firm has a top-up permission.</u>	
<u>INSPRU</u>	...	
<u>IPRU (BANK)</u>	Only the following apply, and only if the firm is a <i>credit institution</i> other than an electronic money institution within the meaning of article 1(3)(a) of the <i>E-Money Directive</i> that has the right to benefit from the mutual recognition arrangements under the <i>Banking Consolidation Directive</i> (IPRU(BANK) 3.2.1R): (1) IPRU(BANK) 3.3.15R, <u>IPRU(BANK) 3.3.16G</u> and <u>IPRU(BANK) 3.5.1R</u> ; and (2) chapter CO (which provides an overview of the underlying policy)	...

~~and the more detailed guidance in chapters CB, CA, BC, BO, FX, CM, DU, TI, TE, TC, TL, TU, TS and TV IPRU(BANK) chapters LM and LS.~~

...

IPRU (INV) *IPRU(INV)* does not apply unless the ...
firm:
(1) has a *top-up permission*;
(2) is an *authorised professional firm, investment management firm, members' adviser, personal investment firm, securities and futures firm, service company or underwriting agent*; and
(3) is not a *lead regulated firm*, ~~or a~~ *media firm or a BIPRU investment firm*.
(*IPRU(INV)* 1.1.1R and 1.2R)

Amend SUP 15.3 as follows:

...

- 15.3.8 G (1) Compliance with *Principle 11* includes, but is not limited to, giving the *FSA* notice of:
- (a) ...
- ...
- (e) entering into, or significantly changing, a *material outsourcing* arrangement (a *bank* ~~should also see~~ *IPRU(BANK) OS 4.2*, and a *building society* should also see *IPRU(BSOC) 11 OS 4.2 SYSC 8*, and an *in surer* should also see *SYSC 13.9* for further details); or

Amend SUP 15.4.1R(1)(c) as follows:

- 15.4.1 R (1) An *overseas firm*, which is not an *incoming firm*, must notify the *FSA* within 30 *business days* of any *person* taking up or ceasing to hold the following positions:
- (a) ...
- ...
- (c) for a *bank* or an *ELMI*: the two or more *persons* who effectively direct its business in accordance with ~~*IPRU(BANK) GN 3.3.1R*~~ *SYSC 4.2.2R* and *ELM 5.3.1*,

respectively;

Amend SUP 16 Annex 2G as follows:

LIQUIDITY RETURN (Form LR)

...

General Notes¹

...

Marketable Securities

...

50 ~~The list of A relevant credit ratings agencyies is given in SGN Appendix H and in Section 9 (Appendix 2) of Chapter TI (Interest rate position risk) of the FSA Policy Guide/IPRU (BANK)~~ means an *eligible ECAI*.

(a) An *eligible ECAI* is defined in the glossary of defined terms used in the Handbook.

51 ~~The list of A recognised stock indicesindex is listed in Section 6 of Chapter TE (Equity position risk) of the FSA Policy Guide/IPRU (BANK)~~ means a *qualifying equity index*.

(a) A *qualifying equity index* is defined in the glossary of defined terms used in the Handbook

...

REPORTING INSTRUCTIONS

A Reporting in euros

...

Definitions

...

A2A ~~Central government/central government guaranteed, including Treasury bills, eligible Local Authority paper and eligible bank bills~~ with a residual maturity of up to 1 year

Include:

...

- ~~Eligible local authority paper, defined as UK local authority bills which are eligible for rediscount at the Bank of England, if they have an original term to~~

maturity of not more than (6 months) 187 days and meet certain requirements concerning publication and notice set out in the Bank of England's notice of 8 June 1983. ~~[Deleted]~~

- UK bank bills which are eligible for rediscount at the Bank of England if they are sterling bills, irrespective of issuer, which are both payable in the United Kingdom and have been accepted by eligible banks (see SGN Appendix G). Also include any holdings of non-UK bills which are eligible for discount at the central bank in the country of issue, as part of its open market operations. ~~[Deleted]~~

...

...

A2D/A2E/A2F Non-government of up to 6 months / between 6 months and 5 years / over 5 years

Non-governmental debt securities which are classified as 'qualifying' by the FSA in its implementation of the Capital Adequacy Directive (see Chapter TI (Interest rate position risk), Section 5.2, of the FSA Policy Guide/IPRU (BANK)). Hence debt instruments should be treated as qualifying if any of the following conditions apply: falling within the definition of *qualifying debt security*.

(a) A *qualifying debt security* is defined in the glossary of defined terms used in the Handbook.

(a) ~~[Deleted]~~

(b) ~~[Deleted]~~

(c) ~~[Deleted]~~

(d) ~~[Deleted]~~

(e) ~~[Deleted]~~

...

A3A-A5A DEBT INSTRUMENTS ISSUED BY ENTITIES IN ZONE B COUNTRIES

A3A Central government/central government guaranteed of up to 1 year

Short term central government (including central government guaranteed) paper and paper eligible for discount at the Central Bank issued by a Zone B Central Government/another Zone B issuer. Also include Treasury bills, eligible local authority paper and eligible bank bills. Only those securities currently in the reporting institution's ownership (including those which are held in a clearing system such as Euroclear) should be recorded. Securities should only be included in this section if they are classified investment grade by a recognised credit ratings agency an eligible ECAI (see SGN Appendix H General Notes, paragraph 50).

A3B-A3C DEBT INSTRUMENTS ISSUED BY ENTITIES IN ZONE B COUNTRIES

A3A/A3C Central government/central government guaranteed of between 1 year and under 5 years / over 5 years

Central government (including central government guaranteed) paper and paper eligible for discount at the Central Bank issued by a Zone B Central Government/another Zone B issuer. Include only those securities issued by, or fully guaranteed by, Zone B central governments and central banks with a residual maturity of over 1 year. Only those securities currently in the reporting institution's ownership (including those which are held in a clearing system such as Euroclear) should be recorded. Securities should only be included in this section if they are classified investment grade by a ~~recognised credit ratings agency~~ an eligible ECAI (see General Notes, paragraph 50).

A3D/A3E/A3F Eligible non-government of up to 6 months / between 6 months and 5 years/over 5 years

Non-government debt securities issued, guaranteed, endorsed or accepted by an entity in a Zone B country and are investment grade. Also include those securities issued, or guaranteed by, an investment firm that is subject to the Capital Adequacy Directive or a ~~regime that is as stringent (for a list of such regimes, see Chapter CS (Consolidated Supervision) Section 10.3 of the FSA Policy Guide/IPRU (BANK))~~ recognised third country investment firm. Only those securities currently in the reporting institution's ownership should be recorded (including where these are held in a clearing system such as Euroclear).

(a) A recognised third country investment firm is defined in the glossary of defined terms used in the Handbook

...

A5A Highly liquid equities and equities indices

Equities that are eligible for a specific risk weight of 42% or less under the FSA's implementation of the ~~Amending~~ Capital Adequacy Directive (~~CAD 2~~) and the amendment to the Basel Accord for Market Risks and which are currently in the reporting institution's possession.

...

D1A – D2B MEMO ITEMS

...

D2A Undrawn treasury concessions granted by the bank

Where an institution has taken on a treasury role on behalf of its group, ~~it may have agreed with the FSA a~~ the institution must notify the FSA of its intention to use the "group treasury concession" for large exposure purposes (see Chapter LE (Large exposures) of the FSA Policy Guide/IPRU (BANK) BIPRU 10). ~~The institution should report here the amount of that treasury concession.~~

Amend SUP 18.1.2G as follows:

- 18.1.2 G *Guidance on building society transfers and mergers is given in IPRU(BSOC) the Building Societies Regulatory Guide.*

Amend SUP App 1 as follows:

- App 1.2.2 G ~~The *FSA* is developing its approach to prudential standards and some provisions in the Supervision manual in a two-stage approach. Initially the *FSA* is including in the *Handbook* interim material as set out in the five Interim Prudential sourcebooks and the Supervision manual, for example SUP 16 (Reporting requirements). The *FSA* is developing material which will provide an integrated approach to the setting of prudential standards. Each of the Interim Prudential sourcebooks is based on the prudential regime that existed before *commencement*, changed, mainly where the *Act*, and other statutory and international developments, have made a change desirable or essential. The Lloyd's sourcebook shows less continuity with the prudential regime previously applied to the *Society of Lloyd's*, as it introduces requirements similar to those already applied to *insurers*. Most grandfathered *firms* have a prudential category and sub-category equivalent to that which they had before *commencement*.~~

Prudential requirements for *firms* are set out in the Prudential Standards part of the *Handbook* according to their prudential category. Certain reporting requirements and other prudential material are contained in the Supervision manual, for example SUP 16 (Reporting requirements).

...

- App 1.3.1 G Table Prudential categories and sub-categories used in the ~~Interim~~ Prudential sourcebooks and the Supervision manual

Prudential categories (Note 1)	Applicable prudential requirements (Note 2)	Prudential sub-categories
...		
<i>Bank*</i>	<u>GENPRU, BIPRU and IPRU(BANK)</u>	<i>EEA bank Overseas bank UK bank</i>
<u><i>BIPRU investment firm</i></u>	<u>GENPRU and BIPRU</u>	<u><i>Full scope BIPRU investment firm</i></u> <u><i>BIPRU limited licence firm</i></u> <u><i>BIPRU limited activity firm</i></u>
<i>Building society*</i>	<u>GENPRU, BIPRU and IPRU(BSOC)</u>	
...

<i>Incoming EEA firm</i>	None (unless another prudential category applies) <u>GENPRU, BIPRU, INSPRU and IPRU(BANK)</u>	<u>EEA bank</u>
...		
<i>UCITS management company firm</i>	IPRU(INV) 1, 5 and 7 <u>UPRU</u>	<i>UCITS firm</i> <i>UCITS investment firm</i>
<i>UCITS investment firm</i>	<u>GENPRU and BIPRU</u>	
...

App 1.4.1 G Many, but not all of the categories are used only in the ~~Interim Prudential sourcebooks~~ the Prudential Standards part of the *Handbook* and the Supervision manual. The prudential category of a *firm* will normally determine:

- (1) which ~~Interim Prudential sourcebook~~ module of the Prudential Standards part of the *Handbook* is applicable to the *firm*;

...

App 1.4.3 G If a *firm* is part of a *group*, each *authorised* member of the *group* will have its own prudential category. *Firms* should refer to the provisions of the relevant ~~Interim Prudential sourcebooks~~ module of the Prudential Standards part of the *Handbook* to determine whether and, if so, how consolidated supervision applies.

Amend SUP TP 1.3.6 as follows:

TP 1.3 Transitional provisions relating to written concessions

...

6. These transitional provisions do not apply to *rules* which are continued by designation of pre-commencement provisions rather than made as new *rules*. Written concessions of such *rules* are carried forward, to similar effect, as *waivers* (given under section 148 of the *Act*) by article 8 of The Financial Services and Markets Act 2000 (Transitional Provision and Savings) (Rules) Order 2001 (SI 2001/1534). The relevant *rules* are:

- (1) ~~in IPRU(BANK), 3.3.15R in chapter GN; and~~ [deleted]
- (2) in *IPRU(INV)*, those identified as designated *rules* in the schedule to *IPRU(INV)* entitled "Powers exercised".

...

Amend SUP Sch 2 Notification requirements as follows:

Sch 2.2	G	Handbook reference	...	Contents of notification	Trigger event
		...			
		SUP 15.4.1R	...	<p>Any <i>person</i> taking up or ceasing to hold the following positions:</p> <p>(a) ...</p> <p>...</p> <p>(c) for a <i>bank</i>: the two or more <i>persons</i> who effectively direct its business in accordance with IPRU(BANK) GN 3.3.1R<u>SYSC 4.2.2R</u></p>	
		...			

Annex M

Amendments to the Dispute Resolution: Complaints manual

Part 1: amendments relating to the redesignation of LLD 7

Amend DISP 1.7.12G as follows. Deleted text is shown struck-through:

- 1.7.12 G Complaints from *members* of the *Society* of Lloyd's regarding the activities of *members' advisers*, which cannot be resolved by the *members' adviser*, cannot be referred to the *Financial Ombudsman Service*. (~~See *LLD* (the *Lloyd's sourcebook*), for further information concerning complaints by *members* of the *Society* of Lloyd's.)~~)

Insert the following text after DISP 1.7.12G. The text is redesignated and restated text. Amendments to the redesignated text are not shown.

- 1.7.13 G The *Financial Ombudsman Service* is not be able to deal with the complaints listed in *DISP* 1.7.14R and separate *rules* and *guidance* are therefore required.
- 1.7.14 R The *Society* must establish and maintain appropriate and effective arrangements for handling any complaint from a *member* or a *former member* about:
- (1) *regulated activities* carried on by the *Society*;
 - (2) the *Society's regulatory functions* carried on by the *Society*, the *Council* or those to whom the *Council* delegates authority to carry out such functions;
 - (3) advice given by an *underwriting agent* to a *person* to become, continue or cease to be, a member of a particular *syndicate*; and
 - (4) the management by a *managing agent* of the underwriting capacity of a *syndicate* on which the complainant participates or has participated.
- 1.7.15 R The *Society* must maintain by *byelaw* one or more appropriate effective schemes for the resolution of disputes between an *individual member* or a *former member* who was an *individual member* and:
- (1) his *underwriting agent*; or
 - (2) the *Society*.
- 1.7.16 R For the purposes of *DISP* 1.7.14R "*individual member*" includes a *member* which is a *limited liability partnership* or a *body corporate* whose members consist only of, or of the nominees for, a single natural person or a group of connected persons.
- 1.7.17 G The schemes to which *DISP* 1.7.14R currently refers are the *Lloyd's*

Arbitration Scheme and the *Lloyd's Members' Ombudsman* respectively, but the *Society* may maintain other independent dispute resolution schemes in addition to, or instead of, either of these schemes.

- 1.7.18 G The schemes referred to in *DISP* 1.7.14R should be operationally independent of the *Society*.
- 1.7.19 G An *individual member* or *former member* who was an *individual member* should not have access to the schemes referred to in *DISP* 1.7.14R unless the complaints arrangements maintained by the *Society* have failed to resolve the complaint to his satisfaction within eight weeks of receiving it.
- 1.7.20 G The *Society* should give the *FSA* adequate notice of all proposed changes to the *byelaws* relating to the schemes referred to in *DISP* 1.7.14R.
- 1.7.21 G When considering what is required to ensure the operational independence of the schemes referred to in *DISP* 1.7.14R, or proposed changes in such schemes, the *Society* should take account of similar arrangements operated by the *Financial Ombudsman Service*.
- 1.7.22 R A contravention of *DISP* 1.7.14R or *DISP* 1.7.15R does not give rise to a right of action by a *private person* under section 150 of the *Act* (Actions for damages) and each of those *rules* is specified under section 150(2) of the *Act* as a provision giving rise to no such right of action.

Amend *DISP* Schedule 5.2G as follows. New text is underlined:

Chapter/Appendix	Section/Annex	Paragraph	Right of Action under s150		
			For private person?	Removed?	For other person?
1 Complaints handling arrangements for <i>firms</i>	<u>All rules apart from <i>DISP</i> 1.7.14R and <i>DISP</i> 1.7.15R</u>	-	Yes	-	-
<u>1</u>	<u>7</u>	<u>14 and 15</u>	<u>No</u>	<u>Yes- <i>DISP</i> 1.7.22R</u>	<u>No</u>
2 Jurisdiction rules	-	-	Yes	-	-
3 Complaints handling procedures of the <i>Financial Ombudsman Service</i>	-	-	Yes	-	-

Chapter/Appendix	Section/Annex	Paragraph	Right of Action under s150		
			For private person?	Removed?	For other person?
4 The <i>standard terms</i>	-	-	N/A	-	-
5 Funding	-	-	Yes	-	-

Part 2: amendments relating to the redesignation of LLD 6

Amend DISP 2.1.4G as follows. New text is underlined and deleted text is shown struck-through:

- 2.1.4 G References in this chapter to "*firms*" are to be construed, where relevant, as including:
- (1) in accordance with the *Ombudsman Transitional Order*, *unauthorised persons* subject to the *Compulsory Jurisdiction* in relation to *relevant complaints*; and
 - (2) as a result of section 226 of the *Act*, *unauthorised persons* who were formerly *firms* in respect of complaints about acts or omissions which occurred at the time when they were *authorised*, provided that the *Compulsory Jurisdiction* rules were in force in relation to the activity in question; and
 - (3) members of the Society of Lloyd's (see DISP 2.5.3G).

Amend DISP 2.5 as follows. New text is underlined and deleted text is shown struck-through:

- 2.5 Which firms are subject to the jurisdiction of the Financial Ombudsman Service?

Firms and VJ participants

- 2.5.1 G ...

- 2.5.1 G ...

Members of the Society of Lloyd's

- 2.5.3 G ~~Members of the Society of Lloyd's are treated as firms for the purposes of the Compulsory Jurisdiction (including the rules in DISP 1 relating to firms' complaints procedures) and are subject to DISP 1 as a result of the insurance market direction given in LLD 6.2.1 D, under section 316 of the Act (Direction by Authority). However, as set out in DISP 1.7, members will individually comply with DISP 1 if and only if all complaints by~~

~~policyholders against *members* are dealt with under the internal procedures established by the *Society* of Lloyd's for handling those complaints, provided that these procedures themselves comply with *DISP* 1. Accordingly, certain of the obligations under *DISP* 1, for example, the obligation to report on complaints received, must be complied with by the *Society* on behalf of *members*.~~

The *insurance market direction* given in *DISP* 2.5.5D is given under section 316(1) of the *Act* (Direction by Authority) and applies to *members* of the *Society* of Lloyd's.

- 2.5.4 D (1) With effect from *commencement*, Part XVI of the *Act* (The Ombudsman Scheme), and in particular section 226 (Compulsory jurisdiction), applies to the carrying on of insurance business by *members*.
(2) For the purposes of (1) 'insurance business' means the *regulated activities of effecting or carrying out contracts of insurance* written at Lloyd's.

Amend *DISP* 3.1.5G as follows. New text is underlined and deleted text is shown struck-through:

- 3.1.5 G References in this chapter to "*firms*" are to be construed, where relevant, as including:
- (1) in accordance with the *Ombudsman Transitional Order*, *unauthorised persons* subject to the *Compulsory Jurisdiction* in relation to *relevant complaints*; and
 - (2) as a result of section 226 of the *Act*, *unauthorised persons* who were formerly *firms* in respect of complaints about acts or omissions which occurred at the time when they were *authorised*, provided that the *Compulsory Jurisdiction* rules were in force in relation to the activity in question; and
 - (3) *members of the Society* of Lloyd's (see *DISP* 2.5.3G).

Amend *DISP* Sch 4 (Powers exercised) as follows:

- 1 The following powers and related provisions in the *Act* and in the *Ombudsman Transitional Order* have been exercised by the *FSA* to make the *rules* in *DISP*:
- (1) ...
- ...
- (4A) ...

(4B) Section 316(1) (Direction by Authority)

(5) ...

...

Annex N

Amendments to the Compensation manual

Amend COMP 1.5.1G as follows. Deleted text is shown struck-through and new text is underlined:

- 1.5 Application to Lloyd's
- 1.5.1 G The *FSA* has exercised its power under section 316 of the *Act* (Direction by Authority) to direct in ~~*LLD-8A (Compensation Arrangements for policyholders)*~~ *COMP 1.5.5D* that certain *core provisions* in the *Act* should apply to *members* of the *Society* of Lloyd's (an "*insurance market direction*"). The effect of the direction is that the *FSA* may, in relation to *members*, and in respect of *insurance market activities* carried on by them, exercise any of the statutory powers conferred by the provisions which are applied by the direction. Those include the powers in Part X to make general *rules* and give *guidance* and also the powers in Part XV to make *rules* for the establishment and operation of a compensation scheme. Accordingly this sourcebook makes provision for the payment of compensation by the *FSCS* in certain cases arising from *insurance business* carried on by *members*, and for raising levies on the *Society*.

...

Insert the following text after COMP 1.5.3G. The text is redesignated and restated text. Amendments to the redesignated text are not shown.

- Compensation arrangements for policyholders
- 1.5.4 G The *insurance market direction* in *COMP 1.5.5D* is intended to protect the interests of *policyholders* and potential *policyholders* by:
- (1) providing for the application of the *compensation scheme* in respect of *contracts of insurance* issued by *members*; and
 - (2) providing for the application of such other provisions of the *Act* as will enable the application of the *compensation scheme* to be effective in relation to *insurance market activities* carried on by *members*.
- 1.5.5 D With effect from 15 October 2003 the following *core provisions* of the *Act* apply to the carrying on of *insurance market activities* by *members*:
- (1) Part X (Rules and guidance) for the purpose of applying the *rules* in *COMP* and relevant interpretative provisions; and
 - (2) Part XV (Financial Services Compensation Scheme).
- 1.5.6 G Section 317(2) of the *Act* (The core provisions) provides that references in

an applied *core provision* to an *authorised person* are to be read as references to a *person* in the class to which the *insurance market direction* applies. In particular, with effect from 15 October 2003, references to a *relevant person* in Part XV of the *Act* include a person who was a *member* at the time the act or omission giving rise to the claim against him took place.

Compensation arrangements for individual members

- 1.5.7 G The *compensation scheme* will not compensate *members* or *former members* if *firms* are unable to satisfy claims made in connection with *regulated activities* relating to their participation in Lloyd's *syndicates*. Separate *rules* and *guidance* are therefore needed.
- 1.5.8 R The *Society* must maintain *byelaws* establishing appropriate and effective arrangements to compensate *individual members* and *former members* who were *individual members* if *underwriting agents* are unable, or likely to be unable, to satisfy claims by those *members* relating to *regulated activities* carried on in connection with their participation in Lloyd's *syndicates*.
- 1.5.9 R For the purposes of COMP 1.5.8R "*individual member*" includes a *member* which is a *limited liability partnership* or a *body corporate* whose members consist only of, or of the nominees for, a single natural person or a group of connected persons.
- 1.5.10 G The arrangements referred to in COMP 1.5.8R:
- (1) will not compensate losses arising only as a result of underwriting or investment risk to which *individual members* or *former members* who were *individual members* are or were exposed by their participation in Lloyd's *syndicates*;
 - (2) may be restricted to compensation for losses arising out of fraud, dishonesty or failure to account; and
 - (3) should cover all *regulated activities* carried on by *underwriting agents* relating to Lloyd's *syndicate* capacity and *syndicate* membership.
- 1.5.11 G The arrangements referred to in COMP 1.5.8R should have a governance structure that is operationally independent from the *Society*, but which is nevertheless accountable to the *Society* for the proper administration of the compensation arrangements.
- 1.5.12 R A contravention of COMP 1.5.8R does not give rise to a right of action by a *private person* under section 150 of the *Act* (Actions for damages) and that *rule* is specified under section 150(2) of the *Act* as a provision giving rise to no such right of action.

Amend COMP Sch 4 (Powers exercised) as follows:

The following powers and related provisions in the *Act* and the Financial Services and Markets Act 2000 (Transitional Provisions, Repeals and Savings) (Financial Services Compensation Scheme) Order 2001 ("the *compensation transitionals order*") have been exercised by the *FSA* to make the rules in

COMP:

- (1) ...
- ...
- (9) ...
- (9A) Section 316(1) (Direction by Authority)
- (10) ...
- ...

Amend COMP Schedule 5.2G as follows. New text is underlined:

Chapter/Appendix		Section/Annex	Paragraph	For private person?	Removed	For other person?
<u>COMP 1</u>		<u>5</u>	<u>8</u>	<u>No</u>	<u>Yes</u> – <u>COMP 1.5.11R</u>	<u>No</u>
COMP 13	Funding (all rules)			Yes	No	No
COMP 14.4.6R				Yes	No	No

Annex O

Amendments to the New Collective Investment Schemes sourcebook

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

COLL TP 1 Transitional Provisions

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional provisions	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
...					
5	<i>COLL 6.9.9R (2) to (6) (Restrictions of business for UCITS management companies)</i>	R	<p><i>UCITS management company</i> must not carry on any of the activities specified in <i>COLL 6.9.9 (2) COLL 6.9.9 (3) COLL 6.9.9 (4) COLL 6.9.9 (5) COLL 6.9.9 (6) COLL 6.9.9R(2) to (6) (inclusive)</i> unless it is a <i>UCITS investment firm</i>:</p> <p>(a) whose <i>permission</i> to carry on any such activity was given before 13 February 2004; or</p> <p>(b) which complies with Chapter 7 of IPRU <u>(INV)BIPRU</u>.</p>	From 1 April 2004 to 12 February 2007	1 April 2004
6	<i>COLL 6.9.9 (2) COLL 6.9.9 (3) COLL 6.9.9 (4) COLL 6.9.9 (5) COLL 6.9.9 (6) COLL 6.9.9R (2) to (6) (Restrictions of business for UCITS management companies)</i>	G	A <i>UK firm</i> will not be able to act as such and exercise an <i>EEA right</i> under the <i>UCITS Directive</i> unless it complies with Chapter 7 of IPRU <u>(INV)UPRU</u> .		
...					

Annex P

Amendments to the Credit Unions sourcebook

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

Part 1: consequential amendments taking effect 31 December 2006

Amend CRED App 1.1 as follows:

App 1.1 This is the table referred to in CRED 2.2.2G.

	Sourcebook or manual	Reference code
...
Business Standards	...	
	Integrated Prudential sourcebook	<i>PRU</i>
	<u>General Prudential sourcebook</u>	<u><i>GENPRU</i></u>
	<u>Prudential sourcebook for Insurers</u>	<u><i>INSPRU</i></u>
...

Part 2: consequential amendments taking effect 1 January 2007

Amend CRED App 1.1 as follows:

App 1.1 This is the table referred to in *CRED 2.2.2G*.

	Sourcebook or manual	Reference code
...
Business Standards	...	
	Integrated Prudential sourcebook	<i>PRU</i>
	General Prudential sourcebook	<i>GENPRU</i>
	<u>Prudential sourcebook for Banks, Building Societies and Investment Firms</u>	<u><i>BIPRU</i></u>
	Prudential sourcebook for Insurers	<i>INSPRU</i>
	<u>Prudential sourcebook for Mortgage and Home Finance Firms, and Insurance Intermediaries</u>	<u><i>MIPRU</i></u>
	<u>Prudential sourcebook for UCITS Firms</u>	<u><i>UPRU</i></u>
...

Annex Q

Amendments to the Electronic Money sourcebook

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

1.1 Application

...

1.1.2 R Table Application of different chapters of *ELM* (except for an *incoming EEA firm* or an *incoming Treaty firm*)

(1) Chapter	(2) Categories of person to which chapter applies	(3) Applicable rules and guidance
...
5 (Systems and controls; Rules of making calculations) <u>(Note 1)</u>	An <i>ELMI</i> An <i>e-money firm</i> that is not an <i>ELMI</i>	The whole chapter <i>ELM</i> 5.1, <i>ELM</i> 5.2 and <i>ELM</i> 5.4
...
<u>Note 1 = <i>ELM</i> 5.1.2 and <i>ELM</i> 5.1.3 contain further application statements with respect to <i>ELM</i> 5.4A.</u>		

...

1.2 Contents and purpose

...

1.2.3 G *ELM* implements the parts of the *E-Money Directive* and (for *ELMIs*) the *Banking Consolidation Directive* dealing with these topics. As from 1 January 2007 the version of the *Banking Consolidation Directive* in force when the *E-Money Directive* came into force (Directive 2000/12/EC) was replaced by the current version. The *FSA's* policy in implementing the parts of the *Banking Consolidation Directive* that apply to *ELMIs* is generally that the current version of the *Banking Consolidation Directive* applies except that generally:

- (1) *ELM* does not implement provisions of the current version of the *Banking Consolidation Directive* that have no counterpart in the previous version; and
- (2) where the *E-Money Directive* applied a part of the previous version of the *Banking Consolidation Directive* that does not have a direct counterpart in the current version, *ELM* continues to implement the

previous version.

...

1.5.2 G Application of other parts of the Handbook to *ELMIs*

Block	Module	Application
High level standards	... Senior management arrangements, systems and controls (<i>SYSC</i>)	... <u><i>SYSC 1 (Application and purpose), SYSC 2 (Senior management arrangements), SYSC 3 (Systems and controls), SYSC 12.1 (Group risk systems and control requirement) and SYSC 18 (Guidance on Public Interest Disclosure Act: Whistleblowing)</i></u> applies to every <i>ELMI</i> .
...
Business Standards	Interim Prudential sourcebooks: <i>IPRU(INS)</i> , <i>IPRU(FSOC)</i> , <i>IPRU(BANK)</i> , <i>IPRU(BSOC)</i> and <i>IPRU(INV)</i> Integrated Prudential Sourcebook (<i>PRU</i>)	<i>ELM 7 (Consolidated financial supervision)</i> applies <i>IPRU(BANK), IPRU(BSOC) and IPRU(INV)</i> to certain <i>ELMIs</i> who are members of a <i>group</i> . Chapter NE of <i>IPRU(BANK)</i> is relevant to <i>ELM 3.5.16R</i> , as described in <i>ELM 3.5.20G</i> . Otherwise, † These sourcebooks do not apply to <i>ELMIs</i> .
	<u>Prudential sourcebook for Banks, Building Societies and Investment Firms (<i>BIPRU</i>)</u>	<i>ELM 7 (Consolidated financial supervision)</i> applies <i>BIPRU 8 (Group risk-consolidation)</i> to certain <i>ELMIs</i> who are members of a <i>group</i> .
	The integrated Prudential Sourcebook (<i>PRU</i>) <u>General Prudential sourcebook (<i>GENPRU</i>)</u>	<i>PRU 1.8 (Action for damages), PRU 8.1 (Group risk systems and controls requirement), PRU 8.4</i> <u><i>GENPRU 1.4 (Actions for damages), GENPRU 3.1 (Cross sector groups), PRU 8.5</i></u> <i>GENPRU 3.2 (Third country groups), PRU 8</i> <u><i>GENPRU 3 Ann 1R (Capital adequacy calculations for financial conglomerates), PRU 8</i></u> <i>GENPRU 3 Ann 2R (Prudential rules for third country groups), PRU</i>

		<p><u>8GENPRU 3</u> Ann 3G (Financial conglomerates: Cooperative decision making by competent authorities and consultation) and <u>PRU 8GENPRU 3</u> Ann 4GR (Classification of groups) apply to an <i>ELMI</i>.</p>
...	<p><u>Other sourcebooks in Prudential Standards (Block 2): Prudential sourcebook for Insurers (INSPRU), Prudential sourcebook for Mortgage and Home Finance Firms, and Insurance Intermediaries (MIPRU) and Prudential sourcebook for UCITS Firms (UPRU)</u></p> <p>...</p>	<p><u>These sourcebooks do not apply to <i>ELMIs</i>.</u></p> <p>...</p>
Specialist sourcebooks other than <i>ELM</i>	<p>Credit unions (<i>CRED</i>), Professional firms, (<i>PROF</i>), Lloyd's (<i>LLD</i>), Collective Investment Schemes (<i>CIS</i>) or <i>COLL</i> and Recognised Investment Exchanges and Recognised Clearing Houses (<i>REC</i>).</p>	<p>These sourcebooks do not apply to an <i>ELMI</i>.</p>

...

...

...

...

2.4 Calculation of initial capital and own funds

...

2.4.13 R Subordinated debt capital does not form part of a *firm's upper tier two capital* unless the following requirements are met (in addition to those in *ELM 2.4.11 R*):

(1) ...

...

(4) the subordinated debt capital complies with the conditions in article 3563(2)(d) of the *Banking Consolidation Directive*;

...

- ...
- 2.4.16 G *ELM 2.4.13 R (4) refers to article 3563(2)(d) of the Banking Consolidation Directive. This article says that the documents governing the issue of the [subordinated debt capital] must provide for debt and unpaid interest to be such as to absorb losses, whilst leaving the [firm] in a position to continue trading. Compliance with the other conditions of ELM 2.4.11 R and ELM 2.4.13 R will usually ensure that a firm complies with article 3563(2)(d). ...*
- 2.4.17 R Material holdings
- (1) ...
- ...
- (6) An item falls into this paragraph if it is a subordinated debt or other item of capital that:
- (a) ...
- (b) (in the case of a *relevant financial services company* or *financial institution*) falls into Article 3563 or Article 3664(3) of the *Banking Consolidation Directive*.
- ...
- 2.4.20 R Adjustments to own funds
- In accordance with article 34(4)61 of the *Banking Consolidation Directive*, *tier one capital* and revaluation reserves must not be included within a *firm's own funds* to the extent that those items do not represent capital that is available to the *firm* for unrestricted and immediate use to cover risks and losses as soon as these occur, whether because of taxation charges, any future foreseeable taxation charges or for any other reason.
- ...
- 2.4.22 R Exclusion from own funds
- In accordance with article 64(4) of the *Banking Consolidation Directive*, the fair value reserves related to gains or losses on cash flow hedges of *financial instruments* measured at amortised cost or any gains or losses on their liabilities valued at fair value that are due to changes in the *firm's* own credit standing must not be included within a *firm's* own funds.
- 2.4.23 G *ELM 2.4.22R* reflects article 64(4) of the *Banking Consolidation Directive*.
- ...
- 3.5 Large exposure risk
- ...
- 3.5.17 R A *firm* may not recognise the benefits of collateral under *ELM 3.5.14R*

unless:

- (1) ...
- (2) the *securities* are listed on a *recognised investment exchange* or *designated investment exchange*; ~~and~~
- (3) ...
 - (a) ...
 - (b) ...
 - (c) the percentage figure is 150% rather than 200% in the case of *debentures* or *government and public securities* issued by regional or local authorities of an *EEA State* or by a *multilateral development bank*; and
- (4) the securities issued by any credit institution do not form part of its regulatory capital resources.

...

3.5.20 G [Deleted]

...

5.1 Application

...

5.1.2 R ELM 5.4A applies with respect to the carrying on of:

- (1) regulated activities; and
- (2) ancillary activities in relation to regulated activities.

5.1.3 R ELM 5.4A also:

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

5.2 Purpose

...

5.2.6 G This chapter implements article 7 of the *E-money Directive* and (for *ELMIs*) articles ~~6~~11(1) and 22 of the *Banking Consolidation Directive*.

5.3 Business to be directed by at least two individuals

...

5.3.2 G *ELM 5.3.1 R*, sometimes known as the 'four eyes requirement', provides that at least two individuals must effectively direct the business of a *firm*. Compliance with the *rule* would help to establish a *firm's* compliance with *Principle 3* ('Management and control') and its continued meeting of the *threshold condition 5* ('Suitability'). It also reflects the requirement in Article 61(1) of the *Banking Consolidation Directive*.

...

5.4A Organisation and internal control mechanisms

5.4A.1 R A *firm* must have robust governance arrangements, which include a clear organisational structure with well defined, transparent and consistent lines of responsibility, effective processes to identify, manage, monitor and report the risks it is or might be exposed to, and adequate internal control mechanisms, including sound administrative and accounting procedures.

5.4A.2 R The arrangements, processes and mechanisms referred to in *ELM 5.4A.1R* must be comprehensive and proportionate to the nature, scale and complexity of the *firm's* activities.

5.4A.3 G *ELM 5.4A.1R* and *ELM 5.4A.2R* reflect article 22 of the *Banking Consolidation Directive*.

...

6.2 Purpose

...

6.2.3 G This chapter implements article 3 of the *E-Money Directive* and article 33a of the previous version of the *Banking Consolidation Directive (Directive 2000/12/EC)*.

...

6.5 Methods of redemption

...

6.5.4 G *ELM 6.5.1 R* reflects article 3(1) of the *E-Money Directive* and article 33a of the previous version of the *Banking Consolidation Directive (Directive 2000/12/EC)*. Neither *ELM 6.5.1 R* nor *ELM 6.5.2 R* takes precedence over the other. A *firm* must therefore organise its affairs so that it can comply with both *rules*.

...

7.3 Consolidated capital adequacy

7.3.1 R If:

(1) ...

(2) another member of that *group* (firm B) is a *firm* that is subject to

BIPRU 8 ~~an FSA consolidation rule;~~

- (3) ...
- (4) firm A is included in the scope of the consolidation under BIPRU 8 ~~the FSA consolidation rule~~ as it applies to firm B;

firm A must comply with BIPRU 8 as it applies to firm B except that the rules in BIPRU 8 relating to non-EEA sub-group do not apply, ~~at all times, maintain capital resources (calculated in accordance with the relevant rules) at a level that ensures that, taking into account (in the manner and to the extent provided for in those rules) the capital resources of other members of the group, firm B complies with the FSA consolidation rules applicable to it. If there is more than one firm in the group that fits the description of firm B, the obligation of this rule applies in relation to all of them.~~

7.3.2 R If:

- (1) ELM 7.3.1R does not apply to a firm;
- (2) the firm is a member of an EEA consolidated group ~~or UK consolidated group~~;
- (3) there is a full credit institution or an investment firm in that EEA consolidated group ~~or UK consolidated group~~; and
- (4) the undertaking in (3) is in the firm's immediate group; and
- (5) that EEA consolidated group is not subject to supervision on a consolidated basis by a competent authority of another EEA State under the Banking Consolidation Directive, the E-Money Directive or the Capital Adequacy Directive;

the firm must comply with BIPRU 8 with respect to that EEA consolidated group as follows:

~~at all times, maintain capital resources (calculated in accordance with the relevant rule) at a level that ensures that, taking into account (in the manner and to the extent provided for in that rule) the capital resources of other members of the firm's group, the firm would comply with BIPRU 8 as it the bank consolidation rules if it applied to the firm.~~

- (6) BIPRU 8 applies as it does to a bank in a UK consolidation group; and
- (7) the rules in BIPRU 8 relating to non-EEA sub-group do not apply.

7.3.2A R If:

- (1) ELM 7.3.1R and ELM 7.3.2R do not apply to a firm;
- (2) the firm is a member of an UK consolidated group;
- (3) there is a full credit institution or an investment firm in that UK

consolidated group; and

(4) the undertaking in (3) is in the firm's immediate group;

the firm must, at all times, maintain capital resources (calculated in accordance with the relevant rule) at a level that ensures that, taking into account (in the manner and to the extent provided for in that rule) the capital resources of other members of the firm's group, the firm would comply with BIPRU 8 as it applies when there is a bank in the UK consolidation group if it applied to the firm. For the purposes of ELM 7.3.3R, the rules in BIPRU 8 apply to the UK consolidated group in the same way as they apply to a UK consolidation group under BIPRU 8. The rules in BIPRU 8 relating to non-EEA sub-group do not apply.

7.3.3 R If:

(1) ELM 7.3.1R, ELM 7.3.2R and ELM 7.3.2AR do not apply to a firm;

(2) ...

7.3.4 R If:

(1) ELM 7.3.1R, ELM 7.3.2R, ELM 7.3.2AR and ELM 7.3.3 do not apply to a firm; and

(2)

7.5 Calculation of capital adequacy on a consolidated basis

EEA group risk own funds

7.5.1 R

(3) the adjustments provided for in article ~~6537~~ of the *Banking Consolidation Directive* apply (if required by the *Banking Consolidation Directive*), in accordance with (1);

...

7.7 Waiver

7.7.1 G Article ~~7352(3)~~ of the *Banking Consolidation Directive* says that competent authorities responsible for the exercising supervision on a consolidated basis may decide that a *credit institution, financial institution or ancillary services undertaking auxiliary banking services undertaking* which is a subsidiary or in which a *participation* is held need not be included in the consolidation in certain cases. ...

(1) ~~where if the undertaking concerned that should be included~~ is situated in a third country where there are legal impediments to the transfer of the necessary information;

(2) if, in the opinion of the competent authorities responsible for exercising supervision on a consolidated basis, the consolidation of the financial situation of the *undertaking concerned that should be*

~~included~~ would be inappropriate or misleading as far as the objectives of the supervision of *credit institutions* are concerned.

...

7.8 Summary of consolidation rules

...

7.8.3 G ~~ELM 7.3.1R says that if the *firm* is part of a *group* that is subject to consolidated supervision under *IPRU(BANK)*, *IPRU(BSOC)* or *IPRU(INV)*, consolidated supervision of the *firm* will also be carried out under those rules.~~

Broadly speaking, *ELM 7.3.1R* to *ELM 7.3.2AR* apply the consolidation rules in *BIPRU 8* to an *ELMI*.

7.8.4 G ~~*ELM 7.3.12R* says, broadly, that if *ELM 7.3.1R* does not apply but the *firm* is part of a *group* with a *full credit institutions* or *investment firm* as a member the *banking consolidation rule* applies. This means that the *firm* will be subject to the consolidation requirements for *banks*. These can be found in chapter CS of *IPRU(BANK)* (consolidated supervision).~~

If an *ELMI* is a member of a *group* that has another member in it subject to *BIPRU 8*, then *ELM 7.3.1R* applies *BIPRU 8* to the *ELMI* in the same way as it applies to the other *firm*.

7.8.5 G ~~Generally, the guidance in *IPRU(BANK)* says if a *firm* is part of a *group* subject to lead supervision under the EU banking or investment services Directives by a competent authority in another *EEA State*, consolidates supervision in accordance with *BIPRU 8* the detailed quantitative guidance in *IPRU(BANK)* does not apply at the level of the *EEA group*. Instead it applies at the level of the *UK sub-group*.~~

ELM 7.3.2R and *ELM 7.3.2AR* say that where *ELM 7.3.1R* does not apply, *BIPRU 8* applies to the *ELMI* if there is a *full credit institution* or *investment firm* in the *group*. If the *ELMI* is part of an *EEA consolidated group* of which the *FSA* is the lead regulator, *BIPRU 8* applies to that *EEA consolidated group*. If the *ELMI* is not part of such a *group* or another *EEA competent authority* is lead regulator for the *EEA consolidated group*, then *BIPRU 8* applies to the *UK consolidated group* of the *ELMI*.

...

7.8.10 G ~~If a *firm* is part of a *financial conglomerate*, the provisions of *GENPRU 3.1 PRU 8.4* apply. If a *firm* is part of a *third-country group*, the provisions of *GENPRU 3.2 PRU 8.5* apply.~~

Annex R

Amendments to the Lloyd's Sourcebook

1. The provisions of the Lloyd's sourcebook referred to in column (1) of the Table in this Annex R are redesignated as set out in column (2) of that Table, in accordance with paragraph D of this instrument.
2. So far as not redesignated by the following instruments, the whole of the Lloyd's sourcebook is deleted:
 - (a) the General Prudential Sourcebook Instrument 2006 (Annex A);
 - (b) the Prudential Sourcebook for Insurers Instrument 2006 (Annex A);
 - (c) the CRD (Consequential Amendments) Instrument 2006 (Annex R).

Table - redesignation of LLD provisions

The table referred to in paragraph D of this instrument is as follows:

Current location of LLD provisions	Destination	Location of restated LLD text
2.2.1 D	SUP 15.3.22 D	Annex L
2.3.1 D	SUP 15.3.23 D	Annex L
2.4.1 D	SUP 15.3.24 D	Annex L
2.4.2 D	SUP 15.3.25 D	Annex L
3.3.1 R	IPRU (INS) 9.61 (1)	Annex G
3.3.2 R	IPRU (INS) 9.61 (2)	Annex G
3.3.3 G	IPRU (INS) 9.72(1)	Annex G
3.3.4 G	IPRU (INS) 9.72(2)	Annex G
4.3.1 R	IPRU (INS) 9.62 (1)	Annex G
4.3.2 R	IPRU (INS) 9.62 (2)	Annex G
6.1.1 G	DISP 2.5.3 G	Annex M
6.2.1 D	DISP 2.5.4 D	Annex M
7.1.2 R	DISP 1.7.22R	Annex M
7.1.4 G	DISP 1.7.13 G	Annex M
7.2.1 R	DISP 1.7.14 R	Annex M
7.5.1 R	DISP 1.7.15 R	Annex M
7.5.2 R	DISP 1.7.16 R	Annex M
7.5.3 G	DISP 1.7.17 G	Annex M
7.5.4 G	DISP 1.7.18 G	Annex M
7.5.5 G	DISP 1.7.19 G	Annex M
7.5.6 G	DISP 1.7.20 G	Annex M
7.5.7 G	DISP 1.7.21 G	Annex M
8.1.2R	COMP 1.5.12R	Annex N
8.1.4 G	COMP 1.5.7 G	Annex N
8.2.1 R	COMP 1.5.8 R	Annex N
8.2.2 R	COMP 1.5.9 R	Annex N
8.2.3 G	COMP 1.5.10 G	Annex N
8.2.4 G	COMP 1.5.11 G	Annex N
8A.1.2 G	COMP 1.5.4 G	Annex N
8A.2.1 D	COMP 1.5.5 D	Annex N
8A.2.2 G	COMP 1.5.6 G	Annex N
15.1.1 R	IPRU (INS) 9.47	Annex G
15.1.4 G	IPRU (INS) 9.63 (1)	Annex G
15.1.5 G	IPRU (INS) 9.63 (2)	Annex G
15.1.5A G	IPRU (INS) 9.63 (3)	Annex G
15.1.8 G	IPRU (INS) 9.63 (4)	Annex G
15.2.1 R	IPRU (INS) 9.48 (1)	Annex G
15.2.2 R	IPRU (INS) 9.48 (2)	Annex G
15.2.3 R	IPRU (INS) 9.48 (3)	Annex G
15.2.4 R	IPRU (INS) 9.48 (4)	Annex G
15.2.5 R	IPRU (INS) 9.48 (5)	Annex G
15.2.6 R	IPRU (INS) 9.48 (6)	Annex G
15.2.7 G	IPRU (INS) 9.64	Annex G
15.3.1 R	IPRU (INS) 9.49 (1)	Annex G

15.3.2 R	IPRU (INS) 9.49 (2)	Annex G
15.3.3 R	IPRU (INS) 9.49 (3)	Annex G
15.3.4 R	IPRU (INS) 9.49 (4)	Annex G
15.3.5 R	IPRU (INS) 9.49 (5)	Annex G
15.3.6 R	IPRU (INS) 9.49 (6)	Annex G
15.3.7 R	IPRU (INS) 9.49 (7)	Annex G
15.4.1 R	IPRU (INS) 9.50 (1)	Annex G
15.4.2 R	IPRU (INS) 9.50 (2)	Annex G
15.4.3 G	IPRU (INS) 9.65 (1)	Annex G
15.4.4 G	IPRU (INS) 9.65 (2)	Annex G
15.4.5 G	IPRU (INS) 9.65 (3)	Annex G
15.4.6 G	IPRU (INS) 9.65 (4)	Annex G
15.4.8 R	IPRU (INS) 9.50 (3)	Annex G
15.5.1 R	IPRU (INS) 9.51 (1)	Annex G
15.5.2 R	IPRU (INS) 9.51 (2)	Annex G
15.5.3 G	IPRU (INS) 9.66	Annex G
15.5.4 G	IPRU (INS) 9.51 (4)	Annex G
15.5.6 R	IPRU (INS) 9.51 (3)	Annex G
15.6.1 R	IPRU (INS) 9.52 (1)	Annex G
15.6.2 R	IPRU (INS) 9.52 (2)	Annex G
15.6.3 G	IPRU (INS) 9.67	Annex G
15.6.4 R	IPRU (INS) 9.52 (3)	Annex G
15.7.1 R	IPRU (INS) 9.53 (1)	Annex G
15.7.2 R	IPRU (INS) 9.53 (2)	Annex G
15.7.3 G	IPRU (INS) 9.68	Annex G
15.7.4 R	IPRU (INS) 9.53 (3)	Annex G
15.8.1 R	IPRU (INS) 9.54 (1)	Annex G
15.8.2 G	IPRU (INS) 9.69	Annex G
15.8.3 G	IPRU (INS) 9.70	Annex G
15.8.4 R	IPRU (INS) 9.54 (2)	Annex G
15.8.5 R	IPRU (INS) 9.55 (1)	Annex G
15.8.6 R	IPRU (INS) 9.71	Annex G
15.8.7 R	IPRU (INS) 9.56 (1)	Annex G
15.8.8 R	IPRU (INS) 9.57 (1)	Annex G
15.8.9 R	IPRU (INS) 9.57 (2)	Annex G
15.9.1 R	IPRU (INS) 9.58 (1)	Annex G
15.9.2 R	IPRU (INS) 9.58 (2)	Annex G
15.9.3 R	IPRU (INS) 9.58 (3)	Annex G
15.11.2 R	IPRU (INS) 9.59 (1)	Annex G
15.13.1 R	IPRU (INS) 9.60 (1)	Annex G
15.13.2 R	IPRU (INS) 9.60 (2)	Annex G
15.13.3 R	IPRU (INS) 9.60 (3)	Annex G
15.13.4 R	IPRU (INS) 9.60 (4)	Annex G
15.13.5 R	IPRU (INS) Appendix 9.17	Annex G
15.13.6 R	IPRU (INS) 9.60 (5)	Annex G
15.13.6AG	IPRU (INS) 9.63 (1)	Annex G
15.13.7 R	IPRU (INS) 9.60 (6)	Annex G
15.13.8 R	IPRU (INS) Appendix 9.18	Annex G
15.13.9 R	IPRU (INS) 9.60 (7)	Annex G
15 Annex 1 R	IPRU (INS) Appendix 9.11	Annex G
15 Annex 2 R	IPRU (INS) Appendix 9.12	Annex G

15 Annex 3 R	IPRU (INS) Appendix 9.13	Annex G
15 Annex 4 R	IPRU (INS) Appendix 9.14	Annex G
15 Annex 5 R	IPRU (INS) Appendix 9.15	Annex G
15 Annex 6 R	IPRU (INS) Appendix 9.16	Annex G
25.2.1 R	SUP APP 2.16.1 R	Annex L
25.3.1 R	SUP APP 2.16.2 R	Annex L
25.5.1 R	SUP APP 2.16.3 R	Annex L
25.6.1 R	SUP APP 2.16.4 R	Annex L
25.7.1 R	SUP APP 2.16.5 R	Annex L
25.8.1 G	SUP APP 2.16.6 G	Annex L

Annex S

Amendments to the Listing Rules

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

Amend LR App 1.1 as follows:

App 1.1 Relevant definitions

...

- bank* (a) a *firm* with a *Part IV permission* which includes *accepting deposits*, and:
- (i) which is a *credit institution*; or
 - (ii) whose *Part IV permission* includes a *requirement* that it comply with ~~IPRU(BANK)~~the rules in GENPRU and BIPRU relating to banks;

but which is not a *building society*, a *friendly society* or a *credit union*;

- (b) ...

Annex T

Amendments to the Handbook consequential on the redesignation of PRU

1. The references in the provisions of the *Handbook* specified in column (2) of Tables 1 and 2 in this Annex T to the provisions in column (3) of those Tables are replaced with references to the corresponding provisions in column (4) of those Tables.
2. A reference in the *Handbook* (other than those mentioned specifically elsewhere in this CRD (Consequential Amendments) Instrument 2006) to a provision in column (1) of the Table in Annex A to the General Prudential Sourcebook Instrument 2006 is replaced with a reference to the corresponding provision in column (2) of that Table.
3. A reference in the *Handbook* (other than those mentioned specifically elsewhere in this instrument) to a provision in column (2) of the Table in Annex A (Creation of INSPRU) to the Prudential Sourcebook for Insurers Instrument 2006 is replaced with a reference to the corresponding provision in column (1) of that Table.

Part 1: Amendments taking effect on 31 December 2006

Table 1

(1) Sourcebook or manual	(2) Provision	(3) PRU reference	(4) New reference
COND	2.6.5G(2)	PRU	GENPRU
	2.6.5G(3)	PRU 7.6	INSPRU 1.5
COB	6.12.12G(2)	PRU 2 PRU 4 PRU 7	GENPRU 2 INSPRU 3 INSPRU 1
	6.12.24R(2)(a)	PRU 7.4.119R PRU 7.4.123R	INSPRU 1.3.119R INSPRU 1.3.123R
	6.12.51R(2)	PRU 7.3.33R	INSPRU 1.2.33R
	TP 4 paragraph14	PRU 7.4	INSPRU 1.3
ICOB	1.2.2G(2)	PRU 7.6.13R	INSPRU 1.5.13R
	4.2.13G(2)	PRU 7.6.13R	INSPRU 1.5.13R
SUP	4.3.13(3)	PRU 7.4	INSPRU 1.3
	4.3.14G	PRU 7.4	INSPRU 1.3
	4.3.16A R(2)	PRU 7.4	INSPRU 1.3
	8.2.7	PRU	INSPRU
	App 2.2.1R(1)(b)	PRU 8.3.45R PRU 8.3.43R	INSPRU 6.1.45R INSPRU 6.1.43R
	App 2.2.1R(1)(c)	PRU 2.2.12R	GENPRU 2.2.17R
	App 2.2.1R(2)(b)	PRU 8.3.45R(2)	INSPRU 6.1.45R(2)
	App 2.2.1R(2)(c)	PRU 2.2.18R	GENPRU 2.2.34R
	App 2.2.1R(2)(d)	PRU 2.2.17R	GENPRU 2.2.33R
	App 2.2.1R(4)(b)	PRU 8.3.45R(3)(c) PRU 8.3.45R(3)(d) PRU 8.3.45R(3)(f)	INSPRU 6.1.45R(3)(c) INSPRU 6.1.45R(3)(d) INSPRU 6.1.45R(3)(f)
	App 2.2.2G	PRU 2.1	GENPRU 2.1
	App 2.3.7G	PRU 1.2.22R	GENPRU 1.2.26R
	App 2.5.1R(2)	PRU 2.2.16R PRU 2.2.24R PRU 8.3.45R(1)(a) PRU 8.3.45R(1)(b)	GENPRU 2.2.32R GENPRU 2.2.28R INSPRU 6.1.45R(1)(a) INSPRU 6.1.45R(1)(b)
	App 2.5.1R(4)(b)	PRU 2.2.16R PRU 2.2.24R PRU 8.3.45R(1)(a) PRU 8.3.45R(1)(b)	GENPRU 2.2.32R GENPRU 2.2.28R INSPRU 6.1.45R(1)(a) INSPRU 6.1.45R(1)(b)
	App 2.5.3R(4)(a)	PRU 2.2.16R PRU 2.2.24R PRU 8.3.45R(1)(a) PRU 8.3.45R(1)(b)	GENPRU 2.2.32R GENPRU 2.2.28R INSPRU 6.1.45R(1)(a) INSPRU 6.1.45R(1)(b)
	App 2.5.3R(4)(b)	PRU 2.2.16R PRU 2.2.24R PRU 8.3.45R(1)(a)	GENPRU 2.2.32R GENPRU 2.2.28R INSPRU 6.1.45R(1)(a)
		PRU 8.3.45R(1)(b)	INSPRU 6.1.45R(1)(b)
	App 2.7.5G	PRU 1.2.22R	GENPRU 1.2.26R

(1) Sourcebook or manual	(2) Provision	(3) PRU reference	(4) New reference
	App 2.12.5G	PRU 2.1 PRU 2.2 PRU 8.3	GENPRU 2.1 GENPRU 2.2 INSPRU 6.1
	App 2.12.6G	PRU 2.2.10G	GENPRU 2.2.22G
	App 2.15.11G(1)	PRU 2.3	INSPRU 7.1
ENF	13.6.3G	PRU 7.6.33R	INSPRU 1.5.33R

Part 2: Amendments taking effect on 1 January 2007

Table 2

(1) Sourcebook or manual	(2) Provision	(3) PRU reference	(4) New reference
SUP	7.3.2G(4)	PRU 8.4	GENPRU 3.1
	11.5.4A	PRU 8.4 PRU 8.5	GENPRU 3.1 GENPRU 3.2
DEC	4.1.8G(4A)	PRU 8.4.50R	GENPRU 3.1.30R

Annex U

Amendments to the Handbook consequential on the redesignation of LLD

1. A reference in the *Handbook* (other than those mentioned specifically elsewhere in this instrument) to a provision in column (1) of the Table in Annex R (Amendments to the Lloyd's sourcebook) is replaced with a reference to the corresponding provision in column (2) of that Table.
2. A reference in the *Handbook* (other than those mentioned specifically elsewhere in this instrument) to a provision in column (2) of Table 1 and Table 2 in this Annex U is replaced with a reference to the corresponding provision in column (1) of those Tables.

Table 1 – LLD to INSPRU

INSPRU	Current designation in LLD
1.1.93 R	LLD 24.3.1 R
1.1.94 R	LLD 24.3.2 R
1.1.95 R	LLD 24.3.5 R
1.1.96 R	LLD 24.3.6 R
1.2.92 R	LLD 24.4.1 R
1.2.93 R	LLD 24.4.2 R
1.4.49 R	LLD 24.5.1 R
1.4.50 R	LLD 24.5.2 R
1.4.51 R	LLD 24.5.3 R
1.5.58 R	LLD 24.6.1 R
1.5.59 R	LLD 24.6.2 R
1.5.60 R	LLD 24.6.3 R
2.1.42 R	LLD 20.3.1 R
2.1.43 R	LLD 20.3.2 R
2.1.44 G	LLD 20.3.3 G
2.1.45 R	LLD 20.3.4 R
2.1.46 R	LLD 20.3.5 R
2.1.47 R	LLD 20.3.6 R
2.1.48 R	LLD 20.3.7 R
2.1.49 R	LLD 20.3.8 R
2.2.17 R	LLD 20.4.1 R
2.2.18 G	LLD 20.4.2 G
3.1.62 R	LLD 21.3.1 R
3.1.63 R	LLD 21.3.2 R
3.1.64 R	LLD 21.3.3 R
3.1.65 R	LLD 21.3.4 R
3.1.66 R	LLD 21.3.6 R
3.2.43 R	LLD 21.4.1 R
4.1.69 R	LLD 22.2.1 R

4.1.70 G	LLD 22.2.2 R
5.1.24 G	LLD 23.2.1 R
5.1.25 G	LLD 23.2.2 R
7.1.57 R	LLD 19.4.1 R
7.1.58 R	LLD 19.4.2 R
7.1.59 G	LLD 19.4.5 G
7.1.60 R	LLD 19.4.6 R
7.1.61 R	LLD 19.4.7 R
7.1.62 R	LLD 19.4.8 R
7.1.63 G	LLD 19.4.9 G
7.1.64 G	LLD 19.4.11 G
7.1.65 G	LLD 19.4.12 G
7.1.66 G	LLD 19.4.13 G
7.1.67 G	LLD 19.4.14 G
7.1.68 R	LLD 19.4.15 R
7.1.69 R	LLD 19.4.16 R
7.1.70 R	LLD 19.4.17 R
7.1.71 G	LLD 19.4.18 G
7.1.72 G	LLD 19.4.19 G
7.1.73 G	LLD 19.4.21 G
7.1.74 R	LLD 19.4.23 R
7.1.75 R	LLD 19.4.24 R
8.1.1 R	LLD 16.2.1 R
8.1.2 R	LLD 16.3.1 R
8.1.3 G	LLD 16.3.2 G
8.1.4 R	LLD 16.3.3 R
8.1.5 G	LLD 16.3.4 G
8.1.6 G	LLD 16.3.5 G
8.1.7 G	LLD 16.3.6 G
8.1.8 G	LLD 16.4.1 G
8.2.1 R	LLD 17.2.1 R
8.2.2 R	LLD 17.3.1 R
8.2.3 R	LLD 17.4.1 R
8.2.4 R	LLD 17.4.3 R
8.2.5 R	LLD 17.4.4 R

8.2.6 R	LLD 17.4.6 R
8.2.7 G	LLD 17.4.12 G
8.2.8 R	LLD 17.4.7 R
8.2.9 R	LLD 17.4.8 R
8.2.10 G	LLD 17.4.9 G
8.2.11 R	LLD 17.4.13 R
8.2.12 R	LLD 17.4.14 R
8.2.13 R	LLD 17.4.15 R
8.2.14 G	LLD 17.5.1 G
8.2.15 G	LLD 17.5.2 G
8.2.16 R	LLD 17.5.3 R
8.2.17 R	LLD 17.6.1 R
8.2.18 R	LLD 17.6.2 R
8.2.19 R	LLD 17.7.1 R
8.2.20 R	LLD 17.7.2 R
8.2.21 R	LLD 17.7.3 R
8.2.22 R	LLD 17.7.4 R
8.2.23 R	LLD 17.8.1 R
8.2.24 R	LLD 17.8.2 R
8.2.25 R	LLD 17.8.3 R
8.2.26 R	LLD 17.8.4 R
8.2.27 G	LLD 17.8.5 G
8.2.28 R	LLD 17.8.6 R
8.2.29 G	LLD 17.8.7 G
8.3.1 R	LLD 3.1.1 R
8.3.2 G	LLD 3.1.3 G
8.3.3 D	LLD 3.1.4 D
8.3.4 D	LLD 3.1.5 D
8.3.5 G	LLD 3.2.1 G
8.3.6 G	LLD 3.2.2 G
8.3.7 D	LLD 3.2.3 D
8.4.1 R	LLD 4.1.1 R
8.4.2 G	LLD 4.1.3 G
8.4.3 R	LLD 4.2.1 R
8.4.4 G	LLD 4.2.2 G
8.4.5 G	LLD 4.2.3 G

8.4.6 G	LLD 4.2.5 G
8.4.7 G	LLD 4.2.7 G
8.5.1 R	LLD 5.1.1 R
8.5.2 G	LLD 5.1.3 G
8.5.3 R	LLD 5.2.1 R
8.5.4 R	LLD 5.2.2 R
8.6.1 R	LLD 18.4.1 R
8.6.2 R	LLD 18.4.2 R
8.6.3 R	LLD 20.2.1 R, LLD 21.2.1 R and LLD 22.2.1 R
8.6.4 R	LLD 24.2.1 R
8.6.5 R	LLD 20.2.2R, LLD 21.2.22R and LLD 22.2.2R

Table 2 – LLD to GENPRU

GENPRU	Current designation in LLD
GENPRU 1.5.1 R	LLD 18.2.1 R
GENPRU 1.5.2 R	LLD 18.2.2 R
GENPRU 1.5.3 G	LLD 18.2.3 G
GENPRU 1.5.4 G	LLD 18.2.4 G
GENPRU 1.5.5 D	LLD 18.2.5 D
GENPRU 1.5.6 G	LLD 18.2.6 G
GENPRU 1.5.7 R	LLD 18.2.7 R
GENPRU 1.5.8 G	LLD 18.2.8 G
GENPRU 1.5.9 G	LLD 18.2.9 G
GENPRU 1.5.10 R	LLD 18.3.1 R
GENPRU 1.5.11 R	LLD 18.3.2 R
GENPRU 1.5.12 R	LLD 18.3.4 R
GENPRU 1.5.13 R	LLD 18.3.5 R
GENPRU 1.5.14 R	LLD 18.3.6 R
GENPRU 1.5.15 R	LLD 18.3.7 R
GENPRU 1.5.16 R	LLD 18.3.8 R
GENPRU 1.5.17 R	LLD 18.3.11 R
GENPRU 1.5.18 R	LLD 18.3.12 R
GENPRU 1.5.19 R	LLD 18.3.13 R
GENPRU 1.5.20 G	LLD 18.3.14 G
GENPRU 1.5.21 R	LLD 18.3.15 R
GENPRU 1.5.22 R	LLD 18.3.16 R
GENPRU 1.5.23 R	LLD 18.3.17 R
GENPRU 1.5.24 G	LLD 18.3.18 G
GENPRU 1.5.25 R	LLD 18.3.19 R
GENPRU 1.5.26 G	LLD 18.3.20 G
GENPRU 2.3.1 R	LLD 19.2.1 R
GENPRU 2.3.2 R	LLD 19.2.2 R
GENPRU 2.3.3 G	LLD 19.2.3 G
GENPRU 2.3.4 G	LLD 19.2.4 G
GENPRU 2.3.5 R	LLD 19.2.5 R
GENPRU 2.3.6 R	LLD 19.2.6 R
GENPRU 2.3.7 R	LLD 19.2.7 R

GENPRU 2.3.8 R	LLD 19.2.8 R
GENPRU 2.3.9 R	LLD 19.2.9 R
GENPRU 2.3.10 R	LLD 19.2.10 R
GENPRU 2.3.11 R	LLD 19.2.11 R
GENPRU 2.3.12 G	LLD 19.2.12 G
GENPRU 2.3.13 R	LLD 19.2.13 R
GENPRU 2.3.14 R	LLD 19.2.15 R
GENPRU 2.3.15 R	LLD 19.3.1 R
GENPRU 2.3.16 G	LLD 19.3.2 G
GENPRU 2.3.17 R	LLD 19.3.3 R
GENPRU 2.3.18 R	LLD 19.3.4 R
GENPRU 2.3.19 R	LLD 19.3.5 R
GENPRU 2.3.20 R	LLD 19.3.6 R
GENPRU 2.3.21 R	LLD 19.3.7 R
GENPRU 2.3.22 G	LLD 19.3.8 G
GENPRU 2.3.23 R	LLD 19.3.9 R
GENPRU 2.3.24 R	LLD 19.3.10 R
GENPRU 2.3.25 R	LLD 19.3.11 R
GENPRU 2.3.26 R	LLD 19.3.12 R
GENPRU 2.3.27 R	LLD 19.3.13 R
GENPRU 2.3.28 R	LLD 19.3.14 R
GENPRU 2.3.29 R	LLD 19.3.15 R
GENPRU 2.3.30 R	LLD 19.3.16 R
GENPRU 2.3.31 R	LLD 19.3.17 R
GENPRU 2.3.32 R	LLD 19.3.18 R
GENPRU 2.3.33 R	LLD 19.3.19 R
GENPRU 2.3.34 G	LLD 19.3.20 G

**INTERIM PRUDENTIAL SOURCEBOOK FOR BUILDING SOCIETIES
(LIMITS ON AGGREGATE HOLDINGS OF OTHER SOCIETIES' LIABILITIES)
INSTRUMENT 2006**

Powers exercised

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

Commencement

- B. This instrument comes into force on 1 January 2007.

Amendments to the Handbook

- C. The Interim Prudential sourcebook for Building Societies (IPRU (BSOC)) is amended in accordance with the Annex to this instrument.

Citation

- D. This instrument may be cited as the Interim Prudential Sourcebook for Building Societies (Limits on Aggregate Holdings of Other Societies' Liabilities) Instrument 2006.

Annex

Amendments to the Interim Prudential sourcebook for Building Societies (IPRU (BSOC))

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

ANNEX 5C

Inter-society Holdings

...

- 5C.2 G A society's aggregate holding of other societies' liabilities should not exceed ~~5%~~ 7.5% SDL or £5m whichever is the higher. The total should also include undrawn as well as drawn amounts under committed facilities provided to other societies. This measure is to be continuous.
- 5C.3 G The FSA expects societies to invest no more than ~~20%~~ 30% of their prudential liquidity or £5m, whichever is the higher (up to a limit of ~~5%~~ 7.5% SDL or £5m whichever is the higher) in aggregate holdings of other societies' liabilities.

...

LIMITED LIABILITY PARTNERSHIPS INSTRUMENT 2006

Powers exercised

- A. The Financial Service Authority makes this instrument in the exercise of the powers and related provisions in or under:
- (1) the following sections of the Financial Services and Markets Act 2000 (“the Act”):
 - (a) section 138 (General rule-making power);
 - (b) section 156 (General supplementary powers); and
 - (c) section 157(1) (Guidance); and
 - (2) Regulations 6 and 12 of the Open-Ended Investment Company Regulations 2001 (SI 2001/1228).
- B. The rule-making powers listed above are specified for the purpose of section 153(2) (Rule-making instruments) of the Act.

Commencement

- C. This instrument comes into force on 6 April 2007.

Amendments to the Handbook

- D. The modules of the FSA’s Handbook of rules and guidance listed in column (1) below are amended in accordance with the Annexes to this instrument listed in column (2).

(1)	(2)
Glossary of definitions	Annex A
Interim Prudential sourcebook for Investment Businesses (IPRU(INV))	Annex B
Prudential sourcebook for UCITS Firms (UPRU)	Annex C
Supervision manual (SUP)	Annex D

Citation

- E. This instrument may be cited as the Limited Liability Partnerships Instrument 2006.

By order of the Board
23 November 2006

Annex A

Amendments to the Glossary of definitions

Insert the following new definitions in the appropriate alphabetical position in the Glossary. The new text is not underlined.

...

eligible LLP members' capital members' capital of a *limited liability partnership* that meets the conditions in *IPRU(INV)* Annex A or, for a *BIPRU firm*, the requirements of *GENPRU* 2.2.94R (Core tier one capital: Eligible LLP members' capital).

...

excess LLP members' drawings the amount by which the aggregate of the amounts withdrawn by a *limited liability partnership's* members exceeds the profits of that *firm*, as calculated in accordance with *IPRU(INV)* Annex A 2.5R (Limited liability partnership excess drawings).

...

Annex B

**Amendments to the Interim Prudential sourcebook for Investment Businesses
(IPRU(INV))**

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

...

3-61(2) R ...

R Table 3-61. The basic financial resources calculation

Financial resources	Financial resources requirement
Capital ("A")	...
...	
- other approved reserves, and	
- partners' current and capital accounts, <u>and</u>	
<u>- eligible LLP members' capital</u>	
Intangible assets <u>and excess LLP members' drawings</u> ("B")	
...	

...

Table 5.2.2(1) CALCULATION OF OWN FUNDS AND LIQUID CAPITAL			
Part 1			
...			
Tier 1			
(1)	Paid-up share capital (excluding preference shares)	A	2
(1A)	<u>Eligible LLP members' capital</u>		
...			
(8A)	<u>Excess LLP members' drawings</u>		

...

...

10-61(1) R ...

R Table 10-61(1)A - Initial capital

the sum of -

...

partners' capital account
eligible LLP members' capital

...

...

R Table 10-61(1)B - Own funds

the sum of

...

partners' capital account
eligible LLP members' capital

initial capital

(A)

...

material interim year net losses
excess LLP members' drawings

...

...

R Table 10-62(2)A - Financial resources – version I

the sum of

...

partners' capital account
eligible LLP members' capital

initial capital

(A)

...

material interim year net losses

excess LLP members' drawings

...

...

R Table 10-62(2)B - Financial resources – version II

the sum of

...

partners' capital account
eligible LLP members' capital

initial capital

(A)

...

material interim year net losses
excess LLP members' drawings

...

...

R Table 10-62(2)C - Financial resources – version II.2

the sum of

...

partners' capital account
eligible LLP members' capital

initial capital

(A)

...

material interim year net losses
excess LLP members' drawings

...

...

CALCULATION OF OWN FUNDS

13.3.2 R ...

Table 13.3.2(1)

This table forms part of rule 13.3.2

FINANCIAL RESOURCES TEST 1 – OWN FUNDS		
Companies		Sole Trader; Partnerships
(1) Paid up ordinary <i>share</i> capital	A	...
(1A) <u>Eligible LLP members' capital</u>		
...		
<u>Initial capital (applicants for authorisation)</u>		
less:		
...		
(10A) <u>Excess LLP members' drawings</u>		

...

CALCULATION

13.10.2 R ...

Table 13.10.2

This table forms part of *rule 13.10.2*

OWN FUNDS	
Companies	Sole Trader; Partnerships
Paid - up ordinary <i>share</i> capital (excluding <i>preference shares</i>) redeemable by shareholders within 2 years)	...
<u>Eligible LLP members' capital</u>	
...	
less	
...	
Material current year losses	
<u>Excess LLP members'</u> <u>drawings</u>	

...

Insert a new Annex A into the Interim Prudential sourcebook for Investment Businesses, as follows. The contents of this annex are not underlined.

Annex A: LIMITED LIABILITY PARTNERSHIPS: ELIGIBLE MEMBERS' CAPITAL

1 Introduction

Application

- 1.1 R This annex applies to any *firm* :
- (1) that is a *limited liability partnership*; and
 - (2) that is a kind of *firm* to whom the provisions of this sourcebook apply, or which is a *UCITS firm*.
- 1.2 R In this annex, an expression in italics has the meaning given in the *Handbook Glossary*.
- 1.3 G (1) *Firms* are reminded that a *limited liability partnership* incorporated under the Limited Liability Partnership Act 2000 is a *body corporate* with legal personality separate to that of its members and is not therefore a form of *partnership* for the purposes of this sourcebook.
- (2) A *limited liability partnership* is not a separate prudential categorisation under this sourcebook but a kind of *firm* for whom the appropriate provisions of this sourcebook are modified to the extent indicated in this annex.

Purpose

- 1.4 G The purpose of this annex is to amplify *Principle 8* (Financial resources) which requires a *firm* to maintain adequate financial resources to meet its investment business commitments and to withstand the risks to which its business is subject. This annex imposes various conditions that must be satisfied for members' capital to count as "Tier 1" or equivalent grade capital in meeting the *limited liability partnership's* financial resources requirement. These conditions are made up of conditions specific to *limited liability partnerships* and general conditions based for the most

part on those set out in article 57 of the *Banking Consolidation Directive*. This assists in the achievement of the *regulatory objectives* of consumer protection and market confidence.

- 1.5 G The following *rules* allow inclusion of members' capital within a *firm's* capital if it meets the conditions in this annex:

Chapter	<i>IPRU(INV) rule</i>	How <i>eligible LLP members' capital</i> should be treated for the purposes of the <i>IPRU(INV) rule</i>
3	Table 3-61	<i>Eligible LLP members' capital</i> may be counted as Tier 1 capital under item "A" within Table 3-61.
5	Table 5.2.2 (1): Item (1A)	<i>Eligible LLP members' capital</i> may be counted as Tier 1 capital within Category A of Table 5.2.2(1).
10	Table 10-61(1)A Table 10-61(1)B Table 10-62(2)A Table 10-62(2)B Table 10-62(2)C	<i>Eligible LLP members' capital</i> may be counted as initial capital within the relevant table.
13	Table 13.3.2(1) Table 13.10(2)	<i>Eligible LLP members' capital</i> may be counted as <i>own funds</i> relating to companies in Table 13.3.2(1) and Table 13.10(2).

2. **CONDITIONS FOR USE OF MEMBERS' CAPITAL**

Members' capital of a limited liability partnership

- 2.1 R In this sourcebook, members' capital of a *limited liability partnership* may be included within a *firm's* resources if it complies with:
- (1) the specific conditions; and
 - (2) the general conditions.

Specific conditions for eligibility

- 2.2 R The specific conditions are that:
- (1) members' capital is made up of the members' capital account;
and

- (2) the members' capital account is an account:
 - (a) into which capital contributed by the members is paid; and
 - (b) from which under the terms of the *limited liability partnership* agreement an amount representing capital may be withdrawn by a member only if:
 - (i) he ceases to be a member and an equal amount is transferred to another such account by his former fellow members or any person replacing him as a member; or
 - (ii) the *limited liability partnership* is otherwise dissolved or wound up and either the *firm* has ceased to be authorised or no longer has a *Part IV permission*.

General conditions for eligibility

- 2.3 R The general conditions in respect of the members' capital are that:
- (1) it is fully paid and the proceeds are immediately and fully available to the *firm*;
 - (2) it is not capable of being redeemed at all (otherwise than in the circumstances set out in the specific conditions) or can only be redeemed on a winding up of the *firm*;
 - (3) any *coupon* is non-cumulative;
 - (4) it is able to absorb losses to allow the *firm* to continue trading;
 - (5) the amount of the item included is net of any foreseeable tax charge;
 - (6) it is available to the *firm* for unrestricted and immediate use to cover risks and losses as soon as they occur;
 - (7) it ranks for repayment on a winding up of the *firm* no higher than a *share* of a company incorporated under the Companies Act 1985 or the Companies (Northern Ireland) Order 1986 (whether or not it is such a *share*); and
 - (8) the *firm* is under no obligation to pay a *coupon* on it at any time.

Surplus eligible LLP members' capital

- 2.4 G If a *firm* has surplus *eligible LLP members' capital* that it wishes to repay in circumstances otherwise than those in the specific conditions, it may apply to the *FSA* for a *waiver* to allow it to do so. If a *firm* applies for such a *waiver* the information that the *firm* supplies to support the application might include:
- (1) a demonstration that the *firm* would have sufficient financial resources to meet its financial resources requirement immediately after the repayment; and
 - (2) a two to three year capital plan demonstrating that the *firm* would be able to meet the requirements in (1) and (2) at all times without needing further capital injections.

Limited liability partnership excess drawings

- 2.5 R A *firm* which is a *limited liability partnership* must in calculating its tier one capital in accordance with the requirements of any chapter of this sourcebook deduct the amount by which the aggregate of the amounts withdrawn by its members exceeds the profits of that *firm* ("*excess LLP members' drawings*"). Amounts of *eligible LLP members' capital* repaid in accordance with the specific conditions are not to be included in this calculation.

Annex C

Amendments to the Prudential sourcebook for UCITS Firms (UPRU)

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

...

2.2 METHOD OF CALCULATION OF FINANCIAL RESOURCES

2.2.1 R This table belongs to *UPRU 2.1.1R (1)*

PART 1	
...	
(8) Material current year losses	
<u>(8A) <i>Excess LLP members' drawings</i></u>	
...	

...

Annex D

Amendments to the Supervision manual (SUP)

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

...

SUP 16 Ann 5R: Investment management firms' reporting forms and requirements relating to their completion

1. Annual Financial Return

...

FINANCIAL RESOURCES STATEMENT

AFS3

£000

£000

Financial Resources

Note: the references in brackets are to the items of capital in Part 1 of IPRU(INV) Table 5.2.2(1)

TIER 1

Paid up share capital (excluding preference shares, but including eligible LLP members' capital) (*Items 1 and 1A*) _____ (36)

...

Less: ...

...

Material current year losses (*Item 7*)/LLPs' excess drawings (*Item 8A*) ...

...

2. Quarterly Financial Return

...

FINANCIAL RESOURCES STATEMENT

QFS3

£000

£000

Financial Resources

Note: the references in brackets are to the items of capital in Part 1 of IPRU(INV) Table

5.2.2(1)

TIER 1

Paid up share capital (excluding preference shares, but including eligible LLP members' capital) (*Items 1 and 1A*) _____ (36)

...

Less: ...

...

Material current year losses (*Item 7*)/LLPs' excess drawings (*Item 8A*) ...

...

...

3. Monthly Financial Return

...

FINANCIAL RESOURCES STATEMENT

MFS3

£000

£000

Financial Resources

Note: the references in brackets are to the items of capital in Part 1 of IPRU(INV) Table 5.2.2(1)

TIER 1

Paid up share capital (excluding preference shares, but including eligible LLP members' capital) (*Items 1 and 1A*) _____ (36)

...

Less: ...

...

Material current year losses (*Item 7*)/LLPs' excess drawings (*Item 8A*) ...

...

CONSOLIDATED FINANCIAL RESOURCES RETURN FOR INVESTMENT MANAGEMENT FIRMS

PART 1: GROUP FINANCIAL RESOURCES:

...

Group Tier 1:

ordinary share capital/eligible LLP members' capital

...

Less:

...

material unaudited
consolidated losses since
balance sheet
date/LLPs' excess drawings

...

SUP 16 Ann 10R: Securities and Futures Firms' Reporting Forms and Requirements Applying to their Completion

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

...

Capital

...

Partnership/Sole trader/Limited liability partnership

...

Initial capital

...

Material unaudited losses/LLPs' excess drawings...

...

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

...

Capital

...

Partnership/Sole trader/Limited liability partnership

...

TANGIBLE NET WORTH

Capital

Less: intangible assets and LLPs' excess drawings

...

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

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

...

D. CAPITAL

...

14A Limited liability partnerships

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

...

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

...

D. CAPITAL

...

14A Limited liability partnerships

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

...

SUP 16 Ann 16R: UCITS management companies reporting forms and requirements applying to their completion

1. Annual Financial Return

...

FINANCIAL RESOURCES STATEMENT

UAFS3

Financial Resources

Note: the references in brackets are to the items of capital IPRU(INV) Table 7.3.1 Part 1

	£000	£000
<u>TIER 1</u>		
Paid up share capital (excluding preference shares, <u>but including eligible LLP members' capital</u>) (<i>Items 1 and 5</i>)		(34)
...		
Less: Investment in own shares (<i>Item 5 6</i>) ...		
Intangible assets (<i>Item 6 7</i>)...		
Material current year losses(<i>Item 7-8</i>)/ <u>LLPs' excess drawings</u> (<i>Item 8A</i>) ...		
Material holdings in credit and financial institutions (<i>Item 8 9</i>) ...		
...		
<u>TIER 2</u>		
Revaluation reserves (<i>Item 9 10</i>) ...		
Fixed term cumulative preference share capital (<i>Item 10 11</i>) ...		
Long term Qualifying Subordinated Loans (<i>Item 11 12</i>) ...		
Other cumulative preference share capital and debt capital (<i>Item 12 13</i>) ...		
Qualifying arrangements (<i>Item 13 14</i>) ...		
...		
<u>TIER 3</u>		
Less Illiquid assets (<i>Item 14 15</i>) ...		

...		
	Short term Qualifying Subordinated Loans and excess Tier 2 capital (Item 15)	(48)
	Qualifying property (Item 17)	(49)
	Liquid capital [47+48+49]	(50)
...		

...

...

2. Quarterly Financial Return

...

FINANCIAL RESOURCES STATEMENT

UQFS3

	£000	£000
--	------	------

Financial Resources

Note: the references in brackets are to the items of capital IPRU(INV) Table 7.3.1 Part 1.

TIER 1

Paid up share capital (excluding preference shares, <u>but including eligible LLP members' capital</u>) (Items 1 and 5)	(34)
--------------------------------------------------------------------------------------------------------------------------	------

...

Less: Investment in own shares (Item 5 6) ...

Intangible assets (Item 6 7)...

Material current year losses (Item 7-8)/LLPs' excess drawings (Item 8A) ...

Material holdings in credit and financial institutions (Item 8 9) ...

...

TIER 2

Revaluation reserves (Item 9 10) ...

Fixed term cumulative preference share capital (Item 10 11) ...

Long term Qualifying Subordinated Loans (Item 11 12) ...

Other cumulative preference share capital and debt capital (Item 12 13) ...

Qualifying arrangements (~~Item 13~~ 14) ...

...

TIER 3

Less Illiquid assets (~~Item 14~~ 15) ...

...

~~Short term Qualifying Subordinated Loans
and excess Tier 2 capital (Item 15)~~ (48)

Qualifying property (Item 17)

 (49)

Liquid capital [~~47+48+49~~]

 (50)

...

SUP 16 Ann 18AR: Retail Mediation Activities Return ("RMAR")

NOTES FOR COMPLETION OF THE RETAIL MEDIATION ACTIVITIES RETURN ("RMAR")

Section D1: Regulatory Capital

...

Eligible capital (mortgage and non-investment insurance)

...

Unincorporated firms and limited liability partnerships

Capital of sole trader or partnership or LLP
members' capital

RR0240

...

Less excess of drawings over profits for a sole
trader or p'ship or LLP

...

...

...

Section D2: FINANCIAL RESOURCES – NON-USD PERSONAL INVESTMENT FIRMS

OWN FUNDS (TEST 1)

...	£
9 Balances on proprietors' or partners' capital accounts <u>or LLP members' capital</u>	RR0260
...	

Section D3: FINANCIAL RESOURCES – USD PERSONAL INVESTMENT FIRMS

OWN FUNDS (TEST 1)

...	£
<u>6</u> Balances on proprietors' or partners' capital accounts <u>or LLP members' capital</u>	RR0299

...

SECTION D4: QUARTERLY FINANCIAL RESOURCES – CAD13 – ISD PERSONAL INVESTMENT FIRMS

...

2. Less: current year losses/LLPs' excess drawings

...

5. Share capital/proprietors' capital/partners' capital/LLP members' capital introduced since the date of the last audited figures

6. Share capital/proprietors' capital/partners' capital/LLP members' capital withdrawn since the date of the last audited figures

...

RR0350
R0352
R0352a

SUP 16 Ann 18BG: Notes for completion of the Retail Mediation Activities Return ("RMAR")

Section D1: Guide for completion of individual fields

...

Eligible capital (mortgage and non-investment insurance)

...

Unincorporated firms and limited liability partnerships

Capital of a sole trader or partnership or See *PRU* 9.3.52R
LLP members' capital

...

Less: excess of drawings over profits for a ...
sole trader or partnership or LLP

SUP 16 ANN 22R: CONSOLIDATED SUPERVISION RETURN FOR INVESTMENT FIRMS

PART 1: GROUP FINANCIAL RESOURCES:

...

Group Tier 1:

ordinary share capital ...
/eligible LLP members'
capital

...

material unaudited ...
consolidated losses/LLPs'
excess drawings since
balance sheet date

...

SUP 16 Ann 23G: CONSOLIDATED SUPERVISION RETURN FOR INVESTMENT FIRMS

Notes to the completion of Part 1: Group Financial Resources

...

A1	The material unaudited consolidated losses/ <u>LLPs' excess drawings</u> since balance sheet date ...
...	

**CONDUCT OF BUSINESS SOURCEBOOK (MENU ON ASSIGNMENT OF
LIFE POLICIES) INSTRUMENT 2006**

Powers exercised

- A. The Financial Services Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):
- (1) section 138 (General rule-making power); and
 - (2) section 156 (General supplementary powers);
- B. The rule-making powers listed above are specified for the purpose of section 153(2) (Rule-making instruments) of the Act.

Commencement

- C. This instrument comes into force on 6 December 2006.

Amendments to the Handbook

- D. The Conduct of Business sourcebook (COB) is amended in accordance with the Annex to this instrument.

Citation

- E. This instrument may be cited as the Conduct of Business (Menu on Assignment of Life Policies) Instrument 2006.

By order of the Board
23 November 2006

Annex

Amendments to the Conduct of Business sourcebook (COB)

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

...

COB 4 Annex 6R (Fees and Commission Statement required by *COB* 4.3.11R(1) and (2))

...

Section 4 - Commission (or equivalent)

4

...

...
Regular contribution business

The following product groups relate to regular contribution investments (including annual and quarterly premium contracts) and includes any non-contractual top-ups or increments (to existing regular contribution investments) which generate *commission (or equivalent)*.

(a) ...

(b) Endowments

A life policy that pays a sum of *money* on the survival of the life assured to a specific date or, if earlier, on death; other than a *traded life policy*.

...

**CONDUCT OF BUSINESS SOURCEBOOK (DISCLOSURE REQUIREMENTS FOR
THIRD PARTY PROCESSORS) INSTRUMENT 2006**

Powers exercised

- A. The Financial Services Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):
- (1) section 138 (General rule-making powers);
 - (2) section 156 (General supplementary powers); and
 - (3) the other rule making powers listed in Schedule 4 to the General provisions.
- B. The rule-making powers listed above are specified for the purpose of section 153(2) (Rule-making instruments) of the Act.

Commencement

- C. This instrument comes into force on 6 December 2006.

Amendments to the Handbook

- D. The modules of the FSA’s Handbook of rules and guidance listed in column (1) below are amended in accordance with the Annexes to this instrument listed in column (2).

(1)	(2)
Glossary of definitions	Annex A
The General provisions (GEN)	Annex B
The Conduct of Business sourcebook (COB)	Annex C

Citation

- E. This instrument may be cited as the Conduct of Business (Disclosure requirements for third party processors) Instrument 2006.

By order of the Board
23 November 2006

Annex A

Amendments to the Glossary of definitions

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

Amend the following definition as shown:

...

*third party
processor*

⁵(1) A *firm* (“Firm A”) which carries on *regulated mortgage activities* or *insurance mediation activities* ~~in relation to non-investment insurance contracts~~ other than advising on life policies, or both, for another *firm* (or an *appointed representative*) (“Firm B”) under a properly documented *outsourcing* agreement, the terms of which provide that when Firm A carries on any of these activities (“the outsourced activities”) for Firm B:

...

(2) A *firm* (“Firm C”) which carries on *regulated mortgage activities* or *insurance mediation activities* ~~in relation to non-investment insurance contracts~~ other than advising on life policies, or both, for a *third party processor* within (1) (“Firm A”), where:

...

...

Annex B

Amendments to the General Provisions sourcebook (GEN)

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

...

Exception: use of third party processors in mortgage and ~~non-investment insurance-business~~ mediation activities

- 4.3.6 R (1) (1) ¹Where a *firm* has outsourced activities to a *third party processor* other than *advising on life policies*, GEN 4.3.1 R does not apply to that *third party processor* when acting as such, so long as the outsourcing *firm* ensures that the *third party processor* and its *employees* comply with that *rule* as if it was the *firm* and they were *employees* of the *firm*.
- (2) Where an *appointed representative* has outsourced *insurance mediation activities* ~~in relation to non-investment insurance contracts~~ other than *advising on life policies* or *mortgage mediation activities* to a *third party processor*, GEN 4.3.1R does not apply to that *third party processor* when acting as such, so long as the *appointed representative's* principal ensures that the *third party processor* and its *employees* comply with that *rule* as if it was the *appointed representative* and they were the *employees* of the *appointed representative*.
- (3) Where an *appointed representative* of a *firm* is carrying on:
- (a) *insurance mediation activities* ~~in relation to non-investment insurance contracts~~ other than *advising on life policies*; or
- (b) ...

...

Annex C

Amendments to the Conduct of Business sourcebook (COB)

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

...

Use of third party processors in life insurance mediation activities

- 1.2.6 R (1) Where a firm (or its appointed representative) outsources insurance mediation activities to a third party processor, it is responsible for the acts and omissions of that third party processor conducting those outsourced activities. In these circumstances, any COB rules requiring the third party processor to disclose identity to customers must be interpreted as a requirement to disclose the firm's identity
- (2) If the third party processor is advising on investments, (1) does not apply.

...

INTEGRATED REGULATORY REPORTING (HOME REVERSION AND HOME PURCHASE PLANS) INSTRUMENT 2006

Powers exercised

- A. The Financial Services Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):
- (1) section 138 (General rule-making power);
 - (2) section 156 (General supplementary powers); and
 - (3) section 157(1) (Guidance).
- B. The rule-making powers listed above are specified for the purpose of section 153(2) (Rule-making instruments) of the Act.

Commencement

- C. This instrument comes into force on the 1 April 2007.

Amendments to the Handbook

- D. The Supervision manual (SUP) is amended in accordance with Annex A to this instrument.
- E. The Dispute Resolution: Complaints sourcebook (DISP) is amended in accordance with Annex B to this instrument.

Citation

- F. This instrument may be cited as the Integrated Regulatory Reporting (Home Reversion and Home Purchase Plans) Instrument 2006.

By order of the Board

23 November 2006

Annex A

Amendments to the Supervision manual (SUP)

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

SUP TP 1 Transitional Provisions

...

SUP TP 1.2 Transitional Provisions table

(1)	(2)	(3)	(4)	(5)	(6)
	Material to which the transitional provision applies		Transitional Provision	Transitional provision: dates in force	Handbook provision: coming into force
...					
12K	<u>SUP</u> <u>16.7.7R,</u> <u>SUP</u> <u>16.7.8R,</u> <u>SUP</u> <u>16.7.9R,</u> <u>SUP</u> <u>16.7.10R,</u> <u>SUP</u> <u>16.7.11R,</u> <u>SUP</u> <u>16.7.12R,</u> <u>SUP</u> <u>16.7.16R,</u> <u>SUP</u> <u>16.7.17R,</u> <u>SUP</u> <u>16.7.24R,</u> <u>SUP</u> <u>16.7.25R,</u> <u>SUP</u> <u>16.7.26R,</u> <u>SUP</u> <u>16.7.27R,</u> <u>SUP</u> <u>16.7.28R,</u> <u>SUP</u> <u>16.7.29R,</u> <u>SUP</u> <u>16.7.35R,</u> <u>SUP</u>	R	<p><u>Solely in respect of information regarding any <i>reversion activity</i> or <i>home purchase activity</i> required to be reported in the <i>RMAR</i> and <i>MLAR</i>, a <i>firm</i>:</u></p> <p><u>(1) is not required to include such information in respect of the applicable reporting periods (as set out in the relevant provisions in <i>SUP</i> 16.7) ending before 1 October 2007;</u></p> <p><u>(2) must include such information in respect of reporting periods ending on or after 1 October 2007;</u></p> <p><u>(3) must include such information under existing mortgage headings (for the <i>RMAR</i>) or loan headings (for the <i>MLAR</i>) as set out in the guidance in <i>SUP</i> 16 Annex 18BG and <i>SUP</i> 16 Annex 19BG respectively.</u></p>	<u>1 April 2007 to 31 December 2008</u>	<u><i>Commencement</i></u>

<u>16.7.36R,</u> <u>SUP</u> <u>16.7.54R,</u> <u>SUP</u> <u>16.7.54AR,</u> <u>SUP</u> <u>16.7.57R,</u> <u>SUP</u> <u>16.7.58R,</u> <u>SUP</u> <u>16.7.62R,</u> <u>SUP</u> <u>16.7.63R,</u> <u>SUP</u> <u>16.7.65R,</u> <u>SUP</u> <u>16.7.66R,</u> <u>SUP</u> <u>16.7.73R,</u> <u>SUP</u> <u>16.7.74R,</u> <u>SUP</u> <u>16.7.75R,</u> <u>SUP</u> <u>16.7.76R</u> <u>and SUP</u> <u>16.7.77R,</u>				
--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------	--	--	--	--

...

16.1 Application

...

16.1.3 R Application of different sections of SUP 16

(1) Section(s)	(2) Categories of firm to which section applies	(3) Applicable rules and guidance
...
SUP 16.4 and SUP 16.5	...	...
...
	(j) a firm with permission to carry on only insurance mediation activity, mortgage home finance mediation activity, or	

		both;	
...
SUP 16.7	...		...
...
	(1)	with <i>permission</i> to carry on one or more of:	
	
	(b)	<i>mortgage home finance mediation activity</i> ; or	
	(c)	<i>mortgage lending home finance providing activity</i> ; or	
	(d)	<i>Mortgage administration administering a home finance transaction</i> ; or	
...
SUP 16.11	...		...
	(1)	a <i>mortgage lender home finance provider</i> ; or	
...

...

16.7 Financial reports

...

16.7.3 G Purpose
Principle 4 ... (or, in the case of firms with permission to carry on insurance mediation activity, ~~mortgage~~ home finance mediation activity, or both, PRU) ...

...

16.7.5 G ...

Firm category	Applicable rules and
---------------	----------------------

		guidance
...		...
(a)	with <i>permission</i> to carry on one or more of:	

(2)	mortgage <u>home finance mediation activity</u> ; or	
(3)	mortgage lending <u>home finance providing activity</u> ; or	
(4)	Mortgage administration <u>administering a home finance transaction</u> ; or	
...		

16.7.6B G The RMAR...carrying on *insurance mediation activity*, ~~mortgage~~ home finance mediation activity or *retail investment activity*... The MLAR is relevant to firms carrying on ~~mortgage lending~~ home finance providing activity or ~~mortgage administration~~ administering a home finance transaction.

16.7.6C R Where reference is made in SUP 16.7 to adequate information relating to:
...

(2) the following activities:

...

(b) ~~mortgage~~ home finance mediation activity; or

...

this includes all sections of the RMAR in addition to those relating to financial reports, except where otherwise indicated.

16.7.6E G Where SUP16.7 requires a report containing adequate information on one or more of the following activities:

... ...

(2) ~~mortgage~~ home finance mediation activity;

(3) ~~mortgage lending~~ home finance providing activity;

(4) ~~mortgage administration~~ administering a home finance transaction;

... ...

16.7.8 R Reports from a UK bank (see SUP 16.7.7 R)

Content of Report	Form or Return (Note 1)	Frequency	Due date
...
* Adequate information relating to the following activities: (1) ... (2) <i>mortgage home finance mediation activity</i> ; (3)
* Adequate information relating to <i>mortgage lending home finance providing activity</i> and <i>mortgage administration administering a home finance transaction</i>
...			

...
16.7.10 R Reports from an EEA Bank (see SUP 16.7.9 R)

Content of Report	Form or Return (Note1)	Frequency	Due date
...
* Adequate information relating to the following activities: (1) ... (2) <i>mortgage home finance mediation activity</i> ; (3)
* Adequate information relating to <i>mortgage lending home finance providing activity</i> and <i>mortgage administration administering a home</i>

* Amendments to the wording of this provision were made by the Board in the Integrated Regulatory Reporting (Amendment) Instrument 2005 (FSA 2005/63) on 17 November 2005 and come into force on 1 January 2007, subject to the application of any transitional provisions detailed in that Instrument.

<i>finance transaction</i>			
...			

...

16.7.12 R Reports from a bank established outside the EEA (see SUP 16.7.11 R)

Content of Report	Form or Return (Note1)	Frequency	Due date
...
* Adequate information relating to the following activities: (1) ... (2) <i>mortgage home finance mediation activity</i> ; (3)
* Adequate information relating to <i>mortgage lending home finance providing activity</i> and <i>mortgage administration administering a home finance transaction</i>
...			

...

16.7.17 R Reports from a building society (see SUP 16.7.16 R)

Content of Report	Form or Return (Note 1)	Frequency	Due date
...
* Adequate information relating to the following activities:

* Amendments to the wording of this provision were made by the Board in the Integrated Regulatory Reporting (Amendment) Instrument 2005 (FSA 2005/63) on 17 November 2005 and come into force on 1 January 2007, subject to the application of any transitional provisions detailed in that Instrument.

(1) ... (2) <i>mortgage home finance mediation activity</i> ; (3) ...			
* Adequate information relating to <i>mortgage lending home finance providing activity</i> and <i>mortgage administration administering a home finance transaction</i>.	...	...	...
...			

...

16.7.25 R Reports required from a securities and futures firm which is a category A or B firm or a broad scope firm (see SUP 16.7.24 R)

Report	Return	Frequency	Due date
...
* Adequate information relating to the following activities: (1) ... (2) <i>mortgage home finance mediation activity</i> ; (3)
* Adequate information relating to <i>mortgage lending home finance providing activity</i> and <i>mortgage administration administering a home finance transaction</i>
...			

...

16.7.27 R Reports from a securities and futures firm which is a category C or D firm

* Amendments to the wording of this provision were made by the Board in the Integrated Regulatory Reporting (Amendment) Instrument 2005 (FSA 2005/63) on 17 November 2005 and come into force on 1 January 2007, subject to the application of any transitional provisions detailed in that Instrument.

or an arranger or venture capital firm (see SUP 16.7.26 R)

Report	Return	Frequency	Due Date
* Adequate information relating to the following activities: (1) ... (2) <i>mortgage home finance mediation activity</i> ; (3)
* Adequate information relating to <i>mortgage lending home finance providing activity</i> and <i>mortgage administration administering a home finance transaction</i>
...			

...

16.7.29 R Reports from a securities and futures firm which is an adviser, local or a traded options market maker (see SUP 16.7.28 R)

Report	Return	Frequency	Due date
...
* Adequate information relating to the following activities: (1) ... (2) <i>mortgage home finance mediation activity</i> ; (3)
* Adequate information relating to <i>mortgage lending home finance providing activity</i> and <i>mortgage administration administering a home finance transaction.</i>
...			

...

16.7.36 R Reports from an investment management firm (see SUP 16.7.35 R)

Report	Return	Frequency	Due date
--------	--------	-----------	----------

* Amendments to the wording of this provision were made by the Board in the Integrated Regulatory Reporting (Amendment) Instrument 2005 (FSA 2005/63) on 17 November 2005 and come into force on 1 January 2007, subject to the application of any transitional provisions detailed in that Instrument.

...
* Adequate information relating to the following activities: (1) ... (2) mortgage <u>home finance mediation activity</u> ; (3) ...	...	...	...
* Adequate information relating to mortgage-lending <u>home finance providing activity and mortgage administration administering a home finance transaction.</u>	...	...	...
...			

...

Authorised Professional firms

- 16.7.54 R (1) An authorised professional firm must submit an annual questionnaire, contained in SUP 16 Annex 9,
- (a) it is only regulated activities are one or more of :
- ...
- (ii) ~~mortgage~~ home finance mediation;
- ...
- (iv) ~~mortgage-lending~~ home finance providing activity;
- (v) ~~mortgage administration~~ administering a home finance transaction; or

...

16.7.54 R Reports from an authorised professional firm (see SUP 16.7.54R)

A

Report	Return (Note 1)	Frequency	Due date
...
(1) ...			

* Amendments to the wording of this provision were made by the Board in the Integrated Regulatory Reporting (Amendment) Instrument 2005 (FSA 2005/63) on 17 November 2005 and come into force on 1 January 2007, subject to the application of any transitional provisions detailed in that Instrument.

(2)	mortgage home finance mediation activity;			
...	...			
	Adequate information relating to mortgage lending home finance providing activity and mortgage administration administering a home finance transaction.	...	...	...
	...			
	Note 2 = ... revenue relating to <i>insurance mediation activity</i> , mortgage home finance mediation activity and <i>retail investment activity</i> .			
	...			

...

16.7.58 R Reports from a members' adviser (see SUP 16.7.57 R)

Report	Return (Note 1)	Frequency	Due date
...
* Adequate information relating to the following activities: (1... (2) mortgage home finance mediation activity ; (3)
* Adequate information relating to mortgage lending home finance providing activity and mortgage administration administering a home finance transaction.
...			

* Amendments to the wording of this provision were made by the Board in the Integrated Regulatory Reporting (Amendment) Instrument 2005 (FSA 2005/63) on 17 November 2005 and come into force on 1 January 2007, subject to the application of any transitional provisions detailed in that Instrument.

...

16.7.63 R Reports required from a credit union (see SUP 16.7.62 R)

Content of report	Form or Return	Frequency	Due date
...
* Adequate information relating to the following activities: (1) ... (2) <i>mortgage home finance mediation activity</i> ; (3)
* Adequate information relating to <i>mortgage lending home finance providing activity</i> and <i>mortgage administration administering a home finance transaction</i>
...			

...

16.7.66 R Reports from an ELMI (see SUP 16.7.65 R)

Content of Report	Form or Return (Note 1)	Frequency	Due Date
* Adequate information relating to the following activities: (1) ... (2) <i>mortgage home finance mediation activity</i> ; (3)

* Amendments to the wording of this provision were made by the Board in the Integrated Regulatory Reporting (Amendment) Instrument 2005 (FSA 2005/63) on 17 November 2005 and come into force on 1 January 2007, subject to the application of any transitional provisions detailed in that Instrument.

*Adequate information relating to <i>mortgage lending home finance providing activity</i> and <i>mortgage administration administering a home finance transaction</i>	...	...	...
...			

...

* 16.7.74 R The activities referred to in SUP 16.7.73 R are:

- (1) ...
- (2) *mortgage home finance mediation activity*;
- (3) ...
- (4) *mortgage lending home finance providing activity*; and
- (5) *mortgage administration administering a home finance transaction*.

* 16.7.75 R Reports from an insurer or friendly society (see SUP 16.7.73R)

Report	Return (Note 1)	Frequency	Due date
Adequate information relating to the following activities: (1) ... (2) <i>mortgage home finance mediation activity</i> ; (3)
Adequate information relating to <i>mortgage lending home finance providing activity</i> and <i>mortgage administration administering a home finance transaction</i>
...			

...

A firm not subject to other reporting requirements in SUP 16.7

16.7.76 R A firm not subject to other reporting requirements in SUP 16.7.1G – SUP16.7.75R (nor to reporting requirements in IPRU (INS) or IPRU

(FSOC):

(1) with *permission* to carry on one or more of:

...

(b) ~~mortgage~~ home finance mediation activity; or

(c) ~~mortgage lending~~ home finance providing activity; or

(d) ~~mortgage administration~~ administering a home finance transaction; or

must submit reports to the *FSA* in accordance with 16.7.77R.

16.7.77 R Reports from a firm not subject to other reporting requirements in SUP 16.7.1G

Report	Return (Note 1)	Frequency	Due date
...
(b) mortgage <u>home finance mediation activity</u> ;			
...			
Adequate information relating to mortgage lending <u>home finance providing activity</u> and mortgage <u>home finance administering</u>
If the firm is a mortgage lender <u>home finance provider</u> or mortgage <u>home finance administrator</u> , annual report and audited accounts.
...
Note 2 = ...relating to <i>insurance mediation activity</i> , mortgage <u>home finance mediation activity</u> and <i>retail investment activity</i> .			

16.7.78 R Where a ~~mortgage lender~~ home finance provider or ~~mortgage~~ home finance intermediary establishes a *special purpose vehicle*, it must ensure that any

report which the ~~mortgage lender~~ home finance provider or ~~mortgage home finance intermediary~~ makes in accordance with SUP 16.7.76 R takes account of the activities of the *special purpose vehicle* as if those activities were the activities of the ~~mortgage lender~~ home finance provider itself.

16.7.79 R An *incoming EEA firm* which is in the United Kingdom carries on only *cross border services* and is not subject to other reporting requirements in SUP 16.7 with *permission* to carry on:

...

(2) ~~mortgage~~ home finance mediation activity; or

(3) ~~mortgage lending~~ home finance providing activity; or

(4) ~~mortgage administration~~ administering a home finance transaction;
or

...

... is subject to the requirements of SUP 16.10 only, and no requirements in respect of the *RMAR* or *MLAR*.

16.11 Product Sales Data Reporting

16.11.1 R ...

This section applies to a firm which is a ~~mortgage lender~~ home finance provider; or in respect of sales to a *private customer* or a *retail customer*:

...

...

16.11.5 R Content of the report

The data report must contain sales data in respect of the following products:

(1) *retail investments*;

(2) *pure protection contracts*; ~~and~~

(3) *regulated mortgage contracts* (but not further advances);

(4) *home purchase plans*; and

(5) *home reversion plans*.

...

SUP 16 Ann 18B

**NOTES FOR COMPLETION OF
THE RETAIL MEDIATION ACTIVITIES RETURN ('RMAR')**

...

Scope

6. ...

(b) *firms with permission to carry on ~~mortgage~~ home finance mediation activity;*

...

Application of RMAR sections

7. *Firms conducting ~~mortgage-lending~~ or ~~mortgage~~ home finance providing activity or ~~administration~~ administering a home finance transaction ...*

8. However, ... a *firm* that has the *permission* to carry on ~~mortgage-lending~~ home finance providing activity or ~~mortgage~~ administration administering a home finance transaction will not be subject to our proposed data

Authorised professional firms

12. APFs ...for *insurance mediation activity* or ~~mortgage~~ home finance mediation activity) are not required to complete ...

13. The application ... and PRU 9.3.10R (for ~~mortgage~~ home finance mediation activity and *insurance mediation activity*).

...

Section B: Profit & Loss Account

...

Note: Home purchase and reversion activity should be included under the existing mortgage headings in this section of the RMAR.

Section B: guide for completion of individual fields

Commissions (gross)	<p>...</p> <ul style="list-style-type: none"> • for regulated mortgage contracts <u>home finance transactions</u>, this includes commissions received for <i>advising on regulated mortgage contracts home finance transactions</i> and <i>arranging</i>, but not lending, <u>providing</u> and <u>administration</u>; <p>...</p>
...	...
Regulated business	...

revenue	For an <i>insurance intermediary</i> or a mortgage <i>home finance intermediary</i> , this should be calculated in the same way as ‘annual income’, as specified in PRU9.3.44R (although in this context the period is not generally annual). This <i>rule</i> states: “For a firm which carries on <i>insurance mediation activity</i> or mortgage <i>home finance mediation activity</i> , ...
...	...

Section C: Client Money and assets

Note: Home purchase and reversion activity should be included under the existing mortgage headings in this section of the RMAR.

...

Note 1: *firms* that only carry on ~~mortgage~~ *home finance mediation activity* ...

...

Section D: Regulatory Capital

Note: Home purchase and reversion activity should be included under the existing mortgage headings in this section of the RMAR.

‘Higher of’ requirements

In this section ... The calculations are the same, however, for both ~~mortgage~~ *home finance mediation activity* ...

If a *firm* carries on one or both of:

- ~~mortgage~~ *home finance mediation activity*, and/or...

...

(i) *firms* carrying on ~~mortgage~~ *home finance mediation activity*,...

Sub-sections: this section is sub-divided as follows:

...

Section D1: guide for completion of individual fields

Is the firm exempt from these capital requirements in relation to any of its retail mediation activities?	... • <i>investment firms</i> not subject to IPRU(INV) Chapter 13 (unless they additionally carry on mortgage <i>home finance mediation activity</i> or <i>insurance mediation activity</i> relating to <i>non-investment insurance contracts</i>).
Mortgage Home finance and non-investment insurance mediation (see sub paragraph (i) above)	
Base requirement	The minimum capital requirements for <i>firms</i>

	<p>carrying on mortgage <u>home finance mediation activity</u> and for <u>insurance mediation activity</u> relating to <u>non-investment insurance contracts</u> are set out in <i>PRU 9.3.30R</i>.</p> <p>If the <i>firm</i> carries on <i>designated investment business</i> as well as mortgage <u>home finance mediation activity</u>, <u>insurance mediation activity</u> ...</p>
5% of annual income (firms holding client money)	For <i>firms</i> that hold <i>client money</i> or other <i>client</i> assets in relation to <u>insurance mediation activity</u> or mortgage <u>home finance mediation activity</u> , this should be calculated as 5% of the annual income (see <i>PRU 9.3.30R(2)</i>) from the <i>firm's</i> <u>insurance mediation activity</u> , mortgage <u>home finance mediation activity</u> , or both.
2.5% of annual income (firms not holding client money)	For <i>firms</i> that do not hold <i>client money</i> or other <i>client</i> assets in relation to <u>insurance mediation activity</u> or mortgage <u>home finance mediation activity</u> , this should be calculated as 2.5% of the annual income (see <i>PRU 9.3.30R(1)</i>) from the <i>firm's</i> <u>insurance mediation activity</u> , mortgage <u>home finance mediation activity</u> , or both.
...	...
Other <i>FSA</i> capital requirements (if applicable)	... ... For example, <i>firms</i> that carry on the activities of mortgage lending <u>home finance providing activity</u> or mortgage administration <u>administering a home finance transaction</u> in addition to mortgage <u>home finance mediation activity</u> and/or <u>insurance mediation activity</u> ...
...	...

...

Section E: Professional Indemnity Insurance

Note: Home purchase and reversion activity should be included under the existing mortgage headings in this section of the RMAR.

...

Note on the scope of Section E: ...

The PII requirements ... set out in *IPRU(INV) 2.3*. APFs that carry on ~~mortgage~~ home finance mediation activity or insurance mediation activity are subject to the full requirements of *MIPRU 3*.

Section E: guide for completion of individual fields

Is the firm exempt from the PII requirements in respect of any	The conditions for exemptions from the PII requirements for <i>firms</i> carrying on <i>insurance</i> or
----------------------------------------------------------------	----------------------------------------------------------------------------------------------------------

regulated activities?	<u>mortgage home finance mediation</u> are set out in PRU 9.2.1R paragraphs (3) to (6). ...
...	...
Is the cover compliant?	... <i>Insurance intermediaries and <u>mortgage home finance intermediaries</u> – PRU 9.2 Personal investment firms - IPRU(INV) 13.1</i> ...
...	...
Limit of Indemnity	... For <i>insurance intermediaries</i> , see PRU 9.2.13R. For <i><u>mortgage home finance intermediaries</u></i> , see PRU 9.2.15R. For <i>personal investment firms</i> , see IPRU(INV) 13.1.4E. ...
Policy excess	For <i>insurance intermediaries</i> and <i><u>mortgage home finance intermediaries</u></i> ...
...	...

...

Sub-heading: approved persons

...

For *firms* carrying on ~~*mortgage*~~ *home finance mediation* activity and/or *insurance mediation* activity relating to *non-investment insurance contracts*...

...

Section G: Training & Competence ('T&C')

Note: Home purchase and reversion activity should be included under the existing mortgage headings in this section of the RMAR.

...

Chapter 2 ... *advising on investments* or on ~~*regulated mortgage*~~ *home finance transactions* ~~*contracts*~~ (see, generally, TC 2.1.4R) ...

...

Section G: guide for completion of individual fields

...	...
Number of staff that give advice	... If staff advise in relation to more than one business type (i.e. <i>mortgage</i> <i>home finance transaction</i> advising, advising on <i>non-investment insurance</i>
...	...
Number of advisers that have passed	...

appropriate examinations	In the case ... <i>employees</i> engaged in <i>advising a customer on a regulated mortgage contract <u>home finance transaction</u></i> other than a <i>regulated mortgage contract <u>home finance transaction</u></i> that the firm has concluded solely for a business purpose (Table TC 2.1.4R (1)(p)) ...
...	...

Section H: Conduct of Business (‘COB’) Data

Note: Home purchase and reversion activity should be included under the existing mortgage headings in this section of the RMAR.

...
Section J: data required for calculation of fees

...
Note: Home purchase and reversion activity should be included under the existing mortgage headings in this section of the RMAR.

...

Part 7: SUP 16 Ann 19BG

NOTES FOR COMPLETION OF THE MORTGAGE LENDING & ADMINISTRATION RETURN (‘MLAR’)

...

INTRODUCTION: GENERAL NOTES ON THE RETURN

1. Introduction

...

- ...
- Regulated mortgage contracts and the wider mortgage market
- Home Reversion plans and Home Purchase plans
- Accounting conventions
- ...

2. Overview of reporting requirements

The data requirements for *firms* carrying on the *regulated activities* of ~~mortgage lending~~ home finance providing activity and ~~mortgage administration~~ administering a home finance transaction consist of quarterly ...

- a firm carrying on both ~~mortgage-lending~~ home finance providing activity and ~~mortgage administration~~ administering a home finance transaction will need to complete the whole of the *MLAR*;
- a firm carrying on ~~mortgage-lending~~ home finance providing activity but not also ~~mortgage administration~~ administering a home finance transaction will need to complete the whole of the *MLAR* except sections G and H;
- a firm carrying on ~~mortgage administration~~ administering a home finance transaction, but not also ~~mortgage-lending~~ home finance providing activity, will need to complete sections A, B, C, G, H and J of the *MLAR*.

...

Firm	Sections of the <i>MLAR</i> not required
Mortgage lender <u>Home finance provider/administrator</u> with no other activities (a)	...
Mortgage lender <u>Home finance provider/administrator</u> that is also subject to the <i>RMAR</i> (a)	...
...	...

...

3. Purpose of reporting requirements

The reasons why the *FSA* requires this data from ~~mortgage lenders~~ home finance providers and *administrators* are as follows:

- ...
- to help assess the risks in the ~~mortgage~~ home finance market as a whole to inform, for example...

The *MLAR* requires ~~mortgage lenders~~ home finance providers and *administrators* to submit four types of data:

- financial data to assist in the prudential supervision of ~~mortgage lenders~~ home finance providers and *administrators*. ...
- quarterly reporting of quantitative and qualitative data by all ~~mortgage lenders~~ home finance providers and *administrators* to enable monitoring of compliance with the requirements of *MCOB*;
- quarterly provision of qualitative ~~mortgage~~ home finance information by all ~~mortgage lenders~~ home finance providers and *administrators* to enable the *FSA* to understand developments in the ~~mortgage~~ home finance markets as a whole, ...

...

Tables A to C: provide the framework for the FSA's financial monitoring and prudential supervision of ~~mortgage lenders~~ home finance providers and administrators;

Tables D to F: provide the framework for the provision of qualitative ~~mortgage~~ home finance information by ~~mortgage lenders~~ home finance providers;

Table G, H: provides the framework for the FSA's monitoring of ~~mortgage administration activities~~ administering a home finance transaction activity.

Table J provides information on fee tariff measures for ~~mortgage lenders~~ home finance providers and administrators.

4. Regulated mortgage contracts and the wider mortgage market

...

(a) ...

(b) ...

The definition of a *regulated mortgage contract* ... by all monies charges.

4 a. Home reversion and home purchase plans

Definitions

(1) Home reversion plan

This is defined in the *Handbook* as follows:

(in accordance with article 63B(3) of the *Regulated Activities Order*) an arrangement comprised in one or more instruments or agreements which meets the following conditions at the time it is entered into:

(a) the arrangement is one under which a *person* (the *reversion provider*) buys all or part of a *qualifying interest in land* from an individual or trustees (the *reversion occupier*);

(b) the *reversion occupier* (if he is an individual) or an individual who is a beneficiary of the trust (if the *reversion occupier* is a trustee), or a related person, is entitled under the arrangement to occupy at least 40% of the land in question as or in connection with a dwelling and intends to do so; and

(c) the arrangement specifies that the entitlement to occupy will end on the occurrence of one or more of:

(i) a *person* in (b) becoming a resident of a care home;

(ii) a *person* in (b) dying; or

(iii) the end of a specified period of at least twenty years

from the date the *reversion occupier* entered into the arrangement;

in this definition "related person" means:

(A) that *person's* spouse or civil partner;

(B) a *person* (whether or not of the opposite sex) whose relationship with that *person* has the characteristics of the relationship between husband and wife; or

(C) that *person's* parent, brother, sister, child, grandparent or grandchild.

(2) Home purchase plan

This is defined in the *Handbook* as follows:

(in accordance with article 63F(3) of the *Regulated Activities Order*) an arrangement comprised in one or more instruments or agreements which meets the following conditions at the time it is entered into:

(a) the arrangement is one under which a *person* (the 'home purchase provider') buys a *qualifying interest in land* or an undivided share of a *qualifying interest in land*;

(b) where an undivided share of a *qualifying interest in land* is bought, the interest is held on trust for the home purchase provider and the individual or trustees mentioned in (c) as beneficial tenants in common;

(c) the arrangement provides for the obligation of an individual or trustees (the *home purchaser*) to buy the interest bought by the home purchase provider during the course of or at the end of a specified period;

(d) the *home purchaser* (if he is an individual) or an individual who is a beneficiary of the trust (if the *home purchaser* is a trustee), or a related person, is entitled under the arrangement to occupy at least 40% of the land in question as or in connection with a dwelling during that period and intends to do so;

in this definition "related person" means:

(A) that *person's* spouse or civil partner;

(B) a *person* (whether or not of the opposite sex) whose relationship with that *person* has the characteristics of the relationship between husband and wife; or

(C) that *person's* parent, brother, sister, child, grandparent or grandchild.

Guidance to Homer Reversion (HR) and Home Purchase Plan (HPP) firms on the completion of the MLAR

This section covers the **interim reporting** of HR and HPP products pending the outcome of the FSA's wholesale review of the MLAR under the FSA's agenda of Better Regulation.

It is recognised that HR and HPP products are not loans as such, being effectively sale and lease products. However, in order to use the MLAR as a vehicle for capturing some data on these products, they are to be treated for MLAR purposes as if they were loan products. This means that:

- (i) For a firm which is a **provider** of HR and/or HPP products:
- HR and HPP products are to be included in the balance sheet within A1.6 “Loans to Customers”. This may differ from the reporting of such products in a firm’s published accounts.
 - Within section A3, which contains a further breakdown of “Loans to Customers”, HR and HPP products are to be reported within the single category A3.5 “Other loans”.
 - As a consequence, FSA will be able to capture the key balances outstanding on these products (including any which may have been securitised) during the interim period.
- (ii) For a firm which is undertaking **administration** of HR and/or HPP products (and where that firm did not also act as provider of those products):
- HR and HPP products being administered for third parties are to be reported in section G
 - Within G1 and G2 they are to be reported within the “Other firms” category. They should however be shown under “regulated loans” solely for the purposes of recording their administration in the MLAR.
 - In section G2.2, when entering the “name of firm” in column 2, add “HR” and/or “HPP” in brackets after the name, as appropriate.
 - However, for this interim period of reporting, FSA does not propose to seek information about any arrears on HR and/or HPP products and hence such information should be excluded from section H.

...

SECTION J: FEE TARIFF MEASURES

J1 Introduction

The purpose of ... the regulated activities of *mortgage lending* *home finance providing activity* and *mortgage administration* *administering a home finance transaction*.

...

16 Products covered by the reporting requirement in SUP 16.11 Annex 20G

...

Part 1 - Products

The following tables ... *retail investments, pure protection contracts, regulated mortgage contracts and other home finance transactions.*

...

Table 4 – OTHER HOME FINANCE TRANSACTIONS

Relevant products include:

Home reversion plans

Home purchase plans

Part 2: Supporting product definitions/guidance for product sales data reporting

...

Other home finance transactions

<u>Finance Type</u>	<u>Description</u>
<u>Home reversion plan</u>	Defined in the Handbook <i>Glossary</i> .
<u>Home purchase plan</u>	Defined in the Handbook <i>Glossary</i> .

SUP 16
Annex
21R

REPORTING FIELDS

...

2 SPECIFIC REPORTING FIELDS

...

(d) Other home finance transactions

(i) Home Reversion Plans

The following data reporting fields must be completed, where applicable:

<u>Data reporting field</u>	<u>Illustrative code (where applicable)</u>	<u>Notes</u>
<u>Date reversion plan commenced</u>	<u>DD/MM/YYYY</u>	
<u>Reversion Characteristics</u>	<u>F = Full reversion</u> <u>FI = Full reversion linked to an investment with a view to providing income</u> <u>P = Partial reversion</u> <u>PI = Partial</u>	<u>Only 1 code can be entered</u>

	<u>reversion linked to an investment with a view to providing income</u> <u>O = Other</u>	
<u>Property postcode</u>	<u>e.g. XY45 6XX</u>	
<u>Reversion Sum</u>	<u>Numeric £</u>	<u>Amount of reversion lump sum or sum used to provide income</u>
<u>Full market value of property</u>	<u>Numeric £</u>	<u>The actual market value of the property or portion of property that is intended for reversion</u>
<u>Discounted value of reverted property</u>	<u>Numeric £</u>	<u>The actual discounted value of the property or portion of property on which the reversion plan is based</u>
<u>Date of birth of main XXX</u>	<u>DD/MM/YYYY</u>	<u>Report the age of the main plan holder only</u>
<u>Purpose of reversion</u>	<u>H = Extra money for home improvements</u> <u>D = Extra money for debt consolidation</u> <u>M = Extra money for home improvements and debt consolidation</u> <u>O = Other</u>	<u>Only 1 code can be entered</u>

(ii) Home Purchase Plans

The following data reporting fields must be completed, where applicable:

<u>Data reporting field</u>	<u>Illustrative code (where applicable)</u>	<u>Notes</u>
<u>Date HPP account opened</u>	<u>DD/MM/YYYY</u>	
<u>Type of rental rate</u>	<u>V = Variable</u> <u>F = Fixed</u> <u>O = Other</u>	<u>Only 1 code can be entered</u>
<u>HPP Characteristics</u>	<u>I = Ijara</u> <u>D = Diminishing Musharaka</u> <u>O=Other</u>	
<u>Type of home buyer</u>	<u>F = First time buyer</u> <u>H = Home mover</u>	<u>Only 1 code can be entered</u>

	<u>R = Re-finance</u> <u>C = Council/Registered social landlord exercising their right to buy</u> <u>O = Other</u> <u>N = Not known</u>	
<u>Term of HPP</u>	<u>Numeric</u>	<u>Number in whole years</u>
<u>Amount granted to home buyer</u>	<u>Numeric £</u>	<u>The sum of money advanced to the consumer in respect of their house purchase</u>
<u>Value of property</u>	<u>Numeric £</u>	<u>The value should be based on:</u> <ul style="list-style-type: none"> <u>• The surveyors valuation (or from a valuation index)</u> <u>• From the customers estimated value as captured on the application form.</u>
<u>Income basis</u>	<u>S = Single income</u> <u>J = Joint income</u>	<u>Use code to indicate whether the income assessment has been made on a single or joint basis.</u>
<u>Date of birth of main home buyer</u>	<u>DD/MM/YYYY</u>	<u>Report the age of the main home buyer only</u>
<u>Main home buyer employment status</u>	<u>F = Full time employed</u> <u>S = Self employed</u> <u>R = Retired</u> <u>O = Other</u>	<u>Applies to main home buyer only</u> <u>Only 1 code can be entered.</u>
<u>Total gross income</u>	<u>Numeric £</u>	<u>The total gross income of all home buyers whose income was used in the credit assessment (see guidance notes for further explanation)</u>
<u>Income verification</u>	<u>Y = Income evidenced</u> <u>N = Income not evidenced</u>	<u>Applies to plans based on one or more persons' incomes (see guidance notes relating to where income is not evidenced)</u>
<u>County court judgements (CCJs) Value</u>	<u>Numeric £</u>	<u>Applies where home buyer/s has had one or more CCJs within the last 3 years- either satisfied or unsatisfied- with a total value greater than £500.</u>
<u>Impaired credit history of main home buyer</u>	<u>A = Arrears</u> <u>V = IVA</u> <u>B = Bankruptcy</u>	<u>Use codes to indicate applicable credit history</u> <u>A = applies to previous home finance transactions where the home buyer/s has had arrears within the last 2 years where the cumulative amount overdue</u>

		<p>at any point reached three or more monthly payments or</p> <p><u>V = applies where the home buyer/s have been subject to an individual voluntary arrangement at anytime within the last 3 years</u></p> <p><u>B = applies where the home buyer/s have been subject to a bankruptcy order at any time within the last 3 years.</u></p>
--	--	------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------

3 OPTIONAL REPORTING FIELDS

1. ...
2. The following data items ... who currently support the ~~SML (Survey of Mortgage Lenders)~~ RMS (Regulated Mortgage Survey) and other *home finance providers.*

Data reporting field	Code (where applicable)	Notes
...
<u>Is payment protection insurance (PPI) being taken out with the home purchase plan?</u>	<u>Y=Yes</u> <u>N=No</u>	<p><u>PPI can be any of the following:</u></p> <ul style="list-style-type: none"> - <u>full accident, sickness and unemployment insurance; or</u> - <u>accident and sickness only; or</u> - <u>unemployment only.</u> <p><u>Report 'Yes' even where the policy was sold or provided free and irrespective of whether the premiums are collected by the lender or the insurer.</u></p>

Annex B

Amendments to the Dispute Resolution: Complaints sourcebook

In this Annex underlining indicates new text.

DISP TP 1 Transitional Provisions

DISP TP 1.1 Transitional Provisions table

(1)	(2)	(3)	(4)	(5)	(6)
	Material to which the transitional provision applies		Transitional Provision	Transitional provision: dates in force	Handbook provision: coming into force
...					
18	<u>DISP 1.5.4R</u> <u>DISP 1.5.6R</u> and <u>DISP 1 Annex 1R</u>	R	<p>(1) Solely in respect of information regarding any <i>reversion activity</i> or <i>home purchase activity</i> required to be reported in <u>DISP 1.5.4R</u>, a <i>firm</i> is not required to include such information in respect of relevant reporting periods (as set out in <u>DISP 1.5.6R</u>) ending before 1 October 2007;</p> <p>(2) For the purpose of reporting complaints under generic product types in <u>DISP 1 Annex 1R</u>:</p> <p>(i) <u>complaints relating to home reversion plans</u> must be reported under the heading of "<u>Lifetime Mortgage</u>"; and</p> <p>(ii) <u>complaints relating to home purchase plans</u> must be recorded under the heading of "<u>Other Regulated Mortgage</u>".</p>	<u>1 April 2007 to 31 December 2008</u>	<u>Commencement</u>

CREDIT UNIONS SOURCEBOOK (AMENDMENT NO 7) INSTRUMENT 2006

Powers exercised

- A. The Financial Service Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):
- (1) section 138 (General rule-making power);
 - (2) section 156 (General supplementary powers); and
 - (3) section 157(1) (Guidance).

Commencement

- B. This instrument comes into force on 1 January 2007.

Amendments to the Handbook

- C. The Supervision manual (SUP) is amended in accordance with Annex A to this instrument.
- D. The Credit Unions sourcebook (CRED) is amended in accordance with Annex B to this instrument.

Citation

- E. This instrument may be cited as the Credit Unions Sourcebook (Amendment No 7) Instrument 2006.

By order of the Board
23 November 2006

Annex A

Amendments to the Supervision manual (SUP)

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

Notes on completing the quarterly and annual returns for Credit Unions

FSA Handbook Reference: SUP 16 Ann 15(1)G

...

Large exposures

page 4 of CQ

...

For example, ~~CRED 10.4.1R~~ defines a large *exposure* is defined as any individual net liability which is at least ~~£5,000~~ £7,500 and at least 10% of the value of the *credit union's* capital.

8A Largest net exposure To work out your *credit union's* largest net *exposure*, you will need to determine:

1. The net exposure on each loan and find the largest figure. The formula for this is:
(loan balance + interest owing)- share balance
2. what is the total capital of your *credit union*? This is defined at **5E**.

...

However, we further know from the above that only net liabilities over ~~£5,000~~ £7,500 are subject to the large *exposures* rule. Below we see all net *exposures* over 10% of total capital and those that do and do not qualify:

Example:

Member number	Share balance	Loan balance + interest owing	Net Liabilities	Is it a large exposure?
150	£3,125	£12,500	£9,375	YES
152	£1,750	£7,000 <u>£10,000</u>	£5,250 <u>£8,250</u>	YES
103	£3,115	£9,002 <u>£12,002</u>	£5,887 <u>£8,887</u>	YES
462	£2,500	£6,700	£4,200	No
204	£2,138	£7,911 <u>£10,911</u>	£5,773 <u>£8,773</u>	YES
109	£4,000	£8,500	£4,500	No

...

8C Aggregate total of large net exposures

...

Taking the example at **8A** above, this figure will be ~~£26,285~~ **£35,285** (see below).

Member number	Share balance	Loan balance + interest owing	Net Liabilities
150	£3,125	£12,500	£9,375

152	£1,750	£7,000 <u>£10,000</u>	£5,250 <u>£8,250</u>
103	£3,115	£9,002 <u>£12,002</u>	£5,887 <u>£8,887</u>
204	£2,138	£7,911 <u>£10,911</u>	£5,773 <u>£8,773</u>
Totals	£10,128	£36,413 <u>£45,413</u>	£26,285 <u>£35,285</u>

8D As % of capital

CRED states that the aggregate total of large net *exposures* must not exceed 500% of the total capital of the *credit union* (~~*CRED* 10.4.2R~~), and must not exceed 300% of the total capital without prior notifying the *FSA* (~~*CRED* 10.4.3R~~). To see if the example satisfies the rules please use the following calculation:

...

So:

$$\frac{\frac{\del{£26,285} \quad \del{£35,285}}{\del{£40,000}}}{\del{£40,000}} \times \frac{100}{1} = \del{65.71\%} \quad \del{88.21\%}$$

Notes on completing the annual return (CY) for Credit Unions

FSA Handbook Reference: SUP 16 Ann 15(2)G

30E Liquidity ratio

...

Large exposures

Whilst these figures relate to the financial year end, your *credit union* will need to look at large *exposure* requirements when issuing loans. For example, *CRED 10.4.1R* defines a large *exposure* is defined as any individual net liability which is at least ~~£5000~~ £7,500 and at least 10% of the value of the *credit union's* capital.

31A Largest net exposure

To work out your *credit union's* largest net *exposure*, you will need to determine:

1. The net exposure on each loan and find the largest figure. The formula for this is:
(loan balance + interest owing)- share balance
2. what is the total capital of your *credit union*? This is defined at **2S**.

...

However, we further know from the above that only net liabilities over ~~£5,000~~ £7,500 are subject to the large *exposures* rule. Below we see all net *exposures* over 10% of total capital and those that do and do not qualify:

Member number	Share balance	Loan balance + interest owing	Net Liabilities	Is it a large exposure?
150	£3,125	£12,500	£9,375	YES
152	£1,750	£7,000 £10,000	£5,250 £8,250	YES
103	£3,115	£9,002 £12,002	£5,887 £8,887	YES
462	£2,500	£6,700	£4,200	No
204	£2,138	£7,911 £10,911	£5,773 £8,773	YES
109	£4,000	£8,500	£4,500	No

...

31C Aggregate total of large net exposures

...

Taking the example at **31A** above, this figure will be ~~£26,285~~ **£35,285** (see below).

Member number	Share balance	Loan balance + interest owing	Net Liabilities
150	£3,125	£12,500	£9,375
152	£1,750	£7,000 £10,000	£5,250 £8,250
103	£3,115	£9,002 £12,002	£5,887 £8,887
204	£2,138	£7,911 £10,911	£5,773 £8,773
Totals	£10,128	£36,413 £45,413	£26,285 £35,285

31D As % of capital

CRED states that the aggregate total of large net *exposures* must not exceed 500% of the total capital of the *credit union*

~~(CRED 10.4.2R)~~, and must not exceed 300% of the total capital without prior notifying the FSA ~~(CRED 10.4.3R)~~. To see if the example satisfies the rules please use the following calculation:

...

So:

$$\frac{\begin{array}{l} \cancel{£26,285} \quad \underline{£35,285} \\ \hline \end{array}}{£40,000} \times \frac{100}{1} = \cancel{65.71\%} \quad \underline{88.21\%}$$

Annex B

Amendments to the Credit Unions sourcebook (CRED)

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

...

...

1.1.3 G Every *credit union* is either a *version 1 credit union* or a *version 2 credit union*. The difference is that a *version 1 credit union* is subject to a *requirement* that it must not lend more than ~~£10,000~~ £15,000 in excess of a member's shareholding. *CRED* 14.5 (Application to vary or cancel *permission*) chapter describes how a *credit union* can switch between the two versions.

...

...

7A.2.7 R A *version 1 credit union* must not:

- (1) pay different dividends on different accounts; ~~and~~ unless:
 - (a) at the time of the payment of any dividends it has a capital to total assets ratio of at least 5%; and
 - (b) the payment of any of those dividends does not reduce the capital to total assets ratio to below 5%; or
- (2) pay dividends out of interim profits more than once a year.

...

...

10.4.1 R For the purposes of this section, a large *exposure* is defined as an individual net liability to the *credit union* which meets both of the following criteria:

- (1) it is at least ~~£5000~~ £7,500;
- (2) it is at least 10% of the value of the *credit union's* total capital.

...

BUILDING SOCIETIES REGULATORY GUIDE INSTRUMENT 2006

Powers exercised

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

Commencement

- B. This instrument comes into force on 1 January 2007.

General guidance on building society regulatory issues

- C. General guidance on the Building Societies Act 1986, and on constitutional and other provisions relating to building societies, is made in the form of the Annex to this instrument. This guidance does not form part of the handbook.

Citation

- D. This instrument may be cited as the Building Societies Regulatory Guide Instrument 2006.

Annex

Building Societies Regulatory Guide (BSOG)

The following is new text and is not underlined. It is general guidance which is closely based on the text which previously appeared in IPRU (B/SOC) Volume 1 (chapter X, chapters 1 to 3 and chapters 6 to 11) and IPRU (B/SOC) Volume 2.

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1 Introduction to the building societies regulatory guide

1.1 Application, purpose and definitions

Application

1.1.1 G This Guide applies to building societies.

Purpose

1.1.2 G This Guide provides guidance on the Building Societies Act 1986 and on various constitutional and other provisions relating to building societies. It is not comprehensive and should not be treated as such.

Frequently used terms

1.1.3 G The following terms are used in this Guide and have the meaning described here:

"the 1986 Act"	the Building Societies Act 1986 [Note: As amended by or under the Building Societies Act 1997 and the Financial Services and Markets Act 2000. The 1986 Act has also been amended by other legislation.]
"the 1997 Act"	the Building Societies Act 1997
"the Accounts Regulations"	the Building Societies (Accounts & Related Provisions) Regulations 1998 (SI 1998/504)
"the Act"	the Financial Services and Markets Act 2000
"AGM"	Annual General Meeting
"amalgamation agreement"	a formal agreement between societies on the terms of their amalgamation
"approved person"	a person approved by the Authority under section 59 of the Act (Approval for particular arrangements) to perform a controlled function
"the Authority"	the Financial Services Authority
"the Banking Consolidation Directive"	the Council Directive of 20 March 2000 relating to the taking up and pursuit of the business of credit institutions (No 2000/12/EC)
"the Banking Regulator"	the Authority or other competent authority in another EEA state, as the case may be

[**Note:** The functions of the Bank of England under the Banking Act 1987, which was repealed by the Act, were transferred to the Authority by the Bank of England Act 1998. Similarly, the

functions of the Commission, and of the Central Office of the Registry of Friendly Societies were transferred to the Authority by and under the Act.]

"the BCD"	the Banking Consolidation Directive
"the board"	the board of directors of a building society
"borrower" or "borrowing member"	a person who is indebted to a society in respect of a loan fully, or where the Rules so provide, substantially secured on land
"the BSA"	the Building Societies Association
"the Combined Code"	the Combined Code on Corporate Governance, developed by the Corporate Governance Committee of the Financial Reporting Council
"the Commission"	the Building Societies Commission [Note: The functions of the Bank of England under the Banking Act 1987, which was repealed by the Act, were transferred to the Authority by the Bank of England Act 1998. Similarly, the functions of the Commission, and of the Central Office of the Registry of Friendly Societies were transferred to the Authority by and under the Act.]
"the Confirmation Criteria"	means in relation to mergers- the three criteria specified in section 95(4) of the 1986 Act which the Authority has to consider when deciding whether to confirm a merger of the business of one society with the business of another society; and means in relation to transfers- the four criteria specified in section 98(3) of the 1986 Act which the Authority has to consider when deciding whether to confirm a transfer of the business of a society to a commercial company
"controlled function"	a function, relating to the carrying on of a regulated activity by a firm, which is specified, under section 59 of the Act (Approval for particular arrangements), in the table of controlled functions shown in the Supervision manual of the Authority's Handbook (see SUP 10.4.5R)
"conversion"	the transfer of business of a society to a specially formed company
"credit institution"	an undertaking whose business is to receive deposits or other repayable funds from the public and to grant credits for its own account; or an electronic money institution within the meaning of article 1(3)(a) of the E-Money Directive (Directive 2000/46/EC) which has the right to benefit from the mutual recognition arrangements under the BCD
"the Electronic Communications Order"	the Building Societies Act 1986 (Electronic Communications)

Order 2003 (SI 2003/404)

"existing company"	A company which is a company within the meaning of the Companies Act 1985 or the Companies (Northern Ireland) Order 1986 and is a public company limited by shares, or is incorporated in an EEA State other than the United Kingdom and has power to offers its shares and debentures to the public, and which is carrying on business as a going concern on the date of the Transfer Agreement
"Fees Rules"	the Rules made by the Authority from time to time under paragraph 17 of Schedule 1 to the Financial Services and Markets Act 2000 prescribing the fees to be paid in connection with the discharge of its functions under the 1986 Act
"First, Second, Third Criterion"	See "Confirmation Criteria", and relating respectively, in relation to mergers, to the criteria specified in subsections (a), (b) and (c) of section 95(4) of the 1986 Act
"First, Second, Third, Fourth Criterion"	See "Confirmation Criteria", and relating respectively, in relation to transfers, to the criteria specified in subsections (a), (b), (c) and (d) of section 98(3) of the 1986 Act
"the IAS Regulation"	the Regulation of the European Parliament and of the Council of 19 th July 2002 on the application of international accounting standards (1606/2002/EC)
"Instrument of Transfer"	The Instrument of Transfer of Engagements required by section 94(6) of the 1986 Act
"listed"	included in an official list
"member"	a shareholding or borrowing member of a society
"Memorandum"	the Memorandum of a building society required by paragraph 2 of Schedule 2 to the 1986 Act
"merger"	an amalgamation or transfer of engagements
"Merger Document"	the document or booklet containing the Schedule 16 Statement
"Merger Notification Statement"	a statement sent to members in the circumstances described in chapter 2 of this Guide
"Merger Resolutions"	the shareholding members' resolution and borrowing members' resolution required to approve a merger where no direction under section 42(B)(3) has been given
"official list"	(a) the list maintained by the Authority in accordance with section 74(1) of the Financial Services and Markets Act 2000 (The official list) for the purposes of Part V of the Act (Official Listing); (b) any corresponding list maintained by a competent authority for

	listing in another EEA State.
"OFT"	Office of Fair Trading
"PIBS"	Permanent interest-bearing shares, a type of deferred share
"proxy voting form"	an instrument appointing a proxy to attend a meeting of a society and vote on the member's behalf
"Qualifying Day"	the day specified in the Transfer Agreement as the qualifying day for the purposes of section 100 of the 1986 Act
"rationale"	the explanation of the reasons for a proposed merger provided to the members of a society by its board of directors
"the registration team"	the team at the Authority which carries out the registration functions under the 1986 Act
"the Rules"	the Rules of a building society
"Schedule 16 Statement" or "the Statement"	the statutory statement required by Schedule 16 to the 1986 Act to be sent to every member entitled to notice of a meeting of the society
"SGM"	Special General Meeting
"shareholder" or "shareholding member"	a person holding a share in a society (by investing in one or more share accounts or holding PIBS or other deferred shares)
"society"	a building society
"specially formed company"	a company formed by a society (and by no other than its nominees) for the purpose of assuming and conducting the society's business in its place, which is a company within the meaning of the Companies Act 1985 or the Companies (Northern Ireland) Order 1986 and is a public company limited by shares, or is incorporated in an EEA State other than the United Kingdom and has power to offer its shares or debentures to the public
"Statutory Cash Bonus"	the bonus required by section 100(2)(b) and (4) of the 1986 Act to be paid to every shareholder of the society who held shares on the Qualifying Day and was not eligible to vote on the requisite shareholding members' resolution
"successor" or "successor company"	A company, whether an existing company or a specially formed company, to which the business of a society is proposed to be transferred
"successor society"	a society accepting a transfer of engagements or the new society in the case of an amalgamation
"takeover"	the transfer of business of a society to an existing company

"the Three Criteria"	the criteria prescribed by section 95(4) of the 1986 Act which the Authority has to consider when deciding whether to confirm a merger
	[Note: The Three Criteria are varied in certain circumstances – see section 6 of chapter 2 of this Guide.]
"transfer"	a conversion or takeover or both, as the context requires
"Transfer Agreement"	the agreement required by section 97(4)(b) of the 1986 Act between a society and its successor company on the terms of the transfer
"Transfer Document"	the document or booklet containing, inter alia, either the Transfer Statement or the Transfer Summary
"Transfer Regulations"	the Building Societies (Transfer of Business) Regulations 1998 (SI 1998/212)
"Transfer Resolutions"	the shareholding members' resolution and borrowing members' resolution required to approve a transfer where no direction under section 42B(4) of the 1986 Act has been given
"transferee society"	a society accepting a transfer of engagements from another society
"transferor society"	a society transferring its engagements to another society
"Transfer Statement"	the statement required by Schedule 17 to the 1986 Act to be sent in or with the notice of the meeting at which the Transfer Resolutions are to be considered or, if a Transfer Summary is sent, made available to every member entitled to notice of a meeting of the society
"Transfer Summary"	The summary of the Transfer Statement which may, in accordance with Schedule 17 to the 1986 Act, be sent, instead of the Transfer Statement, in or with the notice of the meeting at which the Transfer Resolutions are to be considered, to every member entitled to receive that notice
"Trustee Account Holder"	a person who is a shareholding or borrowing member of a society, by virtue of being the sole or representative joint holder of an account which he holds in trust for another person or persons any one or more of whom cannot reasonably practicably act in relation to that account themselves by reason of ill-health or old age or any physical or mental incapacity or disability, as provided by section 102D of the 1986 Act, whether or not the account holder is a shareholding or borrowing member in respect of any other accounts
"vesting date"	the date on which all the property, rights and liabilities of the society making the transfer, except any shares in the successor company, are transferred to the successor company

- 1.2 Principal purpose of a building society and funding and lending limits
- 1.2.1 G A building society can only be or remain established under the 1986 Act if its purpose, or principal purpose, is making loans which are secured on residential property and funded substantially by the society's members (the 'principal purpose test') (section 5 of the 1986 Act).
- 1.2.2 G If an established building society no longer meets the principal purpose test, the Authority may:
- (1) direct it to submit a restructuring plan designed to ensure that the society will meet the principal purpose test by a certain date and that it will continue to meet that test in the future (section 36 of the 1986 Act);
 - (2) direct it to submit to its members for their approval at a meeting the requisite resolutions for a transfer of the society's business to a company (section 36 of the 1986 Act); or
 - (3) petition the High Court for the society's winding-up (section 37 of the 1986 Act).
- 1.2.3 G Building societies are subject to lending and funding limits, which help to determine their compliance with the principal purpose test (sections 6 and 7 of the 1986 Act).
- 1.2.4 G When the Authority assesses a building society's compliance with the principal purpose test, it takes into account:
- (1) whether the society is meeting, and is expected to continue to meet, its lending and funding limits (sections 6 and 7 of the 1986 Act);
 - (2) the actual and projected proportion of the society's gross income that is, or is expected to be, derived from activities that are related to the making of loans secured on residential property. (Income from the society's property related insurance and valuation services might be regarded as related to the making of loans secured on residential property, but income from the society's motor insurance business (if any) would not); and
 - (3) all other relevant quantitative and qualitative factors.
- 1.2.5 G The Authority expects societies to draw up their corporate and other business plans so as to provide reasonable assurance that they will comply with the principal purpose test and their other obligations under the 1986 Act.
- 1.2.6 G In particular, societies should ensure that any programme of securitisation does not threaten compliance either with the principal purpose, or with the lending or funding nature limits. Sections 6(3) and 7(3) of the 1986 Act respectively make clear that only items included in total assets or total liabilities in a society's accounts count towards the nature limits. The adoption of International Accounting Standards by some societies changed the accounting treatment of securitised assets for those societies from 1 January 2005. The Building Societies Act 1986 (Modification of the Lending Limit

and Funding Limit Calculations) Order 2004 (S.I. 2004/3200) amended the 1986 Act so that securitised assets and related liabilities may continue to be excluded from nature limit calculations, regardless of how they are included in the accounts of a society. Therefore societies which use International Accounting Standards to prepare their accounts will not be disadvantaged in relation to the nature limits.

1.3 Constitutional matters

Constitutional form

- 1.3.1. G Building societies have a particular constitutional form: they are mutuals run for the benefit of their members (i.e. their borrowers and savers). A society cannot therefore be owned or controlled by an outside institution or major shareholder. Society boards and management have a special responsibility to protect the interests of their members through the highest standards of corporate governance.
- 1.3.2 G Although societies are not publicly quoted, they should have regard to the Combined Code when they establish and review their corporate governance arrangements.

Fit and proper test for directors

- 1.3.3 G A building society's directors are elected by its members. Subject to certain exceptions, any natural person may be elected as a building society director (section 60 of the 1986 Act). Members have the right to nominate any candidate for election. Unless that person is subject to an Authority prohibition order, the board cannot refuse to accept a candidate's nomination because the board does not regard that person as fit and proper. Prior to the election, the board should take reasonable steps to establish whether there are any facts or matters concerning the candidate's fitness and propriety which the members should be aware of. If there are, the board should bring them to the members' attention before the election takes place. The Authority will not vet candidates for election.
- 1.3.4 G A person elected as an executive or non-executive director of a building society must not exercise a controlled function unless the Authority gives its approval (sections 59 and 60 of the Act). The Authority will not approve a director unless it is satisfied that he meets, and will continue to meet, the Fit and Proper Test for Approved Persons (see the Fit and Proper Test for Approved Persons sourcebook in the Authority's Handbook (*FIT*)). An approved person must also comply with the requirements of the Statement of Principle and Code of Practice for Approved Persons sourcebook in the Authority's Handbook (*APER*).

Other requirements and guidance

- 1.3.5 G Part VII of the 1986 Act contains requirements relating to the management of building societies.
- 1.3.6 G Every building society must have at least two directors and one of the directors must be appointed chairman (section 58 of the 1986 Act). The chairman should not hold an executive position in the society. This helps to separate strategic direction from the day to day management of the business and helps the chairman to take an independent view of management issues. It also protects against undue concentration of power.

- 1.3.7 G Every building society must have a chief executive (section 59(1) of the 1986 Act). The chief executive should be a member of the board.
- 1.3.8 G A small building society may not need as many executive directors as a large building society, but every society should have at least one.
- 1.3.9 G Given the mutual status of building societies, a clear majority of directors on a society's board should be non-executive. Non-executive directors should not be given the expectation that they will remain on the board until retirement. They should serve for a fixed term, both initially and for any subsequent term. The appropriate ratio of non-executives to executives will vary with the scale, nature and complexity of the society's business.
- 1.3.10 G It will rarely be appropriate or desirable for a chief executive or other executive director to remain as a non-executive board member after his or her retirement.
- 1.3.11 G The board should have an appropriate range of skills and experience to control and direct the society's activities effectively. The composition of the board should be reviewed at regular intervals to ensure that its management and other resources are at least adequate for the society's current business and the business it proposes to undertake.
- 1.3.12 G When a director is to be appointed under a formal service contract, the board should consider carefully the terms of the contract it offers. When it does so, it should take into account (for example) the need to attract and retain directors with appropriate experience, knowledge and skill; the need to preserve the board's freedom of action; the potential cost of the contract proposed; the period of notice the society will have to give, and the potential liability it will incur, if it terminates the contract other than for misconduct. The objective should be for notice or contract periods of one year or less.
- 1.3.13 G The Accounts Regulations require a building society to give particulars of its directors' and chief executive's service contracts in its annual Report and Accounts. If there are no service contracts, the building society should say so.
- 1.3.14 G Every building society must have a secretary (section 59(2) of the 1986 Act). The secretary should ensure that board procedures are followed and regularly reviewed. He should also provide guidance on the board's responsibilities and how they should be discharged.

Dealings with directors

- 1.3.15 G Part VII of the 1986 Act places restrictions on certain types of dealing between a building society and its directors. For example:
- (1) it requires a director, who is interested in a contract with the society, to declare that interest to the board (section 63 of the 1986 Act); and
 - (2) it prohibits a building society from entering into an arrangement, by which a director will acquire a non-cash asset of more than a certain value from the society, unless the society has approved the arrangement by resolution at a general meeting.

A building society should maintain written procedures and controls which ensure compliance with these restrictions.

Loans to directors

- 1.3.16 G The 1986 Act also restricts a building society's ability to make loans to a director or a person connected with a director (section 65 of the 1986 Act). In the circumstances, it would be inappropriate for a building society to follow its usual loan procedures when a director or connected person makes a loan application. The responsibility for approving such loans should not rest with staff members, even if the loan falls within a normal staff mandate. A building society should have written procedures for dealing with loan applications from directors or persons connected with them and every director should be familiar with them. Those procedures should include consideration by the board, or a board committee, before any loan application is approved. That review should have regard, for example, to the terms of the proposed loan and whether it is permitted by the 1986 Act.

1.4 Accounting records and reporting requirements

Accounting records and systems

1.4.1 G Every building society is required (by section 71 of the 1986 Act) to keep accounting records which:

- (1) explain its transactions;
- (2) disclose, with reasonable accuracy and promptness, the state of its business at any time; and
- (3) enable the directors and the society to properly discharge their respective duties under the 1986 Act and article 4 of the IAS Regulations (if applicable).

1.4.2 G The accounting records should contain:

- (1) day to day entries of all sums received and paid by the society;
- (2) day to day entries of every transaction which will, or may reasonably be expected to, give rise to assets or liabilities of the society; and
- (3) a record of the society's assets and liabilities and, in particular, the assets and liabilities of any class specifically regulated under section 6 (the lending limit) and section 7 (the funding limit) of the 1986 Act.

Reporting requirements

1.4.3 G The Accounts Regulations set out specific legal and regulatory requirements about the form and content of the financial statements which a building society and its directors must produce. A building society should ensure that the documents it presents to its members are understandable and balanced so that they report the society's setbacks as well as its successes.

1.4.4 G The Accounts Regulations and the 1986 Act require a building society to disclose to its members, by its annual report and accounts:

- (1) the interests of the society's directors;
- (2) the interests of its chief executive (on the matter of service contracts) and other officers (on the matter of options to subscribe for shares or debentures);
- (3) individual directors' remuneration;
- (4) particulars of service contracts for the directors and chief executive;
- (5) current and past directors' additional retirement benefits; and
- (6) directors' interests in the shares or debentures of a connected undertaking.

In the interests of transparency, a building society should also explain whether it adheres to some or all of the Combined Code and, if so, in what respects.

1.5 Electronic communications

- 1.5.1 G The Electronic Communications Order allows a building society to communicate electronically with its members on constitutional matters, including those referred to in later chapters of this Guide, if certain conditions are met. The Order covers communications about the business to be transacted at annual general meetings. It also covers communications on occasional matters, such as special meetings, mergers and transfers of business. In all cases the consent of the member or other person to the means of communication must be obtained.
- 1.5.2 G The Electronic Communications Order does not amend the 1986 Act requirement to submit certain returns to be placed on its public file. Nor does it affect the supervisory financial returns required to be submitted by the rules in the Authority's Supervision manual.
- 1.5.3 G This Guide reflects law and practice as at 23rd November 2006 and does not take into account subsequent developments.

CHAPTER 1A

Applications for the right to obtain access to the registers of members of building societies

1A.1	Introduction	
1A.1.1	G	This chapter gives guidance to building societies, and to those members of building societies considering making an application to the Authority about the exercise of the right to obtain access to the registers of members of building societies. This right is governed by the provisions of paragraph 15 of Schedule 2 to the 1986 Act. Societies should be aware, however, that the Electronic Communications Order 2003 modifies various provisions of the 1986 Act to enable the use of electronic communications between societies, their members and other persons, subject to their consent. In particular, the Order provides for the inclusion of a member's electronic address in the register of members in addition to a postal address. The remaining text of this chapter has not been amended to take account of the Order, but the Authority will in general be prepared to use electronic communication if requested by the society or the applicant and some procedures may have to be adapted accordingly.
1A.1.2	G	This guidance is not a definitive interpretation of the 1986 Act. That is a matter for the courts.
1A.2	Registers of members	
1A.2.1	G	Each society is under a statutory obligation to maintain a register of its members (although the form in which it is maintained is at the discretion of the society). The register must show each member's name and address and whether that person is a shareholding member or a borrowing member. The register must be kept at the society's principal office or such other place or places as the society's directors think fit.
1A.2.2	G	Companies are under a statutory obligation to make their share registers available for inspection by the general public. There is no equivalent obligation on building societies with respect to the registers of their members. A society is not required to allow access to its register other than in the circumstances provided for in paragraph 15 of Schedule 2 to the 1986 Act. Except to the limited extent that access is permitted under that paragraph, a society's register of members is confidential (and subject to data protection legislation).
1A.2.3	G	There are two principal reasons for the confidentiality of the registers of members of building societies. First, it is to protect the privacy of members, whether individually or generally, so the fact that a person is either a shareholder in or a borrower from a particular society (or both) is not subject to indiscriminate disclosure. Second, it is to protect the commercial interests of societies given that it could be to their competitive disadvantage if the identities of their shareholding and borrowing members, who are their customers, were readily available to competitor organisations (the identity

		of whose customers is not so available).
1A.2.4	G	However, building societies are mutual associations of members. As such, it is in principle reasonable for members to be able to pursue a direct interest in the business and management of “their” society and to get in touch with each other on matters of mutual concern.
1A.2.5	G	Within the framework set out in paragraph 15 of Schedule 2 to the 1986 Act, it is the responsibility of the Authority to balance the rights of individual members generally to privacy, and of societies to commercial confidentiality, with the reasonable right of particular individual members to get in touch with each other on matters relating to the affairs of their society. The confidentiality of the information held on the register can be set aside only where the applicant can make out the case within the exceptional circumstances described in paragraph 15 of Schedule 2. In the opinion of the Authority, the exception is to be considered as much a privilege as a right.
1A.3		Statutory framework
1A.3.1	G	Paragraph 15 of Schedule 2 to the 1986 Act governs when and how access to the register of members of a building society may be obtained. Subject to the exception provided for in paragraph 15(1) of Schedule 2, access may only be granted on a direction by the Authority. Paragraph 15(2) of Schedule 2 provides that a member may, if qualified to do so, make a written application to the Authority to exercise the right to obtain members’ names and addresses from the register of the society of which he or she is also a member, for the purposes of communicating with those other members of the society on a subject relating to its affairs. The text of the relevant legislation is at Annex 1.
1A.3.2	G	Paragraph 15(1) of Schedule 2 provides for an exception to the requirement to make an application to the Authority. Where the Authority has cancelled a society’s permission to accept deposits and the society has not had its permission reinstated by the Authority, a member of that society has the right to obtain the names and addresses of its members from the register without application to the Authority. In this case, the applicant is not required to have been a member for any specified period but the minimum shareholding or minimum mortgage debt requirements described in paragraph <i>BSOG</i> 1A.3.3 may still apply.
1A.3.3	G	A member is qualified for the purposes of obtaining access under paragraph 15(1) or (2) of Schedule 2 if, under the rules of the society, he or she may join in a members’ requisition for a special meeting or in nominating a person for election as a director. This means that the applicant must be an investing or borrowing member of the society. If the society’s rules prescribe a minimum investment or mortgage debt the member must hold shares or have a mortgage debt of at least that amount. The minimum cannot exceed £100 in either case (which figure the Treasury may change by Order). In cases covered by paragraph 15(2) of Schedule 2, the society may also require the applicant to have been a member for such period as may be specified in its rules. In most cases this is two years (the maximum

		permitted by the 1986 Act).
1A.3.4	G	<p>An application under paragraph 15(2) of Schedule 2 is subject to the payment of a reasonable fee, currently £25, to the Authority. Where an application is made, the Authority may direct the society to give the member access to the register provided the Authority is satisfied that:</p> <p>(1) the applicant requires the right for the purposes of communicating with members of the society “on a subject relating to its affairs”; and</p> <p>(2) the applicant has not, since making the application, voluntarily ceased to be a member of the society.</p>
1A.3.5	G	The Authority must also have regard to “the interests of the members as a whole” and “to all the other circumstances”.
1A.3.6	G	If access is granted it may only be used to obtain the names and addresses of members for the purposes of communicating with them on a subject relating to its affairs (see also paragraphs <i>BSOG</i> 1A.5.10 to <i>BSOG</i> 1A.5.12).
1A.3.7	G	Before giving a direction, the Authority is required to give particulars of the application to the building society concerned and to give it the opportunity to make representations. If either the applicant or the society so requests, the Authority must give both the opportunity of being heard by it.
1A.3.8	G	A direction given by the Authority may be subject to such limitation or conditions as the Authority may think fit.
1A.3.9	G	If the Authority directs that the applicant shall have the right to obtain access to the register, the applicant may apply in writing to the society, describing the subject on which it is proposed to communicate with other members of the society. The society is required to give the applicant all necessary information as to where the register is kept and reasonable facilities (including office accommodation) for inspecting it and taking copies of any names and addresses.
1A.3.10	G	The applicant only has the right to take names and addresses from the register. A society may make the information from the register available to an applicant in such a way that only those names and addresses are disclosed.
1A.3.11	G	Information obtained by the applicant from the register of the society concerned and relating to a member of that society may not be disclosed to any other persons without the consent of that member whose name and address has been taken from the register. Nor may it be disclosed for purposes not connected with the purposes given at the time the Authority made its direction. Contravention of these requirements is a criminal offence.
1A.3.12	G	Paragraph 6 of Schedule 14 to the 1986 Act provides that any dispute as to the rights of a member under paragraph 15 of Schedule 2 shall be referred to the Authority and treated as a reference to arbitration; and its award shall

		have the same effect as that of an arbitrator in a reference under paragraph 4(1) of Schedule 14.
1A.4	Making an application	
1A.4.1	G	Applications should be made to the Authority in writing in the form of Annex 2 to this chapter.
1A.4.2	G	Each application must be accompanied by the prescribed fee, which is currently £25 (cheques should be made payable to the Financial Services Authority). This fee is not refundable in any circumstances.
1A.4.3	G	Should an applicant wish to obtain access to the registers of more than one society (the applicant must, of course, be a qualified member of each of them), there must be a separate application, for each of which a separate fee must be paid.
1A.4.4	G	The Authority will acknowledge all applications within 5 working days of receipt.
1A.4.5	G	To assist the Authority in its consideration of an application, and the society in making any representations on it, the application should set out clearly and concisely the issues about which the applicant wishes to communicate with other members and the purposes in doing so. In addition to this statement, the Authority requires at the time of the initial application a draft of the communication that would be sent should the Authority direct the society to give the applicant access to the register.
1A.4.6	G	Without prejudice to its consideration of an application in any particular case, applicants should note the following general guidelines when preparing an application:
		(1) the Authority will expect the member making the application to have read carefully the relevant provisions of the 1986 Act and this chapter;
		(2) it is important to be specific about the purpose of the application, how it relates to the affairs of the society and why and how access to the register of members is necessary to achieve the applicant's objective;
		(3) an applicant should think carefully about the purpose and content of the proposed communication before making the application so as to minimise the need for substantive changes to it at a later date;
		(4) an application may be supported by such information or documents as the applicant may wish, but these will be considered to form part of the application, will be seen by the society and be open to comment by it;
		(5) where an applicant submits two or more applications (together or in quick succession) it should be made clear as to why access to the

		register of members of each of the societies is necessary and how the purpose of each application relates to the affairs of that society;
	(6)	should an applicant be successful he or she will incur expenditure in taking names and addresses from the register and then producing and mailing the communication and the applicant should take this into account before submitting an application.
1A.5	Considering an application	
1A.5.1	G	The Authority will consider, first, whether the application contains all the relevant information. It may ask the applicant to provide further information or clarify what has already been given.
1A.5.2	G	If, in the opinion of the Authority, the application is defamatory, frivolous or vexatious, the Authority may decide that it would be inappropriate to consider it further. The applicant will be informed of such decision as soon as practicable. In such cases the Authority may give the applicant an opportunity (normally only once) to revise the application to take the Authority's opinion into account. If a revised application is received by the Authority within 10 working days of the Authority's notice that the previous application was unacceptable (or such other period as the Authority may, in the circumstances, consider reasonable), a further fee will not be payable.
1A.5.3	G	If the Authority is satisfied that the application provides all the relevant information and is, on the basis of that information, a valid application for the purposes of paragraph 15 of Schedule 2, the Authority will send the application, together with any supporting information or documents provided by the applicant, to the society. The society will be asked to confirm that the applicant was qualified to make the application at the time it was made and, if so, invited to make written representations on it to the Authority. The Authority will also ask the society whether it wishes to make oral representations at a hearing held by the Authority. The Authority will normally expect a society to submit its representations, or to confirm that none are to be made, within 15 working days of receipt of the copy of the application.
1A.5.4	G	Once the Authority has received the society's written representations, together with any supporting information or documents, a copy will be sent to the applicant with an invitation to make written comments on them to the Authority. The Authority will also ask whether the applicant wishes to make oral representations, irrespective of whether the society has indicated that it would wish to do so. The Authority will normally expect an applicant to provide written comments or to confirm that none are to be made within 15 working days of receipt of the invitation.
1A.5.5	G	Once the Authority has received the applicant's written comments, a copy of them will be sent to the society. This will normally be for information only. However, in any case where, in the opinion of the Authority, the applicant has introduced new matters which can properly be dealt with as part of the existing application, the society will be given the opportunity to make further representations. If the applicant has introduced new matters

		which, in the opinion of the Authority, cannot properly be dealt with as part of the existing application, the Authority may ask the applicant to make a new application or it may disregard the new matters for the purposes of the application under consideration. In the latter case the Authority will inform the applicant accordingly.
1A.5.6	G	The Authority may seek further information or other documents from either the applicant or the society at any time.
1A.5.7	G	Paragraph 15(2) of Schedule 2 sets out the criteria to which the Authority should have regard in considering an application:
		(1) the purpose of the proposed communication must be on “a subject relating to its (the society’s) affairs”;
		(2) the Authority should have “regard to the interests of the members as a whole”;
		(3) the Authority should have “regard ... to all the other circumstances”.
1A.5.8	G	Paragraph 15(3) of Schedule 2 provides that the Authority may give a direction “subject to such limitations or conditions as the Authority may think fit”.
1A.5.9	G	The Authority will consider each application on its merits. The purpose of the guidance in paragraphs <i>BSOG</i> 1A.5.10 to <i>BSOG</i> 1A.5.20 is to give a broad indication of the Authority’s approach and the criteria to which it will have regard.
A Subject Relating to its (the Society's) Affairs		
1A.5.10	G	The 1986 Act does not define “affairs”. As a general proposition, the Authority considers that “affairs” will primarily relate to matters connected with the society’s finances, its business activities and the manner in which it carries on those activities, and not just to the applicant’s personal affairs. Bearing in mind the considerations discussed in paragraph <i>BSOG</i> 1A.2.3, the matters about which the member wishes to communicate with other members, will, in the opinion of the Authority, normally need to be of a substantial nature and must relate to the particular society concerned. The Authority will expect the applicant to demonstrate not only why he or she is personally concerned about, or affected by, these matters (rather than simply being concerned or affected in some more general way) but also why it is necessary that this concern is communicated direct to other members.
1A.5.11	G	Paragraph 15 of Schedule 2 requires each application to be considered separately by the Authority so that it cannot consider applications with the same, or similar purpose, or related to the same, or similar issue, as if they were a “class application”. So, for example, an application from a member wishing to obtain the required support of other members to stand for election to the board of directors of a society will be considered individually and on its merits, notwithstanding any previous decision the Authority may have taken on an application with the same, or similar, purpose.

1A.5.12	G	The Authority will wish to be satisfied that the wording of the communication is consistent with the stated purpose of the application. It may invite the society to comment on the communication but the society cannot itself stipulate what its terms should be.
The Interests of the Members as a Whole		
1A.5.13	G	The Authority will balance the wider interests of the membership as a whole with those of any one individual member or group of members. The Authority will require the applicant to demonstrate that the communication raises matters which are likely to be of interest to the society's members generally or at least a substantial section of them. The Authority will take into consideration any evidence of support from other members of the society, should the applicant claim that this has already been given.
1A.5.14	G	Whilst the right to make an application is open to all qualified members of the society, the Authority is of the opinion that, as a general proposition, access to the register is not an appropriate vehicle for the pursuit of a private grievance between a member and the society or the pursuit of a more general campaign affecting the building societies sector as a whole. The Act provides for a reference to the Financial Services Ombudsman for the investigation of a customer complaint and the 1986 Act provides for a reference to the High Court (in Scotland, the Court of Session) for the resolution of a membership dispute.
1A.5.15	G	The 1986 Act does not require that a person who is given access to the register must write to all the members. To do so would mean that the right of access was of little practical value. In the opinion of the Authority, it is acceptable for the applicant to write, for example, to a random selection of members or to those living in a particular geographical area. However, the Authority may require the communication to indicate whether or not it has been sent to all the members or only a proportion of them (and, if so, on what basis that proportion was selected).
All the Other Circumstances		
1A.5.16	G	The circumstances that may be appropriate for the Authority to take into account can only be identified in the particular case at the particular time. As a general proposition, the Authority will take into account any relevant information in respect of the applicant's relationship with the society. This could include, for example, previous applications for access to the register. The Authority will also take into account whether the applicant has raised the issue about which he or she is concerned at the society's annual general meeting or whether he or she would be able to do so at a future meeting. The Authority will at the same time take into account any evidence that the society has attempted to frustrate the member's legitimate right to speak on the issue at the annual general meeting or seems likely to do so on a future occasion.
1A.5.17	G	The Authority will also take into account the likely effect on building societies generally should the applicant be given access to the register of

		members of a particular society and write to the other members as proposed. It will consider whether, should it direct that an applicant be given access to the register of one society, this could have any adverse impact on other societies, for example, a possible risk to confidence. The Authority will also expect the applicant to explain why it is not possible to obtain support in some other way and so why it is necessary to have the privilege of accessing the register of members. The Authority will expect an applicant to show an awareness of these wider considerations and will wish to be assured that they will be appropriately reflected in both the tone and the content of the communication.
1A.5.18	G	An applicant will be expected to disclose to the Authority whether he or she is acting in a purely personal capacity or on behalf of, or in concert with, any other person or institution, or whether he or she has an interest in the society beyond the fact of being a member of it. Where the applicant has not made such a disclosure, but the Authority has reason to believe that he or she may be acting for or in concert with another party, the Authority will make enquiries to establish the facts and will invite the applicant to comment on its findings. Each application to inspect the register of members is considered on its merits. Where an application is made by a member whom the Authority considers to be in effect acting on behalf of a third party commercial institution, it will in particular have regard to:
		(1) the nature of the member's own interest in the application and the third party institution's objectives;
		(2) the interest of members as a whole in preserving privacy and the society's right to commercial confidentiality in its membership list;
		(3) any interaction between the application and the detailed and mandatory procedures under the 1986 Act governing mergers of building societies or as the case may be transfers of business to commercial companies; and
		(4) other means open to the member and the third party institution to communicate with members on the relevant subject.
		The interests of the members as a whole should not be confused with the personal interests of one or more individual members.
Such Limitations or Conditions as the Authority may think fit		
1A.5.19	G	The 1986 Act imposes a specific restriction on any person who has taken information from the register of members. That is, the information may not be further disclosed (by that person or anyone to whom the information has been disclosed in accordance with the direction given by the Authority) except with the consent of the member to which it relates or for the purposes for which the 1986 Act provides. This is an essential safeguard against the abuse of the privilege of being given access to the register of members and contravention of the restriction is a criminal offence.

1A.5.20	G	The Authority will consider what limitations or conditions it should properly attach to a direction in each particular case. However, and without prejudice to the exercise of its discretion, the Authority will normally consider limitations or conditions in the following areas:
		(1) whether the information taken from the register may be further disclosed and, if so, those to whom it may be disclosed and, in particular, if the Authority decides to direct access to the register of members in the circumstances outlined in paragraph <i>BSOG</i> 1A.5.18G, it will impose such conditions as may be necessary to ensure that the third party institution does not directly or indirectly gain access to the information in the register or use the proposed communication by the applicant with other members to damage the society;
		(2) that the communication must be in writing and addressed separately to each of the members to whom it is sent;
		(3) that the material terms of the communication sent must be those seen by the Authority at the time it reached its decision on the application;
		(4) that the communication is accurate, is not offensive, is not misleading (including any inference that the communication is being made by, or on behalf of, the society), is not likely to bring about a loss of confidence in the society (or in societies generally) or otherwise harm its current or future business;
		(5) that the communication must be sent within a specified time;
		(6) that the applicant is given a specified period during which the relevant information is to be made available.
1A.6		Oral hearings
1A.6.1	G	Should either the society or the applicant ask for an opportunity of being heard by the Authority, then it will invite both parties to attend a hearing. If neither party so requests, the Authority will normally decide the application on the basis of the written evidence available to it, including the application, the society's comments (paragraph <i>BSOG</i> 1A.5.3) and the applicant's written comments (paragraphs <i>BSOG</i> 1A.5.4 and <i>BSOG</i> 1A.5.5) together with the results of any enquiries the Authority itself may have made.
1A.6.2	G	If there is an oral hearing this will normally be taken by one or more persons authorised by the Authority to act on its behalf.
1A.6.3	G	The Authority will normally give the applicant and the society not less than 10 working days formal notice that there will be a hearing, including the place and time at which it will be held.
1A.6.4	G	The hearing will normally be held in public. However, if either the applicant or the society requests that the hearing be held in private, the

		person(s) taking the hearing will listen to arguments from both parties before deciding whether to admit the public (which may include representatives of the media).
1A.6.5	G	Whilst the proceedings will be comparatively informal, the applicant and the society may, if they wish, be legally represented. In any such case, the Authority must be notified at least 5 working days in advance of the hearing so that it may inform the other party. The applicant and the society may also be assisted by such other persons as the Authority considers reasonable in the circumstances.
1A.6.6	G	The person(s) taking the hearing will introduce the proceedings and deal with any preliminary matters. The applicant and the society will then each be invited to present their cases, in that order. Each will have the opportunity to comment on the case presented by the other. The person(s) taking the hearing may ask such questions as they consider necessary, particularly to establish or elucidate matters of fact, but will not respond to questions from either of the parties. This procedure may be varied according to the circumstances of the particular case.
1A.7	Deciding an Application	
1A.7.1	G	The person taking the hearing will not normally announce a decision at the hearing or give any indication as to the Authority's likely decision.
1A.7.2	G	The Authority's decision with reasons will always be given in writing. The Authority will normally expect to issue its decision within 15 working days of a hearing. A copy will be sent to the applicant and to the society.
1A.7.3	G	The Authority will make its decision public. It would also normally expect to make copies of its written decision with reasons available to those interested to see it. It may decide not to do so, however, where it considers that publication could be prejudicial to the interests of shareholders or depositors in or with the society. The Authority will, if either applicant or society objects to the publication of its written decision, give both parties the opportunity to make representations to it.

Annex 1

Extract from the 1986 Act

Schedule 2, paragraph 15

“Right of members to obtain particulars from the register

15.

(1) At any time when a building society -

- (a) has had its permission under Part IV of the Financial Services and Markets Act 2000 to accept deposits cancelled; and
- (b) has not subsequently been given such permission,

a member of the society shall, subject to sub-paragraph (1A) below, have the right to obtain, from the register kept under paragraph 13 above, the names and addressees of members of the society, for the purpose of communicating with them on a subject relating to the affairs of the society.

(1A) Sub-paragraph (1) above shall not apply unless the member in question:

- (a) is qualified under the rules of the society to join in a members' requisition for a special meeting, or to join in nominating a person for election as a director; or
- (b) would be so qualified if any requirements as to length of time a person must have been a shareholding or borrowing member were omitted.

(2) If, at any time not falling within sub-paragraph (1) above, a member of a building society who is qualified under the rules of the society to join in a members' requisition for a special meeting, or to join in nominating a person for election as a director, makes a written application to the Authority for the right to obtain names and addresses from the register, the Authority:

- (a) if satisfied that the applicant:

- (i) requires that right for the purpose of communicating with members of the society on a subject relating to its affairs; and
 - (ii) has not, since making the application, voluntarily ceased to be a member of the society; and
- (b) having regard to the interests of the members as a whole and to all the other circumstances;

May direct that the applicant shall have the right to obtain from the register the names and addresses of the members for the purpose of communicating with them on that subject.

- (2A) The Authority may charge a reasonable fee for considering an application under sub-paragraph (2) above.
- (3) Any direction under sub-paragraph (2) above may be given subject to such limitations or conditions as the Authority may think fit.
- (4) Before giving a direction under sub-paragraph (2) above, the Authority shall give particulars of the application to the building society and shall afford the society an opportunity of making representations with respect to the application; and the Authority shall, if the applicant or the society so requests, afford to the applicant and to the society an opportunity of being heard by it.
- (5) A member entitled under this paragraph to obtain the names of members of a building society may apply in writing to the society, describing in the application the subject on which he proposes to communicate with other members of the society; and the society shall give him all necessary information as to the place or places where the register, or part of it, is kept, and reasonable facilities for inspecting the register and taking a copy of any names and addresses in the register.
- (6) A building society shall not be obliged to disclose to a member making an application under this paragraph any particulars contained in the register other than the names of the members and their addresses, and may construct the register in such a way that it is possible to disclose the names and addresses to inspection without disclosing any such other particulars.
- (7) No information obtained under sub-paragraph (1) or (2) above or this sub-paragraph and relating to a member of the society may be disclosed except:
 - (a) with the consent of that member; or
 - (b) in the case of information obtained under sub-paragraph (1) or (2) above, for purposes connected with the purpose mentioned in that paragraph.

- (8) Any person who discloses information in contravention of subparagraph (7) above shall be liable:
- (a) on conviction on indictment, to imprisonment for a term not exceeding two years or to a fine or both; and
 - (b) on summary conviction, to a fine not exceeding the statutory maximum.”

Annex 2

**APPLICATION FOR THE RIGHT TO OBTAIN ACCESS
TO THE REGISTER OF MEMBERS OF A BUILDING SOCIETY**

This form is to be completed by a member of a building society who wishes to be given access to the register of members of the building society of which he or she is a member in accordance with paragraph 15 of Schedule 2 to the Building Societies Act 1986 (as amended by and under the Financial Services and Markets Act 2000) and who is qualified under that paragraph to make such an application. Before completing this form you are advised to read the guidance published by the Financial Services Authority. Copies of this form may be downloaded from the FSA's Handbook webpage on Regulatory Guides <http://fsahandbook.info/FSA/html/handbook/D44>.

On completion this form should be sent to the Financial Services Authority, 25 The North Colonnade, Canary Wharf, London E14 5HS.

1. Name of the society of which you are a qualified member to whose register of members you wish to be given access:

2. Name and address of applicant:

Name

Address

Telephone

3. Share account details

Account name (s)

Account number (s)

4. Mortgage account details

Account name (s)

Account number (s)

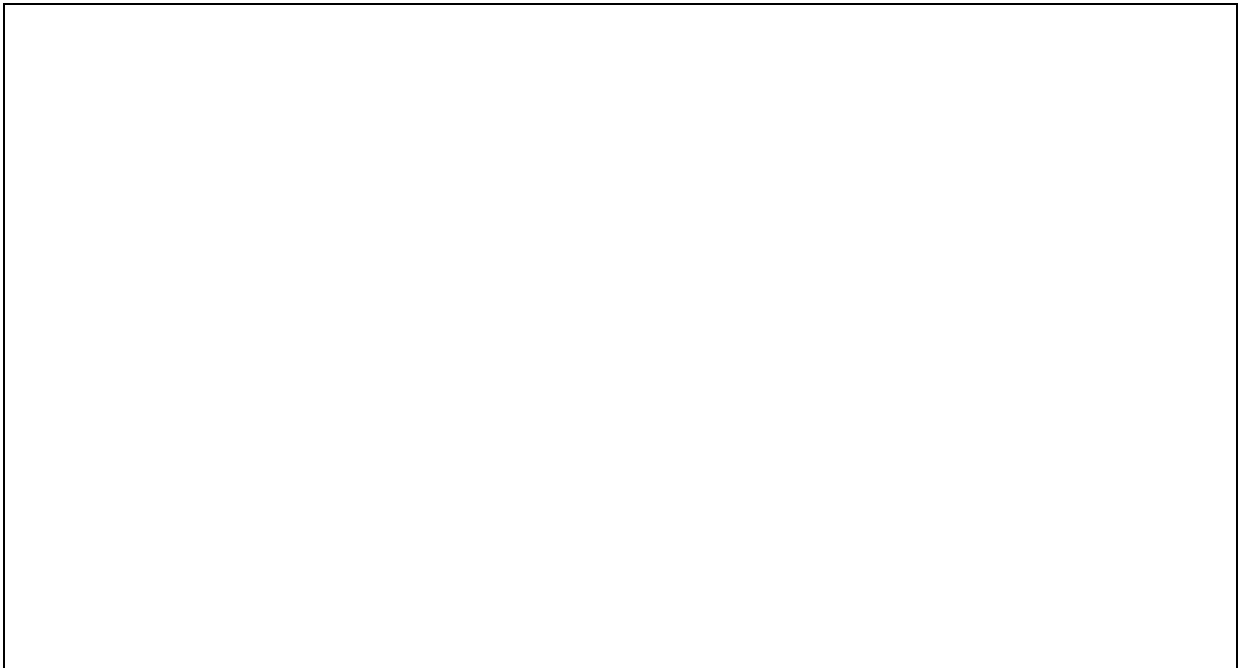
NOTE

If the name and/or the address in which you hold either or both of the above accounts are different from the name and address given for the purposes of this application, please specify that in which it/they are held.

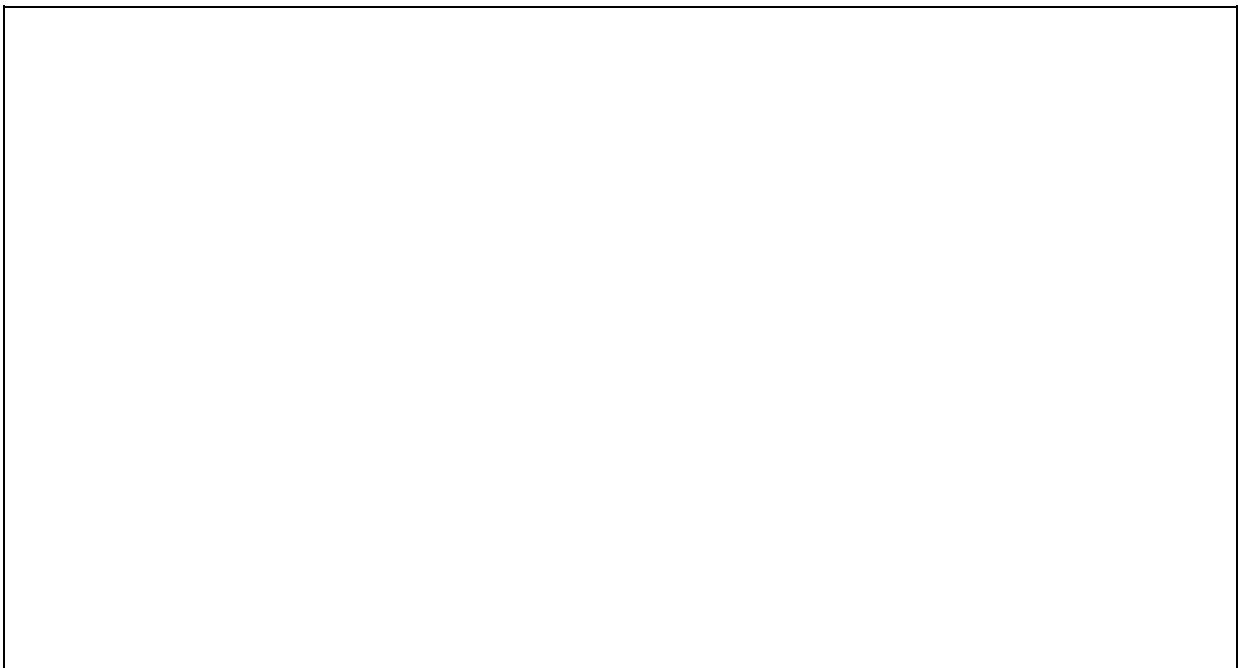
Name

Address

5. Please specify the subject on which you wish to communicate with other members of the society and the points you would wish to make in your communication. Please also enclose a draft of your proposed communication.



6. If there is any other information or documents, in addition to your draft communication, you would wish to form part of your application, please specify.



DECLARATION

7. I declare that I am qualified under the rules of the society named above to make this application.

8. I understand that this application form, and any information or documents enclosed with it, may be sent to the society, which may make representations about it to the FSA.

9. I have read and understand the statutory restrictions which will restrict me from disclosing any information I take from the register if I am given access to it.

10. I enclose payment of £25 in respect of this application. I understand that this fee is not refundable.

Signed

Date

CHAPTER 2	
Merger procedures	
2.1	Introduction
	Purpose of the chapter
2.1.1	<p>G This chapter ultimately derives from the Merger Procedures Guidance Note issued by the Commission in May 1999. It gives guidance on the requirements of the 1986 Act, as amended by and under the Act, under which certain functions of the Commission were transferred to the Authority. This chapter is not intended to be exhaustive and is not a substitute for looking at the 1986 Act and the Mergers Regulations 1987 (SI 1987/2005) as amended by the Mergers (Amendment) Regulations 1995 (SI 1995/1874), the Merger Notification Statement Regulations 1999 (SI 1999/1215), where applicable, and a society's own Rules. Nor is it a substitute for the society seeking its own legal advice. It gives a description of the relevant provisions of the 1986 Act, of the information which must be made available to the Authority and to societies' members, together with an outline of the procedures to be followed at general meetings, and the voting majorities required to pass the Merger Resolutions which the members are to be asked to approve. This chapter describes the role of the Authority in approving the statements to members under Schedule 16 to the 1986 Act, in its prudential supervision of mergers, and in confirmation hearings. It also gives a broad indication of the way in which the Authority may be expected to exercise its discretionary powers. Except as described in section 6, to which section 7 of this chapter also applies, this chapter is concerned only with voluntary mergers under Sections 93 and 94 of the 1986 Act.</p>
2.1.2	<p>G It is for the boards of societies to assess the case for a merger, and they must explain and recommend their decision to their members. However the Authority's staff are available to give advice on the procedures to be followed and the information required to ensure that the members can reach fully informed decisions. Societies are strongly recommended to consult the Authority early on in the formative stages of merger discussions. Such consultation will, of course, be treated in the strictest confidence. It will also be helpful to have regard to the indicative timetable set out in paragraph <i>BSOG 2.8.3</i>.</p>
2.1.3	<p>G Societies should consult their own legal advisers about the application of the provisions of the 1986 Act, and the general law, to the particular features of a proposed merger.</p>
2.1.4	<p>G This chapter considers each stage of the merger procedure in chronological order. The remainder of this section gives a synopsis of the relevant requirements of the 1986 Act, which are then discussed in more detail in subsequent sections:</p>
	<p>(1) Section 2.2 - Preliminary Matters, considers the rationale for a merger and its terms and the handling of public announcements, and</p>

			gives guidance on certain prudential issues.
		(2)	Section 2.3 - Information Provided to Members, discusses the form and content of the statutory Schedule 16 Statement and the accompanying rationale and statements by the board of the society, and describes the form of application to be made to the Authority for approval of the Statement.
		(3)	Section 2.4 - General Meetings and Resolutions, discusses the resolutions and majorities required to pass them, the notice of meeting, the register of members and members' entitlement to vote, the arrangements for general meetings and the scrutineers' report. It also describes the Authority's discretionary powers.
		(4)	Section 2.5 - Confirmation, describes the form of application to the Authority for confirmation of a merger, and the procedures which the Authority expects to follow in considering and hearing written and oral representations and in reaching its decision.
		(5)	Section 2.6 - Transfer of Engagements under Direction, describes the modified procedure to be followed when a society has been directed by the Authority to transfer its engagements to another society and/or to proceed by board resolution.
		(6)	Section 2.7 - Registration and Dissolution, briefly discusses the process of registration of amalgamations or transfers of engagements and dissolution of the amalgamated or transferor societies.
		(7)	Section 2.8 - Timetable, reviews the expected timetable, including statutory notice periods, which may be expected to apply to a merger from start to finish.
Statutory requirements			
2.1.5	G	The statutory provisions concerning mergers are in Sections 93 to 96 of, and Schedule 16 to, the 1986 Act, where three types of transaction are provided for:	
		(1)	Amalgamation, where two or more societies unite to form a new "successor" society;
		(2)	Transfer of engagements, where a society (the transferor) transfers its membership and the whole of its undertaking to another (the transferee), which then continues as before; and
		(3)	Partial transfer of engagements, where a society transfers only a part of its membership and business to another society (for example, some outlying branches).
		The procedures for all three are much the same, and the differences are explained in the relevant sections of this chapter. The Authority's practice as described in this chapter is derived exclusively from previous experience	

		of transfers of engagements because, so far, there have been no amalgamations nor partial transfers under the 1986 Act. However, it is not expected that the Authority's handling of amalgamation procedures would be significantly different from what is described here.
2.1.6	G	The purposes of the provisions of the 1986 Act are to ensure that the members are given all the material information they need about the terms of the merger which they are asked to approve and a proper opportunity to cast their votes. Subsequently, they are to be given the opportunity to make representations about that process before the merger is confirmed.
2.1.7	G	The 1986 Act makes no provision for a merger to be initiated by any other means than a proposal by a board put to the society's members. It requires that each member who is entitled to receive notice of the general meeting at which the Merger Resolutions are to be moved must also receive a copy of the Schedule 16 Statement. A merger must be approved by a shareholding members' resolution and a borrowing members' resolution. There is an additional voting requirement for the approval of a partial transfer of engagements.
2.1.8	G	If the terms of a merger include provision for the payment of compensation to directors or other officers for loss of office or of income, then the proposed payments must be approved by a separate special resolution. A further special resolution may also be required if there is to be a distribution to members which exceeds the limits described in paragraph <i>BSOG 2.4.4</i> .
2.1.9	G	Sections 93 to 96 of the 1986 Act specify certain procedures for the consideration of representations by interested parties concerning confirmation, and the criteria which the Authority must consider before deciding whether or not to confirm a merger. The Authority may not consider matters concerning the merits of merger proposals or the fairness of the terms which the members have approved by passing the Merger Resolutions.
2.1.10	G	The statutory requirements of the 1986 Act are explained and discussed in more detail in subsequent sections of this chapter. In addition, societies and their advisers must have regard to the legislation mentioned below.
Enterprise Act 2000		
2.1.11	G	Societies should inform the Office of Fair Trading of a proposed amalgamation or transfer of engagements where the UK turnover associated with the enterprise which is being acquired exceeds £70 million or the enterprises which cease to be distinct supply or acquire goods or services of any description and, as a result of the merger, together supply or acquire at least 25 per cent of all those particular goods or services of that kind supplied in the UK or in a substantial part of it.
		The OFT has a function to obtain and review information relating to merger situations, and a duty to refer to the Competition Commission for further investigation any relevant merger situations where it believes that it is or may be the case that the merger may or may be expected to result in a

		<p>substantial lessening of competition.</p> <p>It is essential that any submission to the OFT is undertaken at the earliest possible opportunity since, should the OFT decide to refer a merger to the Competition Commission that would be a “material fact” to be disclosed in the Schedule 16 Statement, unless it is impracticable to put the matter to members until the Competition Commission has reported.</p>
Transfer of Undertakings (Protection of Employment) Regulations 2006 (SI 2006/246)		
2.1.12	G	<p>These Regulations have the effect that the employees of a transferor society automatically become the employees of the transferee society following the merger. They require, in particular, information to be given in certain cases to employees’ representatives, long enough before the merger takes place, to enable consultations to be held between the society and those representatives. Failure to inform or consult in this way is a ground for reference of the matter to an employment tribunal and there are other significant provisions. Societies are advised to consult "A Guide to the 2006 TUPE Regulations for Employees, Employers and Representatives" which explains the Regulations and which is available from the TUPE section of the Department of Trade and Industry Employment Matters webpage, under the heading "Trade Unions and collective rights" – see www.dti.gov.uk/employment/.</p>
Taxes Acts		
2.1.13	G	Societies should take advice on the timing and amount of tax liabilities.
Electronic Communications Order 2003		
2.1.14	G	<p>Societies should be aware that this Order modifies various relevant provisions of the 1986 Act. This enables the use of electronic communications between societies, their members and other persons on matters relating to a proposed merger, such as the Schedule 16 statement and the voting arrangements. The Order requires that societies must obtain consent before using electronic means of communication. The remaining text of this chapter has not been amended to take account of the Order. A society proposing to use electronic communications in relation to a merger will need to take its own legal advice as to how the procedures described in this chapter will have to be adapted. In that event the Authority will also adapt its own procedures appropriately.</p>

2.2	Preliminary matters	
	Rationale for a merger	
2.2.1	G	It is a matter for the board to decide whether to recommend a merger to its members. The overriding duty of the board is to reach a view having regard to what is in the best interests of the society, and its members as a whole, both present and future, borrowing members and shareholding members. The board may also reasonably consider the interests of customers who are not members, of the staff, suppliers of goods and services, and of the wider community.
2.2.2	G	A well planned and well matched merger can benefit both the shareholding and borrowing members and the staffs of both societies by producing a combined society with the financial strength and management expertise and experience needed to compete successfully in the market place. It must be recognised, however, that in many instances it will take time for economies of scale to be achieved and a careful assessment of projected costs is essential to a realistic view of whether such economies are likely to be achievable. On the other hand, a merger between two weak and over-extended societies may produce an even weaker one. It is better to negotiate a merger from a reasonably secure position than to be obliged to seek a merger when the society has become too weak to carry on as an independent entity.
2.2.3	G	This chapter cannot deal exhaustively with all the factors to be taken into account by a board when deciding whether to recommend a merger to its members. Moreover, there will be factors peculiar to particular cases. However, the following paragraphs draw attention to those matters which the Authority expects boards to consider in all cases.
2.2.4	G	Consideration of a merger can normally be expected to emerge from the board's regular consideration of the strategic options available to the society. That is not to say that merger as a transferor society should always figure as an option in every society's corporate plan. On the other hand, every board should be alive to business trends which point to, or which, if not altered, will point to, the need to consider options for merger. In short, a merger should be foreseen and planned. Alternatively, of course, a board which wishes its society to remain independent must have a clear strategic view of how that can be achieved in a variety of realistic planning scenarios. Whether or not a board is considering a merger, it should as a matter of prudence, know how it would respond to a proposal or counterproposal to merge or to transfer its business to a commercial company.
2.2.5	G	If a board foresees the possibility of a merger, then it should plan for that eventuality. Societies which see themselves as transferees will need to consider the desired characteristics of potential partners, including, for example, geographical presence, mortgage book quality, and product market share. Societies contemplating the transfer of their engagements will need to consider whether the interests of their members would best be served by a local or regional alliance or access to a national network of branches and

		services. The board may also reasonably consider the interests of customers who are not members, of the staff, suppliers of goods and services, and of the wider community. It is also reasonable, particularly for local and regional societies, to consider the implications for the local economy, where, for example, a regional or head office may eventually be closed to achieve economies of scale.
2.2.6	G	The range of issues which both boards have to consider will vary from case to case and is for the board to decide. At one end of the scale there will be the case where a small society merges with a large one and, at the other end, where two or more societies of broadly comparable size join to form one significantly larger. Whatever the proposal under consideration the board will necessarily have regard to this primary duty to reach a view on what is in the best interests of the society, and its members as a whole. It will also be conscious of the need to give an account of the board's rationale in recommending the merger to members, in particular if a statutory merger statement is included in the Merger Document (see paragraph <i>BSOG</i> 2.3.23).
Terms of a merger		
2.2.7	G	The terms negotiated between the parties in a merger will be set out in a formal agreement. In the case of a transfer of engagements, Section 94(6) of the 1986 Act requires the "extent of the transfer", and in practice the other agreed terms, to be recorded in an Instrument of Transfer. For an amalgamation, Section 93(2) of the 1986 Act requires the parties to agree on a Memorandum and Rules for the successor society, and each to approve the terms of the amalgamation by Merger Resolutions, so that there must be agreement on the terms. The Authority will expect the Instrument of Transfer or amalgamation agreement to be signed before the Authority approves the Schedule 16 statement, although it will be conditional on, among other things, approval by members and confirmation by the Authority. In both cases the boards of the societies will have approved the Instrument or agreement and the Schedule 16 statement and, in the case of an amalgamation, the Memorandum and Rules of the successor society. Before such approval by the boards, drafts of the proposed Memorandum and Rules should have been cleared with the registration team. The Rules of transferee societies should provide that members of transferor societies are not disenfranchised for any period after the merger is effected (see paragraph <i>BSOG</i> 2.3.16 and rule 4(9) of the BSA Model Rules 5th edition).
2.2.8	G	Although vesting of the "property, rights and liabilities" of the transferor society in the transferee society on completion of a transfer of engagements is a statutory process by virtue of Section 94(8) of the 1986 Act, the Instrument of Transfer performs an important function. Not only is it required by the 1986 Act, but it is required to identify the extent of the transfer (Section 94(6)), since a transfer can be of all or part of the engagements of the transferor society. Thus, on a transfer of all the engagements of a society, the Instrument of Transfer should include a specific statement that all are included. If the transfer is of part only, then the instrument should specify precisely what is being transferred. As

		explained, an amalgamation agreement is required in practice for all amalgamations, but again the actual process of transferring the assets of the societies to, and vesting them in, the new society is by operation of the 1986 Act. Section 93(4) of the 1986 Act, which does this, does not allow for exceptions to the vesting since the nature of an amalgamation is that all the assets of all the societies are vested in the successor society.
2.2.9	G	The Instrument of Transfer, or amalgamation agreement, will also allow matters of detail to be recorded. So it will contain, for example, provision for:
		(1) any changes to the terms and conditions of PIBS and share and deposit accounts, including the integration of the product lines of the transferor society(ies) into those of the transferee or successor society;
		(2) any changes to the terms and conditions of mortgage accounts and other loans;
		(3) any bonus to be paid to members;
		(4) the terms and conditions on which staff will be employed or made redundant;
		(5) pension scheme arrangements;
		(6) integration of operations;
		(7) the terms and conditions on which directors and other officers are to continue in office or cease to hold office, including the posts they will hold and any extra-contractual compensation to be paid for loss of office or reduction in emoluments;
		(8) the specified target date for completion of the merger, bearing in mind that the actual date is a product of the 1986 Act (Sections 93(3)(b) & (4) and 94(8)), and for action if that date is not achieved;
		(9) any conditions precedent, such as members' votes and the Authority's confirmation, and for the circumstances in which the Instrument or amalgamation agreement might be terminated.
Bonus Payments to Members		
2.2.10	G	Whether any bonus is to be paid to members and, if so, its amount and distribution, are matters to be agreed by the boards of the societies concerned and to be approved by their members, subject to the discretion described in paragraphs <i>BSOG</i> 4.41 and <i>BSOG</i> 4.42. However, the Authority will wish to be satisfied that the combined society will maintain a prudent level of capital resources after the bonus is paid. A bonus may, for example, be paid to the members of a transferor society with a higher capital ratio than the transferee society so as to equalise the reserves which both bring to the combined society. If it is thought desirable also to pay a bonus

		to the members of the transferee society, then the reserves of the combined society may be “equalised” at a level below the capital ratio of the transferee society, but only if it is prudent to do so. The statutory requirements for approval of bonus payments are described in paragraph <i>BSOG 2.4.4</i> .
2.2.11	G	A bonus is a distribution of the funds of either or both societies, and may be paid by a number of methods, or some combination of them, including, for example: a flat rate lump sum; a sum calculated as a percentage of balances; or an increase or (for mortgage accounts) a decrease in the interest rates paid or charged for a limited period. Maintenance of interest rate differentials existing before the date of completion of the merger between those offered by (say) the transferor society and the transferee society would not normally be characterised as a bonus. However, each society, and the Authority, will wish to be satisfied that any differential is consistent with its established pricing policy and is not the result of a change adopted, for example, when the society decided to seek a merger. Each case where interest rate differentials are to be maintained, for whatever period, will need to be considered to determine whether or not it constitutes a bonus, and societies may wish to take professional advice on the matter.
Compensation to Directors and Other Officers		
2.2.12	G	<p>Any compensation proposed to be paid to directors or other officers must be disclosed in the Schedule 16 Statement and approved by a separate special resolution of the members (see paragraphs <i>BSOG 2.3.11</i> and <i>BSOG 2.4.3</i>). “Compensation” is not defined in the 1986 Act, except to the extent that section 96(8) says that it includes benefits in kind. In the Authority’s opinion, compensation does not include statutory redundancy payments, damages for breach of contract or other payments, for example, falling due under the terms of a pre-existing contract of employment, or a pre-existing arrangement giving rise to a reasonable expectation. However, it does include any proposed ex-gratia payments in money or money’s worth. Societies should consider very carefully the extent to which any proposed payment may exceed the amount provided for by statute or contract. In view of the requirement in Section 96(3) of the 1986 Act that unauthorised payments must be repaid by the recipient, societies are advised to take legal advice on any payments which are not specifically authorised by the terms of a resolution passed by the members in accordance with Section 96(1) of the 1986 Act. All proposed payments requiring approval by such special resolution should be disclosed in the Schedule 16 Statement under the power in paragraph 1(4)(f) of that Schedule. In addition, the Schedule 16 Statement should disclose any other payments to directors or other officers arising directly from the merger. So that members are aware of the direct interest of the directors or other officers in a merger, societies should consider whether the amount, as distinct from the fact, of statutory or contractual payments should be disclosed where these arise directly from the merger.</p> <p>More generally, societies need to consider whether any facts relevant to any director or other officer, or to any person(s) connected with them, should be disclosed where these are material to the interests of the members who are</p>

		to be asked to vote on the proposed merger. In determining the amount of compensation which might be justified, the board must strike a balance between fairness to the individuals who will suffer a loss of income and the interests of the members, bearing in mind that the compensation will be at a cost either to any bonus to the members or to the reserves to be transferred to the combined society.
Public announcement		
2.2.13	G	Boards of both societies may wish to announce a merger proposal as soon as agreement in principle has been reached between them and, in particular, to inform their members and staff of the proposed terms. However, boards will often wish to delay an announcement for as long as possible, perhaps for prudential or commercial reasons, or because they first wish to settle all the details of the proposed terms. Societies with listed PIBS will need to have regard to the Authority's requirement concerning early disclosure of information affecting the price of securities. Subject to this, there is no objection to delay, in principle, and there may be good reasons for it. Unfortunately, experience shows that every day's delay after agreement in principle has been reached carries an increasing risk of premature leak. Indeed, the very reasons for delay may make the merger a subject for intense speculation and increase the risks of a leak. In these circumstances then, boards must have contingency plans to make an early announcement to deal with any potentially damaging rumours and to avoid members being misled or left in a state of uncertainty.
2.2.14	G	The announcement, particularly information provided directly to members and staff, should make it clear that the merger proposal is subject to approval by the members and completion of the statutory procedures. Boards should be careful to avoid giving even the impression that the outcome is a foregone conclusion, and should indicate any matters of substance on which the proposed terms of the merger remain to be settled. Briefing of staff who will be responsible for responding to enquiries from members and the press should be considered carefully and prepared in advance of the announcement to avoid any risk of members being unintentionally misled.
2.2.15	G	The Authority is not required to approve the content or wording of announcements or preliminary information sent to members. However, it will be happy to comment on drafts shown to it at an early stage, and may be able to help societies to avoid unintentionally misleading statements.
Prudential issues		
2.2.16	G	Before a firm proposal is agreed, the participating societies should consult with the Authority's staff to discover whether there is any prudential objection to the proposal. The Authority will need to be satisfied that the combined society will be managed prudently from the date of completion of the merger and comply with the Principles for Businesses and with all the relevant rules made by the Authority. The Authority will also wish to know that post-merger arrangements and agreements provide for the proper integration or rationalisation of the operations of the combined society, and

		of its connected undertakings, joint ventures or arrangements with third parties (for example, for the provision of unsecured loans, insurance and investment services) and that any commercial conflicts of interest have been resolved.
2.2.17	G	In all cases, prudential information should be provided, but the amount of information will depend upon the circumstances of each case. For example, if a merger involves societies of much the same total asset size, or where the merger will result in a significant increase in the transferee society's assets, or involves a change of strategy, new kinds of business or carrying on business in a new geographical area, the Authority will expect substantial prudential information and societies should also expect this to form the basis of more detailed discussions with the Authority's staff. On the other hand, in a merger where a small society is transferring its engagements to a very much larger one, the prudential information to be provided is likely to be that much less. In all cases the Authority will ask for the prudential information at an early stage so that there is adequate time for discussion before it is asked formally to approve the Schedule 16 Statement.
2.2.18	G	Boards should note, however, that while the Authority will expect the kinds of information described here, it is for the boards themselves to exercise due diligence and to be satisfied that the merger and its terms are prudent and in the interests of their members.
2.2.19	G	As is noted, the Authority's need for prudential information can be expected generally to relate to prudential issues, but societies may find it helpful to note the following paragraphs which describe some of the particular issues which the Authority will expect to be addressed.
Direction and management		
2.2.20	G	Current and future board composition and succession plans for, say, the three years immediately following the merger.
2.2.21	G	Current and future senior management and structure, indicating spans of responsibility (which may most easily be presented in chart form) and any areas where there may be a need for additional expertise or experience to be acquired by the combined society with plans and timescale for acquiring such expertise.
Accounting and control systems		
2.2.22	G	Generally, outline plans and timetables for the integration of accounting, control and inspection systems, including the linking or harmonisation of computer systems. This may usefully be divided between initial or short term arrangements and foreseen longer term developments. More particularly, the information should include arrangements to ensure continuity and the integration of:
		(1) accounting records;
		(2) systems of internal control, including management information

			systems and IT systems; and
		(3)	systems of inspection (internal audit)
		For all significant mergers the Authority will wish to receive, prior to the effective date of the merger, a letter from the transferee society's external auditors stating whether, in their opinion, the accounting records and systems of control and of inspection established for the merged society will be effective from the effective date.	
Business plan			
2.2.23	G	The rationale for the merger will need to be explained and justified in full, including existing and potential future business and marketing opportunities, the benefits of geographical concentration or diversification of business, economies of scale (particularly administrative), and future funding and lending strategies. Proposals for rationalisation or integration of administrative offices and branches will need to be set out in full, including the implications of the proposed merger for the terms and conditions of staff employment and their future job prospects with the combined society.	
Financial prospects			
2.2.24	G	Information on the financial prospects for the combined society will need to include:	
		(1)	estimates, broken down to an appropriate level of detail, of short term additional costs and long term savings (if any) anticipated from the merger; and
		(2)	revenue account, balance sheet and solvency ratio projections for the first three to five years of operation.
		This information must be supported by statements of the assumptions on which it has been based. In addition, the effect of changes on those assumptions should be illustrated, from a best case to a worst case scenario.	
Connected undertakings and agencies			
2.2.25	G	The integration and future operation, management and control of connected undertakings, together with arrangements with other parties for the continuing provision of services under agency agreements, should be described in full.	

2.3	Information Provided To Members	
	Statutory requirements	
2.3.1	G	Part I of Schedule 16 to the 1986 Act requires a building society which desires to merge with another society to send to every member entitled to notice of a meeting of the society a statement concerning the matters specified in the Schedule. The statement is to be included in or with the notice of the meeting at which the Merger Resolutions are to be moved. No statement shall be sent unless its contents, so far as they concern the specified matters, have been approved by the Authority. Where the transferee society has obtained the consent of the Authority to proceed by board resolution then it is exempt from this requirement (see paragraphs <i>BSOG 2.4.41</i> and <i>BSOG 2.4.42</i>).
2.3.2	G	Meeting arrangements and resolutions are discussed in section 4.
The Schedule 16 Statement		
2.3.3	G	The Schedule 16 Statement must set out the present financial positions of each of the merging societies, the terms of the merger agreed between them and summarise the main provisions of the Instrument of Transfer. It must also include any other matter which the Authority may require. In the case of an amalgamation, the Statement must additionally include the proposed Memorandum and Rules of the successor society which are to be approved by the special resolution required to approve the merger (Section 93(2) of the 1986 Act), as well as the terms of the amalgamation agreement between the societies.
2.3.4	G	The Schedule 16 Statement does not have to be a discrete document. In fact it will usually be convenient to include it in a comprehensive Merger Document also containing the board's rationale for recommending the merger, the notice of the meeting at which the Merger Resolutions are to be moved, an explanation of the merger procedure (including details of the confirmation stage - see section 5) and a description of the requirements of the society's Rules concerning entitlement to vote. However, the Schedule 16 Statement within the Merger Document should be clearly identified as such (either by printing it on a different colour of paper or by some other means). An example of a pro forma Merger Document is given in Annex 1.
2.3.5	G	The required contents of the Schedule 16 Statement are discussed in detail in the following paragraphs.
The financial position		
2.3.6	G	Paragraph 1(4)(a) of Schedule 16 to the 1986 Act requires the Statement to contain information concerning the financial position of each of the societies participating in the merger. The members should be given sufficient information to enable them to gain an accurate understanding of the key financial features of their businesses. The information will include

		a balance sheet, recent results and certain financial ratios; for this purpose it is necessarily rather more detailed than is required for the annual Summary Financial Statement. In addition, further information will be required concerning accounting policies and other matters, as set out in paragraph <i>BSOG 2.3.10</i> .
2.3.7	G	The information should comprise consolidated accounts of each society and its connected undertakings prepared at a common balance sheet date which should be no more than 6 months before the date on which the Statement is approved by the Authority, or the date on which the Statement is to be sent to the members if that is expected to be significantly later. Information regarding results should relate to the relevant period ending on the chosen balance sheet date. The figures may be derived from audited or unaudited accounts. In either case, the source must be stated. If unaudited figures are used, the Authority will require a “letter of comfort” from the relevant society’s external auditors confirming that, in their opinion:
		(1) the figures have been correctly abstracted from the society’s records;
		(2) the financial information is not misleading in the context in which it appears; and
		(3) in reviewing the data relating to the Statement, nothing has come to their attention which would cast doubt on the directors’ statement (see paragraph <i>BSOG 2.3.8</i>) that there has been no material change affecting the information given.
2.3.8	G	Since the financial information will necessarily relate to a period ending somewhat before the date of approval of the Schedule 16 Statement, the board is required to state whether or not there have been any material changes to the financial position in the interim. If the effect of a change cannot be quantified, it must be described so that the members at least know that it has been identified and is relevant to their consideration of the proposed merger. Failure to disclose such changes will be relevant to the Authority’s subsequent consideration of the society’s application for confirmation of the merger (see paragraphs <i>BSOG 2.5.4</i> , <i>BSOG 2.5.12</i> and <i>BSOG 2.5.13</i>).
2.3.9	G	Differences in accounting policies could result in some loss of comparability between the financial information given for each society. Some adjustments to the figures may, therefore, be necessary to give the members a proper understanding of the societies’ relative financial positions. Any adjustments made should be explained by way of a note. If there are no significant differences in accounting policies, then that should be stated for the avoidance of doubt.
2.3.10	G	Notes to the financial position should also provide information on the following matters:
		(1) the book amounts and market values of listed securities held as liquid assets;

		(2)	the book amounts and current market values of land and buildings; with an indication of the basis on which current market value has been determined;
		(3)	any significant differences in policy or practice with regard to the depreciation and estimated asset lives of tangible fixed assets;
		(4)	pension arrangements of each society including, for funded schemes, details of latest actuarial valuations;
		(5)	summary information on the business of connected undertakings;
		(6)	an estimate of the costs and benefits of the proposed merger.
Interests of Directors and Other Officers			
2.3.11	G	Subparagraphs 1(4)(b) and (c) of Schedule 16 to the 1986 Act require the Statement to disclose any interests of the directors in the merger and any compensation to be paid to them or other officers. This information must be comprehensive and clear. It should include the following:	
		(1)	the interests of the directors in the merger, including appointment of existing directors to the main board or local board of the combined society, or to any other position with that society, together with any significant resultant change in present or expected future levels of fees or other emoluments and benefits in kind;
		(2)	any compensation payable to directors or other officers for loss of office or reduction in emoluments, and the basis on which it is calculated; if a global sum is proposed to be given to a group of persons, the intended manner of apportionment should be stated (see paragraph <i>BSOG 2.2.12</i>);
		(3)	any payments to be made to directors or other officers arising from the merger, whether provided for in contracts of employment or under covenant or some arrangement giving rise to a reasonable expectation;
		(4)	any proposed benefits to directors or other officers by way of fees for professional services, stating the nature of the services to be provided and the anticipated annual fee income; and
		(5)	any other benefits to directors or other officers, or to any persons connected with them, arising from, or as a consequence of, the merger.
2.3.12	G	If the directors or other officers have no material interest, either by way of change in remuneration, as widely defined above, or by payment of compensation for loss of office or in any other form, for example, a pension, this should be stated explicitly, for the avoidance of doubt.	

	Bonus Payments to Members	
2.3.13	G	Paragraph 1(4)(d) of Schedule 16 to the 1986 Act requires the Statement to specify the bonus, if any, to be paid to members in consideration of the merger. The Authority's views on what may, or may not, be regarded as bonus are given in paragraph <i>BSOG</i> 2.2.11, and the statutory requirements for approval of bonus payments are described in paragraph <i>BSOG</i> 2.4.4.
2.3.14	G	The method of calculation of a bonus should be explained in the Schedule 16 Statement; for example, x% of the lower of the share account balances held at the end of the last financial year and those balances held on the effective date of merger (giving precise dates and times for calculating the balances), and the estimated maximum total amount payable to members. The effect on the reserves of the combined society should be shown by stating the estimated gross and net costs of the bonus and the resulting reduction in the reserve/asset ratio (see also <i>BSOG</i> Annex 1, items A.3 and B.6). The ratio of gross capital to shares and borrowing of the combined society, after allowing for the net cost of the bonus to be paid to members, should be estimated to be x%, and on the same basis of calculation, but not accounting for the bonus payment, the ratio should be estimated to be y%.
	Other Matters	
2.3.15	G	As is noted in paragraph <i>BSOG</i> 2.2.9, the Instrument of Transfer (or amalgamation agreement) will normally make provision for a number of matters in addition to those concerning the interests of directors and other officers and any bonus to be paid to the members. Such matters must be explained in the Schedule 16 Statement, together with any other matters of which the Authority may require particulars to be given (see paragraph 1(4)(f) of Schedule 16 to the 1986 Act). They are discussed in the following paragraphs.
2.3.16	G	Post-merger membership rights should be secured by the adoption of BSA Model Rule 4(9) (Fifth Edition, November 1997) or a similar Rule to the same effect. The purpose of the Rule is to ensure that members of a transferor society are not disenfranchised. It provides that they are deemed to have been members of the transferee society from the date when they became members of the transferor society. Societies' Rules, in conformity with the 1986 Act, must provide, inter alia, that a member is entitled to vote on a resolution of the society if he was a member at the end of the last financial year before the voting date and on the voting date. If, for example, a transferee society has a financial year ending on 31 December, its AGM in the following April and the effective date for a merger is in March, then the deemed membership Rule will enfranchise those who were members of the transferor society on or before 31 December. The existence, or absence, of this Rule must be recorded in the Schedule 16 Statement in any case where it is likely to have any significant effect on members' rights.
2.3.17	G	Proposed changes to the terms and conditions of share and deposit accounts must be fully and clearly explained in the Schedule 16 Statement. In a transfer of engagements, shares and deposits held with the transferor society

		will become held with the transferee society. Such accounts will either be transferred into the nearest equivalent account of the transferee society, become new products of the transferee society, or continue on existing terms but be closed to new investors. It is most helpful to tabulate the proposed integration of accounts in a schedule listing the accounts of the transferor society opposite the accounts of the transferee society to which they are to be transferred, together with the interest rates payable, or proposed to be paid, on each account. A similar presentation will be required to show the proposed integration of accounts in an amalgamation. In preparing this the provisions of Section 8 of the 1986 Act should be borne in mind.
2.3.18	G	Proposed changes to the terms and conditions of mortgage accounts must be explained (see paragraph 1(4)(e) of Schedule 16 to the 1986 Act). Alternatively, if no changes are proposed to be made, the Schedule 16 Statement must include an assurance to that effect, for the avoidance of doubt.
2.3.19	G	Terms and conditions of employment of staff, including any special bonus or other benefits in connection with the merger, as provided by the Instrument of Transfer (or amalgamation agreement), must be set out. In addition, the Authority will require the Schedule 16 Statement to include an explanation of the Board's intentions with regard to the closure or integration of head office departments and branches, any reductions in the number of staff employed and redundancies, insofar as these matters are not provided for in the Instrument of Transfer (or amalgamation agreement).
2.3.20	G	Future pension arrangements for staff, directors and other officers, as provided by the Instrument of Transfer (or amalgamation agreement), are to be set out.
2.3.21	G	Finally, the conditional and termination clauses of the Instrument of Transfer (or amalgamation agreement) should be summarised.
		Board Rationale and Statements
2.3.22	G	A board putting a merger proposal to its members has, in addition to its statutory duty to provide a Schedule 16 Statement, a fiduciary duty to provide its members with essential factual information and a fair assessment of the issues so that they can take informed decisions on whether to approve the board's proposals. The Authority, therefore, expects that the Merger Document (see paragraph <i>BSOG</i> 2.3.4) will include an explanation by or on behalf of the board of the reasons for the merger and the choice of merger partner. This rationale should give a fair assessment of the advantages and disadvantages of the merger and should be entirely consistent with the facts set out in the Schedule 16 Statement. In addition to explaining the rationale and its consequences for the members, it should explain the effect on the staff's terms and conditions of employment and expectations for future employment prospects. The planned timescale for integration of the businesses should also be explained.

2.3.23	G	<p>The 1986 Act requires that members must be notified of written non-confidential proposals to their society either to merge with another society or to be taken over by a commercial company. Part II of Schedule 16 to the 1986 Act imposes a duty to send a merger statement to members, advising them of a proposal to merge, and Part IA of Schedule 17 to the 1986 Act imposes a like duty to send a transfer proposal notification, advising them of a proposed takeover. If a proposal of either kind has been received, then notification of the prescribed particulars must be sent to every member entitled to notice of a meeting, either separately or together with every notice of the society's annual general meeting, and (where such notification has not already been given) must be included with every notice of the special meeting at which Merger Resolutions are to be moved.</p>
2.3.24	G	<p>Where notification of takeover or other merger proposals accompanies the notice of a meeting to consider Merger Resolutions, then</p>
		<p>(1) any merger statement must give notice of the fact that a written merger proposal has been received unless notice has already been given to members, or it was received 42 or less days before the meeting, with details of the identity of the proposer, with or without particulars regarding the proposal. If the proposer requests in writing that the proposal be treated as confidential, disclosure is not required. The merger which the members are being asked to vote upon need not be the subject of a merger statement.</p>
		<p>(2) any transfer proposal notification must give notice of the fact that a written proposal has been received with details of the identity of the proposer, with or without particulars regarding the proposal. If the proposer requests in writing that the proposal be treated as confidential, disclosure is not required.</p>
		<p>An invitation to discuss a possible proposal probably would not constitute a proposal within either Schedule. Provision of merger or transfer proposal statements is a statutory requirement. Provided they accompany the notice of meeting, they may be included in a Schedule 16 Statement, or alternatively may more conveniently be included as one or more discrete paragraphs within the board's rationale explaining its choice of merger partner.</p>
2.3.25	G	<p>The rationale itself is not a statutory requirement, and is not subject to approval by the Authority. However, the Authority will take account of the information it provides when considering whether to confirm the merger (see section <i>BSOG 2.5</i>, particularly paragraphs <i>BSOG 2.5.9</i> and <i>BSOG 2.5.12</i>). Societies will, therefore, find it helpful to consult the Authority's staff about the drafting and content of the rationale.</p>
2.3.26	G	<p>The whole Merger Document should be covered by a responsibility statement by the directors of each society. This may be given along the following lines:</p> <p>“The directors of Building Society and the directors of Building Society accept responsibility for the information relating to their respective</p>

		societies which is contained in this document. To the best of the knowledge and belief of the directors (who have taken all reasonable care to ensure that such is the case) the information contained in this document is in accordance with the facts and does not omit anything likely to affect the import of such information”.
2.3.27	G	The Authority will require the Schedule 16 Statement to include a statement as to whether or not the merger will conflict with any contractual obligations, including agency agreements, of either society or their connected undertakings.
Application and the Authority’s Approval		
2.3.28	G	A society’s formal application to the Authority for approval of a Schedule 16 Statement is likely to be the culmination of many weeks of discussion with the Authority’s staff who will have reviewed and commented upon a draft or successive drafts of the Statement, having had regard also to drafts of the Instrument of Transfer (or amalgamation agreement) and the prudential information described in section 2.2 Societies should also have cleared any proposed Rule changes or, in the case of an amalgamation, the proposed Memorandum and Rules of the successor society, with the registration team. The probable sequence of events is described more fully in section 2.8. The case where the Authority has consented to a transferee society proceeding by board resolution, and thereby exempting it from the requirement to put Merger Resolutions, and sending a Schedule 16 Statement, to its members, is described in paragraphs <i>BSOG 2.4.41</i> and <i>BSOG 2.4.42</i> .
2.3.29	G	Schedule 16 Statements must be prepared to the same standards as apply to financial statements and directors’ reports. An application to the Authority for approval of a Schedule 16 Statement must be made in writing and should include a declaration made on behalf of the board, that the Statement is complete and includes all material information of which, in the opinion of the directors, the members should be aware. That declaration should say whether or not there have been any other merger or takeover proposals (confidential or otherwise see paragraph <i>BSOG 2.3.23</i>) and confirm that the information about them is correct. The application should be accompanied by the following documents:
		(1) an authenticated copy of the executed amalgamation agreement or Instrument of Transfer, as the case may be;
		(2) two authenticated copies of the final draft of the Merger Document (or documents) in printer’s proof form, including the Schedule 16 Statement, the board rationale, the notice of the general meeting and Merger Resolutions (including, in the case of an amalgamation, the proposed Memorandum and Rules of the successor society), any merger or transfer proposal statements as mentioned in paragraphs <i>BSOG 2.3.23</i> and <i>BSOG 2.3.24</i> , and the directors’ responsibility statements;

		(3)	any other documents, such as a covering letter for the Merger Document(s) and proxy voting forms;
		(4)	an assurance from the chairman of each society that the Schedule 16 Statement is complete, accompanied by a compliance schedule listing the requirements of the 1986 Act and of this chapter for a Schedule 16 Statement and indicating where in the statement of that society that requirement has been met and confirmation that all the interests of the directors and officers are included in it;
		(5)	an assurance by, or on behalf, of the board that the society's systems for verification of membership records are capable of providing the information required to fulfil the relevant requirements of the 1986 Act and the Rules (see paragraph <i>BSOG 2.4.15</i>);
		(6)	a letter of comfort from the society's external auditors as specified in paragraph <i>BSOG 2.3.7</i> ;
		(7)	the appropriate fee as specified in the current Fees Rules;
		(8)	confirmation that the final draft as submitted for approval does not differ from that previously seen by the Authority or, where it does, indicating each change that has been made.
2.3.30	G	The Authority's approval of the Schedule 16 Statement will be confirmed by returning to the society one authenticated copy of the Statement with the Authority's certificate of approval signed by an authorised signatory for the Authority. There is no statutory requirement for copies of Schedule 16 Statements to be placed on the public files of societies but, because the documents are in the public domain, it is the Authority's practice to pass copies to the registration team for filing. Were a public announcement about the merger not to be made until after the Authority had approved the Schedule 16 Statement, the Authority would not pass a copy of the Statement to the registration team until after the announcement. The supporting documents listed above will not be passed to the registration team.	
2.4	General Meetings and Resolutions		
2.4.1	G	This section describes the requirements of the 1986 Act concerning members' entitlement to vote, the register of members and the sending of notices of meetings. It also discusses general meeting arrangements, the resolutions and majorities required and the counting of votes. Finally, it gives guidance on the discretion which the Authority may exercise in these matters. The directors of each society must satisfy themselves that they observe the general law on meetings, the relevant provisions of the 1986 Act and their own Rules.	
Resolutions and Voting Majorities			
2.4.2	G	The 1986 Act provides that a merger must be approved by the requisite	

		Merger Resolutions (Sections 93(2)(c) and 94(2) and (5)(a)) as follows:
	(1)	a shareholding members' resolution (see definition in paragraph 27A of Schedule 2 to the 1986 Act) passed on a poll by a majority of at least 75% of shareholders qualified to vote and voting; and
	(2)	a borrowing members' resolution passed on a poll by a simple majority of borrowing members qualified to vote and voting (see definition in paragraph 29(1) of Schedule 2 to the 1986 Act);
		provided that, in each case, notice has been duly given that the resolution is to be moved as a shareholding members' resolution or a borrowing members' resolution, as the case may be. A member may vote either in person at the meeting or by appointing a proxy (paragraphs 27A(b) and 29(1) of Schedule 2 to the 1986 Act do not provide that the voting on these may be conducted by postal ballot).
		[Note: In the case of a partial transfer of engagements, in addition to the approval of the members as a whole by passage of the shareholding members' resolution and borrowing members' resolution described above, the society must obtain the approval of an "affected shareholders' resolution", which must be passed by the majority of the affected shareholders eligible to vote; that is, those shareholders in respect of whose shares it is proposed that the engagements should be transferred (Section 94(3) and (4)) of the 1986 Act. But note that the resolution must be passed by a majority of the affected members eligible to vote, not just a simple majority of those who actually do vote.]
2.4.3	G	Section 96(1) of the 1986 Act provides that, where a society wishes to pay compensation to directors or other officers for loss of office or diminution of emoluments, such compensation must be approved by a special resolution of the society's members (see also paragraph <i>BSOG</i> 2.2.12), separate from the Merger Resolutions. The special resolution must be passed by a majority of at least 75% of those qualified to vote and voting. The Treasury has not made regulations under Section 96(2) of the 1986 Act to set limits below which compensation may be paid without the authority of a special resolution. Therefore, in every case where compensation is proposed, the members must vote on the proposal as a separate issue from whether they approve the merger itself. "Other officers" include, in addition to the Chief Executive and Secretary, any persons who exercise managerial functions under the immediate authority of a director or the Chief Executive of a society (Section 119 of the 1986 Act defines "manager" and "officer").
2.4.4	G	The members' approval of bonus payments is required as part of the Merger Resolutions (see Section 96(4) to (6) of the 1986 Act) and see paragraph <i>BSOG</i> 2.2.11 for the Authority's view of what may constitute a bonus). If the total gross cost of the proposed bonus(es) (i.e. without any adjustment for prospective corporation tax recovery) is within the prescribed limit, then approval for it need only be included in each of the Merger Resolutions of the society whose funds are to be distributed. If it exceeds that limit then it must be included in each of the Merger Resolutions of each participating

		society. The prescribed limit was changed by the Building Societies (Mergers) (Amendment) Regulations SI 1995/1874 amending SI 1987/2005 and now is:
	(1)	in either a full transfer of engagements or an amalgamation, 5% of the total assets, as stated in the Schedule 16 Statement, of the society to whose members the bonus is to be paid;
	(2)	in a partial transfer of engagements, 5% of the share liabilities, as given in the Schedule 16 Statement, to be transferred;
	(3)	or a sum equal to the society's reserves after deducting its fixed assets (apportioned pro rata in respect of 4.4(2)), whichever is the less. The Regulations should be consulted for the full detail of the calculations.
Entitlement to Vote		
2.4.5	G	Paragraph 5 of Schedule 2 to the 1986 Act provides that no person may be a member of a building society unless he or she is a shareholding member or a borrowing member. A shareholding member is a person who holds a share in the society (that is, an investment in a share account or PIBS). A borrowing member is a person who is indebted to the society in respect of a loan fully secured on land. However, the Rules may provide that borrowing membership is conferred by a loan substantially secured on land, or shall cease if the loan is foreclosed or the land is taken into possession by the society. A minor (that is a person under 18 years of age) may be a member, but may not vote on any resolution.
2.4.6	G	The mandatory provisions of Schedule 2 to the 1986 Act concerning a member's entitlement to vote on a resolution, which must be reflected in societies' Rules, are that the member must be a member on the voting date, must have been a member at the end of the last financial year before the voting date (paragraph 23(1) of Schedule 2) and must have attained the age of 18 years (paragraphs 5(3) and 34(2) of Schedule 2) on or before the date of the meeting. So far as borrowing members are concerned, the member is not entitled to vote in that capacity if his indebtedness to the society at any relevant date is less than £100 (paragraphs 29(2) and 36 of Schedule 2).
2.4.7	G	However, Schedule 2 specifies the following further provisions, some, none or all of which may be included in a society's Rules with respect to the entitlement of shareholding members to vote on any resolution; a person must (see Schedule 2 paragraphs 23(3) to (5) and 36):
	(1)	have a qualifying shareholding (which must not be set higher than £100), in one or more share accounts or PIBS, on the "qualifying shareholding date";
	(2)	hold shares on the voting date; and
	(3)	have held shares continuously between those two dates.

2.4.8	G	<p>The “qualifying shareholding date” is either the last day of the financial year preceding the voting date or, if the voting date falls during that part of a financial year which follows the conclusion of the society’s Annual General Meeting commenced in that year, the first day of the period beginning 56 days before the date of the meeting. Therefore, if a society’s Rules, following the BSA Model Rules (Fifth Edition), include the provisions concerning shareholding and continuity of membership described in paragraph <i>BSOG</i> 2.4.7, and if the voting date is later than the AGM in that year, a person to be entitled to vote on a shareholding members’ resolution must:</p>	
		(1)	have been a shareholding member on the last day of the previous financial year;
		(2)	have held shares to the value of at least £100 on the day 56 days before the date of the meeting;
		(3)	have held shares continuously from the 56th day through to the voting date; and
		(4)	hold shares on the voting date.
		<p>But note that there is no requirement for continuity of shareholding between 2.4.8(1) and (2). (In contrast, in the case of an ordinary or special resolution, membership at 2.4.8(1) may be satisfied by either borrowing or shareholding membership provided the shareholding member satisfies the other conditions of 2.4.8(2) to (4) in order to vote in his or her capacity as a shareholder.) Note also that a person cannot meet a requirement for “holding shares” on a given date, or during a given period, by relying on his holding of a share account with an overdrawn balance; and a person cannot meet a requirement for being a “member” on a given date (for example, at 2.4.8(a)) by relying on his holding of such a share account.</p>	
2.4.9	G	<p>The mandatory provisions of Schedule 2 to the 1986 Act concerning entitlement to vote on a borrowing members’ resolution are, as noted above, that the member must have been, and be, indebted to the society for at least £100 (whether on one or more accounts) at the end of the last financial year before the voting date, and on the voting date, in respect of an advance fully secured (or, if the Rules permit, substantially secured) on land (paragraphs 5(2), 23(1), 29(2) and 36 of Schedule 2) and have attained the age of 18 years by the date of the meeting (paragraphs 5(3) and 34(2) of Schedule 2). But note that there is no dispensation in the 1986 Act for the Rules to reduce the qualifying amount below £100, nor to provide for a continuity of membership qualification.</p>	
2.4.10	G	<p>Schedule 2 makes provision in respect of joint shareholders (paragraph 7) and joint borrowers (paragraph 8). The only person entitled to exercise the right to vote on behalf of the joint shareholders or joint borrowers is the one who is named first in the records of the society, described respectively as the “representative joint (share)holder” or the “representative joint borrower”.</p>	

2.4.11	G	<p>A member may vote once only on any resolution, irrespective of the number of accounts he or she may hold. The amount of the balance(s) held on an account(s) is not material, except to qualify to vote (see paragraphs <i>BSOG</i> 2.4.7 and <i>BSOG</i> 2.4.8). Thus, a member with several share accounts and/or several mortgage accounts, whether as sole and/or representative joint shareholder or representative joint borrower, may vote once only on any resolution. When the membership votes as a whole on an ordinary or a special resolution, each member may vote only once, whether he or she is a shareholding or a borrowing member or both. Where shareholding members and borrowing members vote separately, as on the Merger Resolutions, members entitled to vote may vote only once, if a shareholding member, on the shareholding members' resolution and once, if a borrowing member, on the borrowing members' resolution. A person entitled to vote both as a shareholding member and as a borrowing member may, of course, vote once on each resolution.</p>
2.4.12	G	<p>The "voting date" is defined by paragraph 23(6) of Schedule 2 as, for this purpose, either:</p>
		<p>(1) for members who appoint a proxy, the last date specified by the society for the receipt of proxy voting forms, which may not be more than 7 days before the date of the meeting (paragraph 24(6) of Schedule 2). A proxy vote remains valid if the member ceases to be a member after the proxy voting date but before the date of the meeting (paragraph 24(2) of Schedule 2); or</p>
		<p>(2) for all other members, the date of the meeting.</p>
2.4.13	G	<p>The guidance given in the foregoing paragraphs of this section is intended to give a general description of the provisions of the 1986 Act and of the Rules suggested by the BSA Model Rules. Societies should satisfy themselves that they observe the specific provisions of the 1986 Act and of their own Rules.</p>
Register of Members		
2.4.14	G	<p>Every society is required to maintain a register of the names and addresses of its members and whether each member is a shareholding member or a borrowing member or both (paragraph 13 of Schedule 2 to the 1986 Act). The register should, so far as possible, be "de-duplicated"; that is, multiple account holders should be identified and their names recorded once only in the register. A society's systems must also be capable of recognising those members who are eligible to vote by, for example, aggregating share account balances of multiple account holders to check that they have the requisite qualifying shareholding, by checking members' continuity of shareholding (if and where applicable), and by identifying minors including (separately) those who will shortly attain their majority (see paragraphs <i>BSOG</i> 2.4.6 and <i>BSOG</i> 2.4.9). Other situations requiring careful consideration are, for example, in relation to powers of attorney, personal representatives, and death of the representative joint holder or borrower. This information is required to ensure that the notice of the meeting is sent</p>

		to all the members entitled to receive it and so that the scrutineers have adequate systems to validate the votes cast on the Merger Resolutions (see also paragraph <i>BSOG</i> 2.4.20).
2.4.15	G	It will be necessary for the directors of a society contemplating a merger to satisfy themselves, in consultation with their external auditors, that the society's systems are capable of delivering the information described above. The Authority will require an assurance on this point when the society applies for approval of the Schedule 16 Statement (see paragraph <i>BSOG</i> 2.3.29(5)). One of the criteria which the Authority has to consider at the confirmation stage is whether some relevant requirement of the 1986 Act or the Rules was not fulfilled (see paragraphs <i>BSOG</i> 2.5.15 to <i>BSOG</i> 2.5.19).
2.4.16	G	The problem of avoiding duplication in the register of members is significant for most societies of any size. It has been aggravated by the proliferation of types of account over the last decade or so. Societies generally now seek to establish, when new accounts are opened, whether or not the applicant is an existing member and, if so, which accounts are relevant to voting and other membership rights. The task of identifying multiple account holders is complicated by confidentiality requirements. For example, if two accounts are held by a Mr A Smith and a Dr A Smith, both at the same address, the society cannot know (in the absence of other information such as date of birth) whether the two accounts belong to the same person, one opened before and one after he qualified, or by the doctor and his son. A letter of enquiry to one asking about both accounts would risk breaching customer confidentiality. If it is the same person, there is a risk that he will be given the opportunity to vote twice or, if neither account holds more than £100 but they aggregate above that qualifying amount, be denied a vote to which he is entitled.
2.4.17	G	Where a society identifies a number of accounts which appear to be held by a single member, but it cannot be sure, then it must send separate meeting notices in respect of each account. However, its systems should identify the possible multiple holding so that, if more than one vote is received in respect of that group of accounts, the scrutineers are alerted to the possibility, and can check the proxy forms for evidence of invalid duplicate votes. The voter's declaration suggested by the BSA, in conformity with paragraph 34 of Schedule 2 to the 1986 Act, provides some protection against votes being cast by minors, and attempts the same for duplicate votes (see Enclosure 2 to BSA Circular 5177). It is, however, the duty of each society to make sure that its register of members is reliable.
General Meeting Arrangements		
2.4.18	G	Paragraphs <i>BSOG</i> 2.4.19 to <i>BSOG</i> 2.4.34 consider the requirements for sending notices of meetings and Schedule 16 Statements to members, and the conduct of meetings at which Merger Resolutions are to be moved. It is for societies to satisfy themselves that they comply with the relevant requirements of the 1986 Act, their Rules and the general law on meetings.
Notice of Meeting		

2.4.19	G	<p>The statutory requirements concerning notices are in paragraph 22 of Schedule 2 to the 1986 Act. Notice of the meeting must be given to each shareholding and borrowing member of the society who would be eligible to vote at the meeting if the meeting were held on the date of the notice (a single date for all notices irrespective of when they are despatched). In addition, notice must also be given to any person who will attain the age of 18 years after the date of the notice but on or before the date of the meeting, and to every person who becomes a shareholding or borrowing member of the society after the date of the notice but before the final date for receipt of proxy voting forms, and who would, in either case, be eligible to vote at the meeting if he remained a member until then. (In practice, this may mean sending out a notice to every such person, even if they will, in fact, not be entitled to vote). The Schedule 16 Statement must be sent in or with the notices (paragraph 1(2) of Schedule 16 to the 1986 Act). Accidental omission to give notice of a meeting to any person entitled to receive it does not invalidate the proceedings at the meeting. However, “accidental omission” does not include a systemic failure to send notices (e.g. omitting to send notices to new members, or omission of a group or class of members from the mailing list arising from a fault in a computer programme), nor all cases of error by management - see also paragraph <i>BSOG</i> 2.4.39.</p>
2.4.20	G	<p>The 1986 Act also provides, in paragraph 21 of Schedule 2, for the length of notice to be given to members. The period of notice given must be not less than 21 days or such longer period as the society’s Rules prescribe. The precise procedures for sending notices, the way in which the days are to be counted, and presumed receipt of notices duly sent, will normally be set out in the Rules. Particular points to note are:</p>
		<p>(1) the 21 days’ notice expires with the closing date for the receipt of proxy voting forms, not the date of the meeting;</p>
		<p>(2) if reliance is to be placed on a provision in the Rules that notices can be deemed to be served 24 hours after posting, then first class post or equivalent means of delivery should be used, but it is advisable to allow a margin of at least an extra day or two, or more if second class post is used;</p>
		<p>(3) if a society contracts with a commercial mailing firm, it must ensure that the firm is comprehensively instructed about the society’s despatch and delivery requirements, and the society should carry out spot checks to satisfy itself that its instructions are being properly carried out. A failure by the contractor may invalidate the meeting, even if the society itself has used its best endeavours to police the operation.</p>
2.4.21	G	<p>The Schedule 16 Statement is required, by paragraph 1(2) of that Schedule, to be sent “in or with” the notice of the meeting to every member entitled to that notice. As is suggested in paragraph <i>BSOG</i> 2.3.4, it may be expedient to include both in a comprehensive Merger Document.</p>
2.4.22	G	<p>Notices and Statements need not be sent to any member in whose case the</p>

		society has reason to believe that communications sent to him at his registered address are unlikely to be received by him (paragraph 14 of Schedule 2 to the 1986 Act). However, a society is required instead to place notices of the meeting prominently in every branch office, or to place advertisements in newspapers circulating in the areas in which the society's members live. Such notices or advertisements must be placed at least 21 days before the date of the meeting, and must state where members can obtain copies of the Schedule 16 Statement, the Merger Resolutions and proxy voting forms (Schedule 2, paragraph 35(4)).
2.4.23	G	It should be noted, however, that a member's "registered address" may not be the address shown in the society's register of members but a different address to which the member has requested that communications from the society be sent (Schedule 2, paragraph 13(4)).
Conduct of the Meeting		
2.4.24	G	The meeting should be held at a time and place considered by the board to be most convenient for the generality of the society's members. This may well not be the same as the traditional time and place for the annual general meeting. In deciding on this, the board should take account of the geographical location of their members. For example, for a society with a majority of its members living in a compact geographical region there must be a strong presumption in favour of an evening meeting. Consideration should be given to the possibility of a larger attendance than usual at a meeting to consider a merger.
2.4.25	G	Subject to the society's Rules, its chairman will normally chair the meeting. His function as chairman of the meeting is to ensure that all views are presented and properly discussed. He is unlikely to be able to fulfil that role if he acts also as chief advocate of a merger which is controversial among members. In such cases it might be appropriate to give to another director the initial task of explaining the merger and of responding to questions from members.
2.4.26	G	Merger Resolutions or the other resolutions mentioned in paragraphs <i>BSOG</i> 2.4.1 to <i>BSOG</i> 2.4.3, cannot be amended at the meeting except in a way which does not change their substance at all. This is because an amendment to such a resolution has to be subject to the same procedure and period of notice to members as the resolution itself. If a board decides, after due notice of such a resolution has been sent to the members, that the resolution should be amended, then it will be necessary to submit the amended resolution, with due notice, to a general meeting at a later date, unless of course there is still time to fulfil the notice requirements.
Conduct of the Voting		
2.4.27	G	The conduct of the voting must not only be fair but also be seen to be fair, otherwise the result may be called into question. So it is highly desirable that the votes are counted by independent scrutineers. The board may ask the scrutineers, in advance of the meeting, for a running tally of the number of votes being cast if it thinks it might properly encourage more members to

		<p>vote if the response is low. However, to ask the scrutineers how the votes are being cast, before the time comes at the meeting to instruct proxies, carries the risk of accusations, however unfounded they may be, and possible challenge at the confirmation stage, that the board suppressed proxy votes against the resolutions, or unduly influenced members to vote in favour. A board which asks the scrutineers for a running tally of votes, and which circulates its members with further exhortations to vote, must be prepared to argue its case in the face of such accusations at the confirmation hearing. Any circular to members sent after the Merger Document must, therefore, be very carefully considered.</p>
2.4.28	G	<p>Experience has demonstrated the need for societies to take the greatest care to ensure that they comply strictly with the statutory procedural requirements and their own Rules on meetings and resolutions. The chairman of the meeting should ensure that he or she is well briefed and aware of the Rules and the general law relating to procedural resolutions, such as resolutions to adjourn the meeting. The Authority will require a confirmatory report from the scrutineers on the validity of the voting procedures when the society applies for confirmation (see paragraph <i>BSOG</i> 2.4.38).</p>
2.4.29	G	<p>The procedures for the conduct of proxy voting will normally be provided for in the society's Rules, in conformity with paragraphs 24 and 34 of Schedule 2 to the 1986 Act which requires that every proxy form sent by a society to its members must enable the member to direct the proxy how to vote (Schedule 2 paragraph 24(4A)). To minimise the risk of the society's proxy voting procedures being misunderstood, the Authority recommends that the proxy form should include:</p>
		<p>(1) adequate space to insert the name of a proxy other than the chairman of the meeting, and a statement (which must also appear in the notice of the meeting) that the proxy appointed need not be a member of the society (a reminder that the voting member's own name should not be inserted might avoid a common problem);</p>
		<p>(2) provision to instruct the proxy to vote either in favour of the resolution, or against it;</p>
		<p>(3) an explicit statement that if the member does not instruct the proxy to vote for or against the resolution, then the proxy will cast the vote, or abstain, as he or she thinks fit;</p>
		<p>(4) the declaration in accordance with paragraph 34 of Schedule 2;</p>
		<p>(5) full recital of the text of the shareholding members' resolution or borrowing members' resolution or, if this is not practicable (e.g. because of space restrictions), a clear indication that the full text may be found in the notice of the meeting;</p>
		<p>(6) instructions as to the return of the completed proxy forms, including the last date for receipt by the society or by the scrutineers. A pre-addressed and pre-paid envelope or other sealed means of return</p>

		should be provided.
2.4.30	G	The 1986 Act does not require societies to send proxy voting forms to members with notices of meetings (except where directors are to be elected). However, the Authority believes that, on a matter as important as a merger, societies would be well advised to send a proxy voting form to members with the notice of meeting. This will avoid any suggestion that members were discouraged from voting, that obstacles were put in their way, or that the society wished (for whatever reason) to be able to identify those who had requested proxy voting forms. If a society decides, nevertheless, not to send proxy forms to members entitled to vote, then it should make clear to the members that proxy voting forms can be obtained on demand from its branches and/or by application to a central point.
2.4.31	G	The arrangements for the collection of the proxy forms should be such as to secure confidentiality and to avoid the risk of loss, whether accidental or deliberate. The procedures may provide for return of proxy forms to the scrutineers either directly (if permitted by the society's Rules) or to the society's offices. Where proxy forms are returned to the society's offices, the Authority recommends that the procedures should incorporate the following features:
		(1) the proxy form should be enveloped or otherwise sealed so that the members' voting instructions are concealed;
		(2) the envelope provided should be clearly marked so that the society can readily identify and separate it from other mail without the envelope being opened;
		(3) staff responsible for receiving and sorting mail should be given specific instructions about the handling of proxy forms and the overriding importance of security;
		(4) secure storage of proxy forms should be provided up to the point at which they are handed over to the scrutineers;
		(5) equivalent handling and security procedures should be applied to proxy forms handed in at branches.
2.4.32	G	The Authority suggests that proxy voting forms for shareholders and borrowers should be easily distinguishable, perhaps by colour coding, both as an aid to members who may be entitled to vote in each capacity, and as an aid to the scrutineers counting the votes.
2.4.33	G	Members may, after submitting a proxy vote, choose to attend the meeting and vote in person. There must, therefore, be satisfactory systems in place at the meeting to identify and cancel any proxy votes they may have returned.
Ballots		
2.4.34	G	Paragraph 33 and 33A of Schedule 2 to the 1986 Act specifically exclude

		shareholding members' resolutions and borrowing members' resolutions from its permission for the Rules to provide for voting by postal or electronic ballot. This is reinforced in the definition of these resolutions in paragraphs 27A and 29 of Schedule 2. Although other resolutions associated with the merger process might be capable of being approved by ballot, in practice voting on all resolutions related to the merger will be by members voting in person or by proxy at a general meeting.
Scrutineers' Report		
2.4.35	G	The scrutineers are responsible for checking the validity of votes cast in person and by proxy. Given the need to ensure that the vote represents the views of the members, the scrutineers should be independent of the society and should not have a direct interest in the result of the voting. It will usually be appropriate to appoint the society's auditors, and it is desirable that they should be appointed not just for the arithmetical count of votes but also to supervise the voting process as a whole so that they are in a position to confirm, after the vote, that all the requirements of the 1986 Act and the society's Rules have been complied with. This would include:
		(1) determining and validating member mailing lists for notices of meetings and Schedule 16 Statements;
		(2) despatch procedures;
		(3) timing of notices and despatch of documents;
		(4) form and content of proxy voting forms;
		(5) receipt and custody of completed proxy voting forms;
		(6) validation of completed proxy voting forms to establish that members are qualified to vote and that forms are properly completed;
		(7) identification and validation of members attending and voting at the general meeting;
		(8) voting procedures at the meeting including casting of proxy votes, count of votes cast in person and aggregation of proxy and personal votes.
2.4.36	G	To fulfil the duties outlined above, it is suggested that the scrutineers would need to:
		(1) examine the systems and procedures to be employed by the society, before they are implemented, to ensure that they are satisfactory;
		(2) carry out such checks and tests as they consider necessary during the operation of the procedures as will enable them to be satisfied that the specified procedures are being carried out in practice;

		(3)	provide that where validation functions are carried out by the society's staff this is done under the direction and supervision of the scrutineers;
		(4)	direct and supervise the count of the votes cast both by proxy and personally at the meeting.
2.4.37	G	Validation checks during the counting of votes may be expected to include the following:	
		(1)	only proxy forms which comply with the 1986 Act and the society's Rules have been used;
		(2)	the member is eligible to vote under the 1986 Act and under the society's Rules (a proxy vote may still be valid even though the member ceases to be a member after the closing date for receipt of proxies - see paragraph <i>BSOG</i> 2.4.12 (2));
		(3)	only one proxy form per member eligible to vote is included in the count (separate forms may be sent to and returned by a person eligible to vote on both a shareholding members' resolution and a borrowing members' resolution);
		(4)	minors are excluded or that there is an explicit confirmation by each member voting by proxy that he is aged 18 or over;
		(5)	the proxy form is completed and signed and is otherwise valid (where a proxy voting form lacks a signature but is otherwise valid, it is usual, if time permits, for the scrutineers to return the form to the member for signature and return in a pre-paid envelope).
2.4.38	G	The scrutineers' initial report will be made to the society at the meeting (which may be adjourned for this purpose). The Authority will require, in support of a society's application for confirmation under Sections 93(2)(d), 94(7)(a) and 95(3), a report from the scrutineers on the result of the vote (distinguishing between votes cast in person and by proxy), the total number of members eligible to vote (and the proportion of that number that the votes cast represent), and also confirmation that, in the opinion of the scrutineers the arrangements for the conduct of voting were such as to ensure that:	
		(1)	notices of the meeting and Schedule 16 Statements were sent to all those entitled to receive them, in accordance with the 1986 Act and the Rules of the society having regard, among other things, to the matters referred to in this chapter;
		(2)	the periods of notice given complied with the requirements of the 1986 Act and of the society's Rules, taking into consideration established conventions for the counting of days;
		(3)	there were satisfactory procedures to ensure confidentiality of proxy

		voting forms and to minimise the risk of loss or unauthorised access;
	(4)	there were satisfactory procedures to ensure that the count of votes cast personally at the meeting included only votes cast by members eligible to vote and who had not mandated, or had withdrawn, a proxy vote.
2.4.39	G	In relation to the notice of the meeting, the scrutineers' report may properly have regard to the provision of paragraph 22(3) of Schedule 2 to the 1986 Act that "accidental omission to give notice of a meeting to, or non-receipt of notice of a meeting by, any person entitled to receive notice of the meeting shall not invalidate the proceedings at that meeting". It should be noted, however, that there is authority to the effect that "accidental" and "non-receipt" would not cover all cases of "error" on the part of the society, for example an erroneous decision of management not to send notices to particular persons or groups of persons.
2.4.40	G	The Authority would find it helpful if the scrutineers' report would also comment upon any procedural difficulties encountered and give an analysis of the reasons why votes were found to be invalid, if the numbers of invalid votes appear to be significant (see also paragraph <i>BSOG</i> 2.5.14).
The Authority's Discretion		
2.4.41	G	The Authority has power under Section 94(5)(b) of the 1986 Act to exempt the transferee society in a transfer of engagements from the duty to call a meeting and put a Schedule 16 Statement and Merger Resolutions to its members, but to proceed instead by board resolution (see paragraph 1(1) of Schedule 16 to the 1986 Act). Before it exercises this discretion the Authority will wish to review the prudential information described in section 2.2 and, in particular, will wish to be satisfied that the merger will not affect the interests of the members of the transferee society to any significant extent. In assessing this last point, the Authority will consider, in particular, the reduction, if any, in the capital ratios of the merged society immediately following the merger and any plans to eliminate, or mitigate, this reduction; and any plans to remove products and services, close branches or change interest rates as a result of the merger. The Authority will also wish to know whether the merger will mean a change of policy by the society, for example by a significant move into a new geographical area or into a new business activity. Unless it is persuaded otherwise in the circumstances of any particular case, the Authority will not normally grant this exemption unless the total assets of the transferee society are substantially larger than the total assets of the transferor society, and a total asset ratio of 5:1 will be used by the Authority as a broad first measure of relative significance. The general presumption will be that a society, being a mutual institution, should consult its members over an issue as important as a merger unless there are compelling arguments to the contrary.
2.4.42	G	However, if the transferor society proposes to pay bonuses in excess of the prescribed limit (see paragraph <i>BSOG</i> 2.4.4) then, notwithstanding that the Authority has granted an exemption, the transferee society must seek the approval of its members of a resolution on the terms of the merger (Section

		96(4)(b) of the 1986 Act). Similarly, if the transferee society has to change its Rules to avoid disenfranchising members of the transferor society (see paragraph <i>BSOG</i> 2.3.16) it must do so by special resolution. It would be wrong to invite the members to approve a Rule change which was a consequence of a merger without inviting them to approve the merger itself.
2.5	Confirmation	
2.5.1	G	No merger can take effect until it has been confirmed by the Authority. This section describes the form of application and public notice required and explains the Authority's view of how the statutory Confirmation Criteria should be interpreted. Finally, it gives guidance on the procedure customarily followed by the Authority when considering confirmation applications and hearing representations. Section 93(2)(d) of the 1986 Act, on amalgamations, and Section 94(7)(a), on transfers of engagements, together with paragraph 7 of Schedule 16, provide that when the necessary Merger Resolutions have been passed the societies concerned must apply to the Authority for confirmation of the merger in such manner as the Authority may direct. The societies are also required, by paragraph 8 of Schedule 16, to publish notices of their applications in one or more of the London, Edinburgh and Belfast Gazettes as the Authority directs, and if it so directs, in one or more newspapers. The choice of official Gazettes and national or local newspapers will, of course, have regard to the area in which the societies' members live.
2.5.2	G	The parties in an amalgamation should make a joint application for confirmation to the Authority, while the parties to a transfer of engagements should make separate applications for confirmation of the transfer. These applications should specify the date on which the merger is intended to take effect and should be accompanied by two authenticated copies of the Instrument of Transfer, or the amalgamation agreement, and of the Merger Document or separate Schedule 16 Statement. In addition, in the case of an amalgamation, three signed copies of the Memorandum and Rules of the successor to the amalgamating societies should be sent to the registration team. The scrutineers' report described in paragraphs <i>BSOG</i> 2.4.38 to <i>BSOG</i> 2.4.40, and a certified copy of the minutes of the general meeting at which the Merger Resolutions were moved, must be enclosed with each application.
2.5.3	G	A pro forma public notice of application, and pro forma letters of application are set out in Annex 2.
The Confirmation Criteria : Statutory Provisions		
2.5.4	G	Section 95(3) and (4) of the 1986 Act provides that the Authority must confirm an amalgamation or transfer of engagements unless it considers that any one or more of the following Three Criteria apply:
		(1) some information material to the members' decision about the merger was not made available to all the members eligible to vote; or

		(2)	the vote on any resolution approving the merger does not represent the views of the members eligible to vote; or
		(3)	some relevant requirement of the 1986 Act or of the Rules of any of the societies was not fulfilled.
			Section 95(5) then provides that the Authority shall not be precluded from confirming a merger by virtue only of the non-fulfilment of some relevant requirement of the 1986 Act or the Rules (the Third Criterion in 2.5.4(3)) if it appears to the Authority that the failure could not have been material to the members' decision about the merger, and the Authority gives a direction under that sub-section that the failure is to be disregarded.
2.5.5	G		Where the Authority would be precluded from confirming a merger by reason of any of the defects specified in the Three Criteria, Section 95(6) provides that it may direct a society to remedy the defects. A direction under that sub-section may require a society to call a further meeting; for example, to vote again in the light of a revised Schedule 16 Statement containing material information previously omitted, or after correction of defects in the systems for sending notices of meeting and Statements and validation of votes. If the Authority is then satisfied, having considered evidence furnished by the society, that the defects have been substantially remedied, it must confirm the merger. If not, then confirmation must be refused.
Scope of the Authority's powers			
2.5.6	G		The Authority's powers in connection with applications for confirmation of a merger are confined to considerations of whether, in the light of the facts, any of the Three Criteria apply. It is not for the Authority to consider, or make judgements about, the merits of a proposed merger or the fairness of its terms; these matters are first for the board of a society, and then for its members to decide. Once the members have approved the merger and its terms, the Authority has no powers to require a society to make any changes to those terms. The Authority's discretionary powers are similarly confined to the matters described in paragraphs <i>BSOG 2.5.4</i> and <i>BSOG 2.5.5</i> .
2.5.7	G		The Authority has no general power to determine disputes between a society and its members. Disputes concerning the services provided by societies in the ordinary course of their business are generally a matter, in the first instance, for a society's internal complaints procedure. They may also fall within the jurisdiction of the Financial Services Ombudsman. Disputes between a building society and a member of the society, in his capacity as a member, in respect of any rights or obligations arising from the Rules of the society or the provisions of the 1986 Act, fall within the jurisdiction of the High Court or, in Scotland, the Court of Session (Section 85 of and Schedule 14 to the 1986 Act). However, the Authority does have power, on the written application of an eligible member, to direct that the member has the right to obtain names and addresses from the society's register of members. Before it gives such a direction, the Authority is required to be satisfied that the member requires that right for the purpose of

		communicating with members of the society on a subject relating to its affairs, and must have regard to the interests of the members as a whole and to all the other circumstances (Schedule 2, paragraph 15). A fee is payable by the applicant. Chapter 1A on applications for access to the register of members explains who is eligible to apply.
Purpose of Confirmation		
2.5.8	G	The purpose of the confirmation process is to enable:
		(1) interested parties to make representations with regard to the Three Criteria;
		(2) the society to respond to those representations;
		(3) the Authority to make such enquiry as it considers necessary to reach informed conclusions on the Three Criteria.
2.5.9	G	The Authority, in reaching its view on each of the Three Criteria, has to assess not only the points made to it in representations, and the society's responses, but also to make such further enquiries as it considers necessary. In deciding how far it should pursue such enquiries, the Authority has to have regard to the role and effect of confirmation, and to the mischief which it is intended to prevent. The Authority considers that one role of confirmation is to provide a protection to members against the provision to them by the society of information which is inadequate, obscure or misleading, and against voting irregularities: in other words to ensure that the vote represents the informed decision of the members. The Authority would hope that this safeguard would work in the majority of cases by raising relevant issues early - by causing the board of a society to take care not to put confirmation at risk on this account - rather than by the Authority finding that it needed to withhold confirmation at the last stage. In considering the First Criterion, the Authority will have regard to the totality of the information provided to the members by the board of a society and not exclusively to the Schedule 16 Statement.
2.5.10	G	The task of the Authority is accordingly:
		(1) to reach a considered view on each of the Three Criteria;
		(2) if that view is that none applies, to confirm;
		(3) if either of the First Two Criteria apply to direct the appropriate remedial action, or to refuse confirmation;
		(4) if the Third Criterion applies, to consider whether it is appropriate to direct that any failure be disregarded: if not, to direct the appropriate remedial action or to refuse confirmation.
		In considering the Three Criteria, the Authority may well have to look again at the Schedule 16 Statement, or at issues which were considered in connection with approving that Statement. In doing so, it has a duty to

		consider information and arguments put to it by representers and by the society, which of their nature were not available earlier, as well as those arising from its own further consideration of the criteria. The Authority would clearly only change the view reached at the time of approval of the Schedule 16 Statement if there were good reasons to do so. But it is under a duty to examine the Statement and connected issues at the time of confirmation in the light of any new information and arguments which become available. Accordingly, the Authority cannot be bound at the confirmation stage to the view that was taken at the earlier stage as to whether further factual information should be included in the Schedule 16 Statement or as to the accuracy of its contents.
2.5.11	G	The task of considering each of the Three Criteria is still necessary even if there are no representations. Without such enquiry and consideration the confirmation process would not properly be carried out. The Authority's view of how the Three Criteria should be interpreted and applied is given in the following paragraphs.
The First Criterion		
2.5.12	G	This criterion requires the Authority to consider whether some material information was not made available to the members. The Authority's own view, in which it concurs with the view developed by the Commission in its confirmation decisions, can be summed up as follows:
		(1) the words "made available to all the members eligible to vote" mean that the criterion is mainly, if not exclusively, directed to the information provided by a society to the generality of its members;
		(2) the extent of "information not made available" can reasonably be assessed by considering how far the totality of information made available falls short of what might be expected to be put to its members by a financial institution of standing and repute seeking to put sufficient information and a fair and balanced assessment of it, and the board's conclusions, to the members to enable them to take an informed decision;
		(3) the words "material to the members' decision" require the Authority then to focus on whether it is within the bounds of reasonable possibility that the members' decision would have been different, had any deficiency in information been made good, i.e. whether it could have changed the decisions on voting of sufficient members to lead to a different conclusion. If it is within the bounds of reasonable possibility that the deficiency might have changed the outcome, it is not for the Authority to determine whether it would actually have done so - it should put the decision back to the members. This test requires the Authority to take account both of the size of the vote and of the size of the majority within it;
		(4) the relevance of a particular piece of information to an investor and to a borrower may well be different. Accordingly, it is necessary to consider materiality separately in relation to the shareholding

			members' resolution and the borrowing members' resolution.
2.5.13	G	The Authority's approach to determining whether this criterion is met will accordingly be:	
		(1)	to review the material put to members, in the light of the members' representations made and the society's responses, but also taking points of its own accord;
		(2)	to consider, on the basis of that review, what information relevant to the decision of shareholders, or of borrowers, or both, might reasonably have been expected to be put to members by the board of a society of repute considering its fiduciary duty, and the extent to which (if at all) the information actually put falls short of that;
		(3)	to consider separately in relation to the shareholding members' resolution and in relation to the borrowing members' resolution, whether any deficiency so identified was sufficient to amount to "information material to the members' decision".
The Second Criterion			
2.5.14	G	This criterion requires the Authority to consider whether the votes on the Merger Resolutions do not represent the views of the members. The main mischief to which it appears to be directed is a merger approved by a small and unrepresentative vote. However, a very low turnout, of itself, does not necessarily mean that the criterion applies. It has to be considered in the context of the other criteria, and of any other factors which may have affected the turnout: for example, whether all the members entitled to vote were fully and clearly informed of the terms of the merger proposal and its consequences; whether the members were afforded adequate facilities and opportunity to cast their votes; and the scrutineers' report on the conduct and counting of votes, including the number of, and reasons for, invalid proxy votes.	
The Third Criterion			
2.5.15	G	This criterion requires the Authority to consider whether the relevant requirements of the 1986 Act and the Rules have been fulfilled. The phrase "some relevant requirement of this Act or the rules of the society" appears explicitly three times in Section 95 of the 1986 Act:	
		(1)	sub-section (4)(c) in the specification of this criterion;
		(2)	sub-section (5) which gives the Authority power to disregard certain non-fulfilments;
		(3)	sub-section (10) which provides that a failure to meet such a relevant requirement shall not invalidate a transfer of engagements, although such failure by a society without a reasonable excuse is a criminal offence.

		The interpretation of the phrase is also directly relevant to sub-section (6) - the power of the Authority to give the society a direction to remedy defects specified in paragraphs (a) to (c) of sub-section (4).
2.5.16	G	<p>Sub-section (11) defines “relevant requirement”:</p> <p>“In this section “relevant requirement”, with reference to this Act or the rules of a society, means a requirement of section 93 or 94 or this section or of Schedule 16 to this Act or of any rules prescribing the procedure to be followed by the society in approving or effecting an amalgamation or transfer of engagements”.</p> <p>The Authority considers that this sub-section should be read naturally. The words “prescribing the procedure to be followed by the society in approving or effecting” a merger apply only to the Rules, in order to specify which of the Rules of the society are “relevant requirements”. They do not apply as a matter of normal construction of the sentence to the “applicable provisions of this Act”: nor is it necessary that they should do so, since those provisions are specified in the sub-section.</p>
2.5.17	G	<p>The Authority recognises that the interpretation of “relevant requirement of the Act”, which it considers stems from the natural construction of Section 95(11) of the 1986 Act and which is necessary to give effect to Parliament’s intentions for Section 95(6) and (10), does not quite fit Section 95(5). The test which the Authority has to apply in the case of sub-section (5) to a non-fulfilment of a relevant requirement of the 1986 Act is:</p> <p>“if it appears to the Authority that it could not have been material to the members’ decision about the amalgamation or transfer”.</p> <p>That test clearly is designed to relate to a failure to meet a procedural requirement or to some other failure which might have an effect on the voting.</p>
2.5.18	G	The wording of Section 95 of the 1986 Act is such that no construction of the phrase is entirely free from difficulty. The Authority’s view is that the wording, and the intentions of Parliament, are best met by following the natural construction of sub-section (11), as a result applying a wide interpretation in sub-sections (4), (6) and (10), but only considering that it is open to the Authority to make a direction under sub-section (5) in relation to non-fulfilment of a procedural requirement or other failure to which the test in that sub-section is apposite.
2.5.19	G	The Authority considers that the relevant requirements of the Rules are those which prescribe the procedure to be followed that is, in particular, the Rules concerning membership, special meetings, notice of meetings, procedure at meetings, entitlement of members to vote on resolutions, appointment of proxies and joint shareholders and borrowers.
Procedure		
2.5.20	G	The procedure to be followed in the confirmation process is prescribed by Part III, paragraphs 7 to 9, of Schedule 16 to the 1986 Act. Any interested

		party has the right to make written representations, and/or to give notice of intention to make oral representations to the Authority with respect to a society's application for confirmation. Written representations are to be copied to the participating societies, which are to be afforded the opportunity to comment on them in writing or orally at the hearing of their applications. (The Authority will in general be prepared to use electronic rather than paper-based communication if requested by the society or a prospective representer and some of the following procedures may have to be adapted accordingly.)
Representations		
2.5.21	G	Persons making representations should state why they claim to be interested parties, for example their category of membership of the society, and the ground or grounds for their representations by reference to the Three Criteria discussed above. Written representations, or notice of a person's intention to make oral representations, or both, must be in writing. They must reach the Authority at the address, and by the date, given in the Merger Document issued to members and subsequently published by notice in the official Gazettes and newspapers as required by the 1986 Act. Persons who make written representations and who subsequently decide also to make oral representations must, nevertheless, give notice of that intention in writing to the Authority by the same date. Representations received out of time will not be considered unless, exceptionally and at the sole discretion of the Authority, they appear to the Authority to raise matters of substance relevant to the Three Criteria which are not already under consideration.
2.5.22	G	Representations or notices to the Authority will fall into one of the following three categories:
		(1) written representations only;
		(2) written representations with notice of intention to make oral representations; or
		(3) notice of intention to make oral representations only.
2.5.23	G	The Authority will acknowledge the receipt of each representation or notice and will send a copy of annex 4 of this chapter, on merger confirmation procedures, to each representer. It will send copies of all written representations to the societies concerned and will afford them an opportunity to comment on them.
2.5.24	G	Copies of the society's comments on representations in category 2.5.22(2) will be sent to those who made the representations so that they may concentrate their oral representations on the points which they consider to remain at issue. Persons making written representations who wish to see the society's response must, therefore, give notice of intention to make oral representations. The Authority will consider the written representations in category 2.5.22(1) and the societies' responses to them in advance of the date set for hearing oral representations. The society may, exceptionally, apply to put to the Authority in confidence documents which the society

		considers to be commercially sensitive: the Authority will decide on the merits of each case whether, and on what terms, to accept them as being confidential. Persons in category 2.5.22(3) will be asked to inform the Authority, in advance of the hearing, of the subject and general grounds of the representations they intend to make and their responses will be copied to the society.
2.5.25	G	Interested parties may join together in making collective representations and they may also appoint a person, either one of their number or another, to represent them at the hearing. They should notify the Authority in advance if this is what they intend to do.
Conduct of the hearing		
2.5.26	G	The Authority may appoint one or more persons to hear and decide applications on its behalf. In the absence of notices of intention to make oral representations the Authority would expect to decide the applications having regard to the written representations, the societies' responses and other information available to it, without the need for an oral hearing.
2.5.27	G	The Authority will notify the societies and those making oral representations of the time and place of the hearing. If there are a significant number of persons wishing to make oral representations, then the hearing may extend beyond one day and may be adjourned from time to time and from place to place. The Authority will try to advise participants of the day when they may expect to make their representations and when the societies' representatives may be expected to respond.
2.5.28	G	The Authority expects that hearings will be in public. Members of the general public and the press will be asked to wait outside at the outset of the hearing. The participants will then be asked if any of them has good reason to object to the admission of the general public and the press (such as, for example, the need to refer to personal financial affairs). The Authority may decide that parts of the hearing shall be in private if that appears to it to be desirable. If there are no reasonable objections, the general public and the press will then be admitted, within the limits of the space available.
2.5.29	G	The procedure will be informal. While all participants will be invited to speak concisely and to avoid repetition the Authority will be considerate towards those who are not professionally represented. The individual or panel taking the hearing on behalf of the Authority may question the participants as the hearing proceeds. The sequence of events will be broadly as follows:
		(1) any preliminary matters (such as the admission of the public or other procedural questions) will be dealt with;
		(2) the person(s) appointed to hear the applications will introduce the proceedings;
		(3) the representatives of the societies will be invited to present their applications for confirmation, including a description of the events at

			the meetings at which the Merger Resolutions were put to the members, the statement of the voting on the resolutions, as well as any other matters which they wish to introduce at that stage;
		(4)	the other participants will be invited to make their representations; where appropriate the Authority would expect to call them in a list marshalled, so far as possible, by subject matter;
		(5)	the representatives of the societies (or of the relevant society) will be invited to reply to, or comment on, the points made by the other participants; and
		(6)	the other participants will be invited to comment on the societies' replies in so far as those replies raise new issues.
2.5.30	G	The above procedure may be varied according to the circumstances at the hearing, and is intended only as a guide to the probable order of events. The hearing may be adjourned if the Authority considers that is necessary to enable facts to be checked or additional information to be obtained.	
The Authority's decision			
2.5.31	G	The Authority will not normally give an oral decision at the end of the hearing and may be expected to reserve its decision to be issued later in writing, setting out its reasons. Copies of the written decision will be sent to the participants and, on request, to any other person. The decision may also be published, and the Authority usually asks the registration team to place copies on the public files of the participating societies.	

2.6	Transfer Of Engagements Under Direction	
2.6.1	G	<p>This section describes the Authority’s powers to direct a society to transfer all its engagements to one or more other societies and/or to proceed by board resolution, and the modified merger procedure consequently prescribed by the 1986 Act. Section 42B of the 1986 Act provides that, if the Authority considers it expedient to do so to protect the investments of shareholders or depositors, it may direct a society, among other things, to transfer all its engagements to one or more other societies within a specified period (subsection (1)(a)). In such a case, or where the Authority would have directed a transfer of engagements, but for the fact that negotiations were already under way, the Authority may also direct that the approval of the transfer of engagements by the transferor society may be by board resolution rather than by Merger Resolution. In these circumstances, because neither a Schedule 16 Statement nor Merger Resolutions are required, the 1986 Act requires the society instead to send to every member entitled to notice of a meeting a Merger Notification Statement before it applies for confirmation of the transfer of engagements, (paragraphs 3 and 4 of Schedule 8A to the 1986 Act). Finally, in these circumstances, the First and Second Criteria concerning information made available to, and the views of, the members (see section 2.5) are replaced by a single criterion: “the members or a proportion of them would be unreasonably prejudiced by the transfer;” (paragraph 5 of Schedule 8A to the 1986 Act).</p>
2.6.2	G	<p>Where a society is proceeding under a Section 42B(3) direction by board resolution, the Schedule 16 Statement is replaced by a Merger Notification Statement and a general meeting of the society is not required. The contents of the Merger Notification Statement are prescribed by The Building Societies (Merger Notification Statement) Regulations 1999 (SI 1999/1215).</p>
2.6.3	G	<p>The Merger Notification Statement must have been approved by the Authority before it is sent to the members, and must be sent within the specified time limit. Applications for approval should, in general, follow the procedure described in paragraph <i>BSOG 2.3.28</i>, and the final draft of the Merger Notification Statement should be accompanied by the relevant documents listed in paragraph <i>BSOG 2.3.29</i>, but as appropriate to the particular case and the less extensive information the statement is required to contain. The statement must include particulars of any compensation payable to directors or other officers of the transferor society to which the Authority has given its consent under paragraph 2(1) of Schedule 8A to the 1986 Act.</p>
2.6.4	G	<p>Section 2.4 (General Meetings and Resolutions) does not apply, except that the directors will need to be satisfied that the society’s register of members is correct to enable the society to send Merger Notification Statements to those entitled to receive them.</p>
2.6.5	G	<p>When the board has resolved to transfer the society’s engagements and Merger Notification Statements have been sent to its members, the society</p>

		<p>may apply to the Authority for confirmation of the transfer of engagements, but using an adaptation agreed with the Authority of the pro forma in Annex 2A. The procedure described in section 2.5 is to be followed, including the publication of notices in the official Gazettes and newspapers and the form of application. However, the lapse of time between each stage of the procedure may be modified according to the particular circumstances of a case, and having regard to the need to protect the investments of shareholders or depositors. While a scrutineer's report will not be required, the Authority will require a report from the society's external auditors on the adequacy of the society's systems to fulfil the requirements of the 1986 Act and the Rules with regard to the sending of Merger Notification Statements. This is, of course, relevant to the Authority's consideration of the Third Criterion.</p>
2.6.6	G	<p>As is noted in paragraph <i>BSOG</i> 2.6.1, the First and Second Criteria are replaced, in those circumstances, by a single criterion as to whether the members or a proportion of them "would be unreasonably prejudiced by the transfer". Whether this special criterion applies will be a matter of judgement for the Authority to make in the light of any representations made to it and its own enquiries in respect of the particular case. It follows also that, in considering the Third Criterion, the Authority will take account of the modified procedure.</p>
2.7	Registration And Dissolution	
2.7.1	G	<p>When the Authority has confirmed a merger (whether voluntary or under direction) it will notify the registration team and the societies concerned.</p>
2.7.2	G	<p>In the case of an amalgamation, the registration team is required to be satisfied as regards the proposed Rules, Memorandum and name of the successor society. The amalgamating societies are, therefore, advised to clear drafts of the proposed Rules and Memorandum with the registration team at an early stage (see paragraph <i>BSOG</i> 2.3.28). When they apply to the Authority for confirmation under Section 93(2) of the 1986 Act, the amalgamating societies must also send three signed copies of the Rules and Memorandum to the registration team (Section 93(2)(d)). If the registration team is satisfied on these matters it will, upon confirmation, register the successor society and issue to it a certificate of incorporation specifying the date (the specified date) from which the incorporation takes effect, and will return to it one copy each of the Rules and Memorandum together with a certificate of registration. Copies are placed on the public file of the successor society.</p>
2.7.3	G	<p>On the specified date of the amalgamation, all the property, rights and liabilities of the amalgamating societies are transferred to the successor society, the successor is given such permission under Part IV of the Act as the Authority considers appropriate, and the amalgamated societies are dissolved and their registrations cancelled (Section 93, sub-sections (4), (5) and (6) and Section 103(1) of the 1986 Act). In deciding on the appropriate terms of the permission for the successor society, the Authority will have regard to the terms of the permissions of the amalgamating societies, including any limitations or requirements. It will also have regard to the</p>

		business plan for the successor society.
2.7.4	G	In the case of a transfer of engagements, the registration team will register a copy of the Instrument of Transfer and issue a registration certificate to the transferee society. A copy of the Instrument of Transfer and the registration certificate are placed on the public file of the transferee society. On the date specified in the registration certificate, the property, rights and liabilities of the transferor society are transferred to the transferee society, by virtue of Section 94(8) of the 1986 Act, the transferor society's authorisation is revoked by the Authority, and the society itself is dissolved (Section 94(10)). The transferor society's registration is subsequently cancelled by the registration team under Section 103(1).
2.8	Timetable	
2.8.1	G	The time taken to complete a merger will vary from case to case. As a general rule of thumb, it is unlikely that a merger can proceed from board decision through approval of the Schedule 16 Statement, general meeting and confirmation hearing, to the effective date, in less than 6 months. It is essential to the good and orderly management of a merger that the societies concerned meet with the Authority's staff as soon as their boards have resolved to seek a merger, and agree upon a provisional timetable. This can then be fixed by the time the Schedule 16 Statement is approved. The members can then be notified, as they must be, of the date provisionally set for the confirmation hearing and of the proposed date of completion of the merger in the Merger Document.
2.8.2	G	The likely sequence of events is as follows:

Stage 1	Informal consultations with the Authority's supervisory staff on both substance and timing of the proposed merger.
Stage 2	<p>Submission to the Authority of:</p> <p>(a) prudential information: this should be available to the Authority for discussion with the society well before the Schedule 16 Statement is submitted for approval;</p> <p>(b) written details of the proposed terms of the merger: it will be helpful for both the societies and the Authority to be clear about these matters as soon as possible after Stage 1 and well before Stage 3 is reached.</p> <p>Submission to the registration team, in the case of an amalgamation, of preliminary draft Rules and Memorandum, noting any unresolved issues.</p>
Stage 3	<p>Submission to the Authority and, in respect of (b) below, to the Registration team in draft of the following:</p> <p>(a) the Instrument of Transfer or amalgamation agreement embodying the merger terms provisionally agreed by the respective boards of</p>

	<p>directors;</p> <p>(b) in the case of an amalgamation, the proposed Rules and Memorandum of the successor society;</p> <p>(c) the Merger Document, including the Schedule 16 Statement, unless consent to proceed by way of board resolution is being sought in respect of the transferee society, together with the explanations of change, comparability and commitments referred to in paragraphs <i>BSOG 2.3.8</i> to <i>BSOG 2.3.10</i> and <i>BSOG 2.3.27</i>;</p> <p>(d) notice of the meeting at which the Merger Resolutions are to be moved, which may form part of (c) above;</p> <p>(e) the proxy voting forms to be used.</p> <p>After examination of these drafts, the Authority or, as the case may be, registration team staff will return them with any comments and, if necessary, will discuss them with the societies and their advisers. Any clearance by the Authority at this stage is provisional, and the Authority may seek further modification of the documents in the light of later information. Similarly, any clearance given by the registration team is subject to review of the proofs submitted at stage 4.</p> <p>If the transferee society is applying for consent to proceed by way of board resolution, formal application to do so (with supporting justification) should be made to the Authority at this stage.</p>
Stage 4	Submission of printers' proofs of the above draft documents.
Stage 5	<p>Informal clearance of near-final proofs (particularly of the Schedule 16 Statement(s)) by the Authority.</p> <p>Informal clearance of proof copies of Rules and Memorandum by the registration team, in the case of an amalgamation.</p>
Stage 6	<p>Formal submission of the Schedule 16 Statement(s) for approval by the Authority. The covering letter should include a declaration on behalf of the board of the society either:</p> <p>(a) that there has been no material change in the financial position of the society since the date of the information provided in the Schedule 16 Statement; or</p> <p>(b) that there has been such a change and that it is fairly reflected in the wording of the statement.</p> <p>This submission should be accompanied by:</p> <p>(c) a certified copy of the Instrument of Transfer or amalgamation agreement as executed;</p> <p>(d) two copies of the final printers' proof of the Schedule 16 Statement signed by the secretaries of each society;</p> <p>(e) a final printers' proof of the complete Merger Document to be sent</p>

	<p>to members, together with any covering letter and other documents to be sent with it, including proxy voting forms;</p> <p>(f) an assurance from the chairman of each society that the Schedule 16 Statement is complete and that all material interests of directors and officers are disclosed in it;</p> <p>(g) an assurance by or on behalf of the board on systems.</p> <p>(h) letter of comfort from the society's external auditors when required (see paragraph <i>BSOG 2.3.7</i>);</p> <p>(i) confirmation that drafts submitted for approval are identical to those seen at stage 5;</p> <p>(j) the fee payable by each society to the Authority.</p>
<p>NB Schedule 16 Statements should not be printed for distribution to members until after Stage 7.</p>	
Stage 7	<p>Approval by the Authority of the Schedule 16 Statement, or the Authority's consent to proceed by board resolution. Approval or consent will be given by letter and one proof copy of the Schedule 16 Statement, with the certificate of approval signed on behalf of the Authority, will be returned to the society.</p>
Stage 8	<p>Printing and circulation of documents to members in time to be received by them at least 21 days before the voting date for the meeting at which the Merger Resolutions are to be moved (see paragraphs <i>BSOG 2.4.12</i>, <i>BSOG 2.4.19</i> and <i>BSOG 2.4.20</i>).</p>
Stage 9	<p>The meetings at which the Merger Resolutions are moved.</p>
Stage 10	<p>If the Merger Resolutions have been passed, application to the Authority for confirmation and publication of notices of that application in the London and Edinburgh or Belfast Gazettes, and in other newspapers (as the Authority directs). The application must notify the Authority of the specified effective date for the merger, and be accompanied by two authenticated copies of the Instrument of Transfer or amalgamation agreement. In addition, in an amalgamation, four signed copies of the Memorandum and Rules of the successor society should be sent to the registration team. The societies must report to the Authority on the outcome of their meetings.</p>
Stage 11	<p>Notification by the Authority of the time and place of the confirmation hearing, if it is necessary to hold an oral hearing. The societies should allow sufficient time before the proposed effective date for the Authority to consider and write its decision, and in case it proves necessary to adjourn the hearing.</p>
Stage 12	<p>Confirmation hearing and decision by the Authority whether to confirm the merger.</p>

Stage 13	Registration by the registration team to give effect to the amalgamation or transfer of engagements.
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2.8.3	G	The following table indicates the likely minimum time to be taken by the main stages outlined above:
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Pre Day 1	Board Resolution to Merge Initial discussions with Authority re timetable and prudential information Submission of terms and initial prudential information to Authority Submission of draft Rules and Memorandum to registration team (amalgamations)
Day 1	First draft of Schedule 16 Statement and chairman's letter and notice of meetings, draft Rules and Memorandum (amalgamations) (Stage 3)
Day 28	Authority gives informal approval to Schedule 16 Statement, Instrument of Transfer signed (Stage 5)
Day 35	Formal Schedule 16 approval by the Authority (Stage 7)
Day 35-43	Printing, enveloping and mailing of Schedule 16 Statement and notice of meetings (Stage 8)
Day 65 - 70	Last date for receipt of proxy votes (depending on Act and Rules)
Day 72	SGM (Stage 9)
Day 75	Application to Authority for confirmation (Stage 10) Rules and Memorandum to registration team (amalgamations)
Day 93	Closing date for receipt of representations
Day 114	Confirmation hearing (Stage 12)
Day 142	Authority's Decision on Confirmation (Stage 12)
Day 160	Effective Date

2.8.4	G	Notes:
		(1) Within the above timetable prudential information to be submitted.
		(2) A significant amount of financial information needs to be assessed by the Authority prior to approval of Schedule 16 Statement.

		(3)	Prior to approval of Schedule 16 Statement a plan/timetable for integration of systems to be drawn up. Auditors sign off required prior to effective date.
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Annex 1
PRO FORMA MERGER DOCUMENT

1. Title Page

Including suggestion to consult professional advisers and reference to meeting notice and voting procedures.

2. Directors' Responsibility Statement

See paragraph *BSOG 2.3.26*.

3. Board Rationale

Including statutory merger statement, if required (see paragraphs *BSOG 2.3.23* and *BSOG 2.3.24*).

4. The Merger Process

Description and explanation of:

- (a) the general meeting and Merger Resolutions;
- (b) the confirmation process, including the right of interested parties to make representations to the Authority, the dates provisionally set for receipt of written representations and notice of intention to make oral representations, and for the confirmation hearing, and the confirmation criteria specified in Section 95 of the 1986 Act;
- (c) the planned effective date of the merger.

5. The Instrument of Transfer of Engagements or Amalgamation Agreement

The address of the principal office of the society where the Instrument of Transfer or amalgamation agreement will be available for inspection, and whether copies of the Instrument or agreement will also be available at branch offices, with a cross-reference to Section B of the Schedule 16 Statement.

6. The Schedule 16 Statement

Statement Required by Schedule 16 to the Building Societies Act 1986

Proposed Transfer of Engagements of [ABC] Building Society to [DEF] Building Society

or

Proposed Amalgamation of [ABC] Building Society and [DEF] Building Society to form [GHI] Building Society

Section A: Financial Position of Each Society

1. *Balance Sheets*

Summarised balance sheets derived from the audited [unaudited] [consolidated] accounts of [ABC] [society] [Group] for the financial year ended (date) [as at (date)] and from the audited [unaudited] [consolidated] accounts of [DEF] [society][Group] for the financial year ended (date) [as at (date)] are set out below:

	Notes	ABC [Group] £m	DEF [Group] £m
<i>Assets</i>			
Liquid assets	4(b)	•	•
Mortgages	4(e)	•	•
Other loans	4(e)	•	•
Fixed and other assets	4(c),(d)	•	•
		<hr/>	<hr/>
		•	•
<i>Liabilities</i>			
Shares		•	•
Borrowings		•	•
Other liabilities		•	•
Subordinated liabilities		•	•
Subscribed capital		•	•
Reserves		•	•
Other capital		•	•
- revaluation reserve		•	•
[- other]		•	•
		<hr/>	<hr/>
		•	•

2. *Results*

Particulars derived from the audited [unaudited] [consolidated] accounts of [ABC] [Group] for the period ended (date) and from the audited [unaudited] [consolidated] accounts of [DEF] [Group] for the period ended (date):

	ABC [Group] £m	DEF [Group] £m
Net interest receivable	•	•
Other income and charges	•	•
Administrative expenses	•	•
Provisions	•	•
	<hr/>	<hr/>
Profit/loss for the period before taxation	•	•
Taxation	•	•
Minority interests	•	•
	<hr/>	<hr/>
Profit/loss for the period	•	•

3. *Key Financial Ratios*

	ABC [Group] %	DEF [Group] %
As a percentage of shares and borrowings:		
Gross capital	•	•
Liquid assets	•	•
As a percentage of mean total assets:		
Profit after taxation for the period	•	•
Management expenses for the period	•	•

The above percentages have been calculated from the balance sheets summarised above.

Gross capital comprises reserves and other capital, plus subscribed capital and subordinated liabilities, and amounts to £..... million for [ABC] and £..... million for [DEF].

Shares and borrowings, adjusted to exclude interest accrued but not yet credited to accounts, amount to £..... million for [ABC] and £.... million for [DEF].

Average total assets is calculated as the mean of the total assets at the beginning and end of the period and amounts to £..... million for [ABC] and £..... million for [DEF].

The estimated gross and net costs of the bonus to be paid to members are £....

The ratio of gross capital to shares and borrowing of the combined society, after allowing for the net cost of the bonus to be paid to members, is estimated to be%. On the same basis of calculation, but not accounting for the bonus payment, this ratio is estimated to be%.

4. *Notes to the Financial Position*

(a) Accounting policies

[Identify any significant differences between the accounting policies adopted by the two societies, and quantify the impact of a change in policy to achieve consistency. If there are no such differences then this should be stated].

(b) Liquid assets include listed securities as follows:

	ABC [Group] £m	DEF [Group] £m
Amount included in the balance sheet	• _____	• _____
Market value	• _____	• _____

(c) Fixed and other assets

	ABC [Group] £m	DEF [Group] £m
--	-------------------------------	-------------------------------

Tangible fixed assets	•	•
[Intangible fixed assets]	•	•
Other assets	•	•
	<hr/>	<hr/>
	•	•
	<hr/>	<hr/>

[Describe the nature of any intangible fixed assets and the method of amortisation thereof, if any]

(d) Tangible fixed assets

	ABC [Group] £m	DEF [Group] £m
Net book amount of land and buildings		
Freehold	•	•
Long leasehold	•	•
Short leasehold	•	•
	<hr/>	<hr/>
	•	•
Other tangible fixed assets	•	•
	<hr/>	<hr/>
	•	•
	<hr/>	<hr/>

[For each society's land and buildings give the difference between the net book amount and estimated current market value, or a director's opinion that there is no material difference between the two. Indicate the basis on which current market value has been determined, the effective date of the valuation and the name(s) of the valuer(s)]

[Identify significant differences in depreciation policy or estimated asset lives, quantifying the impact of any change to a common basis]

(e) Provisions for losses on mortgages and other loans

	ABC [Group] £m	DEF [Group] £m
Specific provisions	•	•

General provisions	• _____	• _____
Total amount offset against mortgages and other loans	• _____	• _____

(f) Pensions

[Describe the pension schemes of each society and the extent to which funded schemes are, on the basis of the latest actuarial valuations, in surplus or deficit. Give date of most recent actuarial valuation.]

(g) Summary information on the businesses of [connected undertakings]

The financial information given above includes the assets and liabilities and results of the Society and the following subsidiary undertakings and associated undertakings.

ABC [Group]

Subsidiary undertakings [names]	Principal activity
Other associated undertakings [names]	

DEF [Group]

Subsidiary undertakings [names]
Other associated undertakings [names]

(h) Post balance sheet events
[see paragraph 3.8]

5. *Costs and benefits of the merger*

[Give a factual assessment of the quantifiable and unquantifiable actual and expected costs and benefits, including integration, rationalisation and future business plans]

Section B: Instrument of Transfer of Engagements or Amalgamation Agreement

The paragraphs below prefaced by “Note” do not appear in [nor are they a paraphrase of the text in] the Instrument of Transfer or amalgamation agreement and are intended for the additional information of members.

The Instrument of Transfer or amalgamation agreement provides, inter alia, for the following matters.

1. *Name of Society*

The name of the combined society will be Building Society.

2. *Transfer of Assets and Liabilities*

On the Effective Date (see item 10) the property, rights and liabilities of [ABC] Building Society will be transferred to and vest in [DEF] Building Society (the combined society). [In an amalgamation, the assets and liabilities of both societies are vested in the new successor society.]

3. *Membership Rights*

[Give the provisions of the Instrument of Transfer or amalgamation agreement concerning deemed membership. See paragraph *BSOG 2.3.16*]

4. *Share Accounts and Deposit Accounts*

On the Effective Date, share and deposit account balances of [ABC] Building Society will become share and deposit account balances with [DEF] Building Society on the following terms:

[Give the provisions of the Instrument of Transfer or amalgamation agreement and refer to the Investment Schedules in Section C]

Note: interest rates which are variable are subject to change either before or after the Effective Date of the merger.

[Provisions concerning PIBS]

5. *Mortgage Accounts*

On the Effective Date, the indebtedness of any person to [ABC] Building Society for a loan made by it [fully] secured on residential property will become indebtedness to [DEF] Building Society to the same extent and such indebtedness will be subject to the same terms and conditions as presently apply except that the Rules of [DEF] Building Society rather than the Rules of [ABC] Building Society shall apply.

[Alternatively, give the provisions of the Instrument of Transfer or amalgamation agreement concerning any change in terms and conditions]

Note: [give any further explanation necessary to a clear statement of any changes, including those effected by the transferee society's Rules]

6. *Bonus to Members*

[Give the provisions of the Instrument of Transfer or amalgamation agreement and the estimated net cost of the bonus. See paragraphs *BSOG 2.3.13* and *BSOG 2.3.14*]

7. *Directors and Other Officers*

[Give the provisions of the Instrument of Transfer or amalgamation agreement]

Note: [Describe any changes in fees and contracts of employment or bonus schemes, or whether there will be no change]

Note: [Describe any compensation to be authorised by separate special resolution, or state that no such compensation is to be paid. State whether any person is not to take up employment with the combined society and that any payments to be made under their contracts of employment do not fall to be approved by special resolution. See paragraphs *BSOG 2.3.11* and *BSOG 2.3.12*]

8. *Employees*

[Give the provisions of the Instrument of Transfer or amalgamation agreement]

Note: [State, unless the Instrument or agreement so provides, whether there are to be any changes to terms and conditions of employment, and what they are, and explain how any staff reductions are to be achieved and the planned timescale.]

9. *Pension Arrangements*

[Give the provisions of the Instrument of Transfer or amalgamation agreement]

10. *Conditions and Termination Provisions*

[Give details of the provisions of the Instrument of Transfer or amalgamation agreement which (a) impose conditions on the completion of the transfer of engagements, such as approval by the members and confirmation by the Authority, and (b) provide for the termination of the agreement if one or more of the conditions is not met or in any other circumstances.]

11. *Rules and Memorandum*

[Explain any proposed Rule changes and, in the case of an amalgamation, any differences in the proposed Rules and Memorandum compared with the existing societies.]

Section C: The Investment Schedules

[These are the schedules referred to in Section B.4 and in paragraph *BSOG 2.3.17*]

Section D: Information for Holders of PIBS

[If either society has issued Permanent Interest Bearing Shares]

Section E: Other Matters

1. Save for [the following and] the matters referred to in Section B.7 no director or other officer of [ABC] Building Society or [DEF] Building Society will

receive any benefits in connection with the merger or will have any material interest in the merger.

[Describe any other interests of directors or other officers and persons (including companies) connected with them by way of, for example, fees for professional services, or supply of goods and services]

2. The directors of [ABC] Building Society and the directors of [DEF] Building Society confirm that the transfer of engagements [amalgamation] will not conflict with any contractual commitments of their Society or its connected undertakings.
3. The directors of [ABC] Building Society and the directors of [DEF] Building Society confirm that there has been no material change in the financial position of their Society or its connected undertakings since [date], the date to which the information in Section A relates [other than the post balance sheet event(s) described in Section A 4(h)].

[Name]
Secretary
[ABC] Building Society
[date]

[Name]
Secretary
[DEF] Building Society
[date]

7. Notice of Special General Meeting

8. Guidance on Voting

[Explanatory notes on:

The time, date and place of the meeting

Eligibility to vote:

- generally
- joint members
- minors

The Poll

Merger Resolutions:

- shareholding members

- borrowing members
- members who are shareholding and borrowing members

[Affected Members Resolution]

[Directors Compensation Resolution]

[Distribution to Members Resolution]

Voting in person

Voting by proxy

Making enquiries, Helpline]

Annex 2

PRO FORMA NOTICE OF, AND APPLICATIONS FOR, CONFIRMATION

- A. Notice of Application**
- B. Application - amalgamation**
- C. Application – transferor society**
- D. Application – transferee society**

Annex 2A

Publication of Notice of application to the Authority for confirmation of an amalgamation or transfer of engagements in the London, Edinburgh, or Belfast Gazettes and in any newspapers as may be directed by the Authority.

BUILDING SOCIETIES ACT 1986

Notice under paragraph 8 of Schedule 16 to the said Act.

Notice is hereby given that Building Society, Register No.....B, whose principal office is at, desires to amalgamate with*/transfer its engagements to*/accept a transfer of the engagements of* Building Society, Register No.....B, and that both societies have jointly*/each society has* applied to the Financial Services Authority to confirm the amalgamation*/transfer*.

Any interested party may make written representations to the Authority and/or give notice of intention to make oral representations to the Authority with respect to the application. Written representations and notices of intention to make oral representations should be received by the Authority at 25 The North Colonnade, Canary Wharf, London E14 5HS by 20 If notice is given of oral representations these will be heard by the Authority on20, at a time and place to be determined by the Authority.

***delete as applicable**

Annex 2B

Form of application to the Authority for confirmation of an amalgamation

To the Financial Services Authority

BUILDING SOCIETIES ACT 1986

APPLICATION UNDER SECTION 93(2)(d) OF THE ACT FOR CONFIRMATION OF AN AMALGAMATION

..... **BUILDING SOCIETY, REGISTER NO.....B, AND**

.....**BUILDING SOCIETY, REGISTER NO.....B**

The above-named societies desire to amalgamate on[insert effective date] and apply to the Authority to confirm the amalgamation.

In making this application the societies declare that:

1. At a meeting of..... Building Society held on 20..., and at a meeting of Building Society held on20..., the following resolutions were passed:

A shareholding members' resolution, as required by section 93(2)(c)(i) of the Act, that the societies do amalgamate in accordance with the terms of an amalgamation agreement, two copies of which, signed by the Secretary of each society for identification, are enclosed with this application.

A borrowing members' resolution, as required by section 93(2)(c)(ii) of the Act, that the societies do amalgamate in accordance with the terms of the above-mentioned agreement.

2. A statement, in accordance with Schedule 16 to the Act, approved by the Authority, so far as it concerned matters specified in that Schedule, was sent to each member of Building Society and of Building Society who was entitled to receive it.
3. Three copies of the Memorandum and Rules of the successor society have been sent to the registration team.

(Seals of the societies making the application)

Date:.....

Annex 2C

*Form of application to the Authority for confirmation of transfer of engagements
(transferor society)*

To the Financial Services Authority

BUILDING SOCIETIES ACT 1986

**APPLICATION UNDER SECTION 95(3) OF THE ACT FOR CONFIRMATION OF
A TRANSFER OF ENGAGEMENTS**

..... **BUILDING SOCIETY, REGISTER NO.....B**

The above-named society desires to transfer its engagements to Building Society on20... [insert effective date] and applies to the Authority to confirm the transfer.

In making this application the society declares that:

1. At a meeting of Building Society held on20.. the following resolutions were passed:

A shareholding members' resolution, as required by section 94(2) of the Act, that Building Society do transfer its engagements to Building Society in accordance with the terms of an instrument of transfer, two copies of which, signed by the Secretary of each society for identification, are enclosed with this application.

A borrowing members' resolution, as required by section 94(2) of the Act that Building Society do transfer its engagements to Building Society in accordance with the terms of the above-named instrument.

2. A statement, in accordance with Schedule 16 to the Act, approved by the Authority, so far as it concerned matters specified in that Schedule, was sent to each member of Building Society who was entitled to receive it.

(Seal of the Society making the application)

Date.....

Annex 2D

***Form of application to the Authority for confirmation of a transfer of engagements
(transferee society)***

To the Financial Services Authority

BUILDING SOCIETIES ACT 1986

**APPLICATION UNDER SECTION 95(3) OF THE ACT FOR CONFIRMATION OF
A TRANSFER OF ENGAGEMENTS**

..... **BUILDING SOCIETY, REGISTER NO.....B**

The above-named society desires to accept a transfer of engagements of
Building Society on20.. [insert effective date] and applies to the Authority to
confirm the transfer.

In making this application the society declares that:

- *1. At a meeting of Building Society held on 20.., the following resolutions were passed:

A shareholding members' resolution, as required by section 94(5)(a) of the Act, thatBuilding Society shall undertake to fulfil the engagements of Building Society in accordance with the terms of an instrument of transfer, two copies of which, signed by the Secretary of each society for identification, are enclosed with this application.

A borrowing members' resolution, as required by section 94(5)(a) of the Act, that Building Society shall undertake to fulfil the engagements of Building Society in accordance with the terms of the above-mentioned instrument.

- *2. The Building Society, pursuant to the consent of the Authority in accordance with section 94(5)(b) of the Act, has undertaken by a resolution of its Board of Directors to fulfil the engagements of Building Society in accordance with the terms of an instrument of transfer two copies of which, signed by the Secretary of each society for identification, are enclosed with this application.

- *3 A statement in accordance with Schedule 16 to the Building Societies Act 1986, approved by the Authority, so far as it concerned matters specified in that Schedule, was sent to each member of Building Society who was entitled to receive it.

(Seal of the Society making this application)

Date.....

***delete as applicable (either paragraph 2, or both paragraphs 1 and 3)**

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	Date	<i>BSOG 2.4.12</i>
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	Majorities	<i>BSOG 2.4.1 to</i> <i>BSOG 2.4.4</i>
Voting Entitlement	Borrowers	<i>BSOG 2.4.5 to</i> <i>BSOG 2.4.13</i> <i>BSOG 2.4.9</i>
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Annex 4

Merger Confirmation Procedures

4.1	Introduction	
4.1.1	G	This annex is for the guidance of those making written representations to the Authority and/or those participating in oral confirmation hearings. It sets out the procedures which the Authority will normally follow.
4.1.2	G	The 1986 Act provides that when the necessary merger resolutions have been passed the societies must obtain confirmation by the Authority of the merger in accordance with Section 93(2) (amalgamations) or Section 94(7) (transfers of engagements) of the 1986 Act. If the Authority confirms the merger it will issue a registration certificate.
4.1.3	G	References to the relevant provisions of the 1986 Act are given in parenthesis in this annex. The term “merger” means either an amalgamation or a transfer of engagements as provided by sections 93 and 94 of the 1986 Act.
4.2	The role of confirmation	
4.2.1	G	The role of the confirmation procedures is limited. Section 95(3) and (4) of the 1986 Act provide that the Authority must confirm a transfer unless it considers that:
	(1)	some information material to the members’ decision about the merger was not made available to all the members eligible to vote; or,
	(2)	the vote on any resolution approving the merger does not represent the views of the members eligible to vote; or,
	(3)	some relevant requirement of the 1986 Act or the rules of any of the societies was not fulfilled.
4.2.2	G	These are the only grounds on which the Authority may refuse confirmation, or direct the society to remedy any defects. It is not the Authority’s function to make any judgement about the merits of the proposals which the members have approved.
4.2.3	G	If the Authority finds that there are defects, it may direct the society to take steps to remedy them. These include the calling of further meetings. If it is then satisfied that the defects have been substantially remedied, it must confirm the merger; if not, it must refuse confirmation (Section 95(6) of the 1986 Act).
4.2.4	G	The Authority may direct that non-fulfilment of some relevant requirement of the 1986 Act or of the rules of the society is to be disregarded, if it appears to the Authority that the failure could not have been material to the

		members' decision (Section 95(5)). "Relevant requirement" in this context means a requirement of section 93, 94 or 95 of or Schedule 16 to the 1986 Act or of any rules prescribing the procedure to be followed by the society in approving or effecting the merger (Section 95(11) of the 1986 Act).
4.2.5	G	The 1986 Act provides that any accidental failure to send the notice of meeting and merger statement to any person entitled to receive them does not invalidate the proceedings at the general meeting (paragraph 22(3) of Schedule 2 to the 1986 Act).
4.3	Representations to the Authority	
4.3.1	G	Any interested party has the right to make representations to the Authority with respect to the societies' applications for confirmation. They should state clearly why the person making the representations claims to be an interested party e.g. membership of the society and the matters to which the representations are directed.
4.3.2	G	Written representations, or notice of a person's intention to make oral representations, or both, must be in writing. They must reach the Authority at 25 The North Colonnade, Canary Wharf, London E14 5HS by the date quoted in the merger documentation issued to members and published in the official Gazettes and (usually) some newspapers. Persons who make written representations, but subsequently decide also to make oral representations must, nevertheless, give notice of that intention, in writing, to the Authority by the same date (paragraphs 8 and 9 of Schedule 16 to the 1986 Act). The Authority will in general be prepared to use electronic rather than paper-based communication for notices and written representations if requested by the society or a prospective representer. A specific electronic address will be provided for that purpose, and some of the relevant procedures may have to be adapted accordingly.
4.3.3	G	Representations or notices to the Authority will fall into one of the following three categories:
	(1)	Written representations only.
	(2)	Written representations with notice of intention to make oral representations.
	(3)	Notice of intention to make oral representations only.
4.3.4	G	The Authority will send copies of all written representations to the society, and will afford it an opportunity to comment on them (paragraph 9 of Schedule 16 to the 1986 Act).
4.3.5	G	Copies of the society's comments on representations in category 4.3.3(2) will be sent to those who made the representations so that they may concentrate their representations at oral hearings on the points which they consider to remain at issue. Persons making written representations who wish to see the society's comments must, therefore, also give notice of intention to make oral representations. Any documents referred to in the

		society's comments will be made available by the society for inspection at a specified place which will be notified to those making oral representations. (The society may, exceptionally, apply to put to the Authority in confidence documents which the society considers to be commercially sensitive: the Authority will decide on hearing argument whether, and on what terms, to accept them as confidential). Persons in category 4.3.3(3) will be asked to inform the Authority, in advance of the hearing, of the subject and general grounds of the representations they intend to make. The Authority will pass this information to the society.
4.3.6	G	Interested parties may join together in making collective representations and they may also appoint a person, either one of their number or another, to represent them at the hearing. They should notify the Authority in advance if this is what they intend to do.
4.4	Purpose of the hearing	
4.4.1	G	The purpose of the hearing is to enable interested parties to make representations, and to enable the Authority to make such enquiry as it considers necessary, both of the society and of those making representations, in order to reach an informed view on those aspects of the decision on confirmation to which the representations are directed. The Authority will examine all the representations, whether written or oral, in relation to the three statutory criteria described in paragraph <i>BSOG</i> 4.2.1. In the light of that examination, and consideration of all the representations and the society's response, the Authority will decide whether to confirm, or direct the society to correct any defects, or to refuse to confirm the merger. It is for the Authority to decide whether the matters discussed in representations are relevant to the statutory criteria.
4.5	Persons hearing the applications	
4.5.1	G	The hearing will be taken by a person or persons appointed by the Authority to hear and decide the applications on its behalf, and they will be assisted by staff of the Authority.
4.6	Time and place	
4.6.1	G	Hearings will normally start at about mid-morning on the day quoted in the merger documentation sent to members, and at a place which will be notified to the participants. If there are a significant number of persons wishing to make oral representations, then the hearing may extend beyond one day and may be adjourned from time to time and from place to place.
4.7	Procedure at the hearing	
4.7.1	G	The Authority expects that oral hearings will be in public. Members of the general public and the Press will be asked to wait outside at the outset of the hearing. The participants will then be asked if any of them has good reason to object to the admission of the general public (including the Press). The Press and the general public will then be admitted, within the limits of the space available, unless an objection by a participant is upheld by the

		Authority. However, the Authority may decide that parts of the hearing shall be in private if that appears to it to be desirable (for example, if representers feel it necessary to disclose their personal affairs).
4.7.2	G	The procedure will be informal. While all participants will be expected to speak concisely and to avoid repetition, the Authority will be considerate towards those who are not professionally represented. The persons appointed to hear the applications may question the participants as the hearing proceeds. The sequence of events will be broadly as follows:-
		(1) Any preliminary matters (such as the admission of the public or other procedural questions) will be dealt with.
		(2) The person chairing the hearing on behalf of the Authority will introduce the proceedings.
		(3) The representatives of the Societies will be invited to speak to their applications, including a description of the events at the meetings at which the merger resolutions were put to the members, a statement of the voting on the resolutions, and any other matters which they wish to introduce at that stage.
		(4) The other participants will be invited to speak to their representations. Where appropriate the Authority would expect to call them in a list marshalled, so far as possible, by subject matter.
		(5) The representatives of the society will be invited to reply to, or comment on, the points made by the other participants.
		(6) The other participants will be invited to comment on the society's replies.
4.7.3	G	The above procedure may be varied according to the circumstances at the hearing, and is intended only as a guide to the probable order of events. The hearing may be adjourned if the Authority considers that necessary to enable facts to be checked or additional information to be obtained.
4.8	The Authority's decision	
4.8.1	G	The Authority will not normally give an oral decision at the end of the hearing. The Authority will subsequently issue a written decision, setting out its reasons. A copy of the written decision will be sent to each of the participants in the hearing and to those who made written representations and, on request, to any other person. The decision may also be published.

CHAPTER 3
Transfer procedures

3.1	Introduction	
	The Purpose of this Chapter	
3.1.1	G	This chapter ultimately derives from the Transfer Procedures Guidance Note published by the Commission in April 1998. It gives guidance on the requirements of the 1986 Act relevant to, and on the procedures to be followed by, a building society proposing to transfer its business to a company having permission under the Act to carry on those regulated activities which it will undertake as a result of the transfer. It is not intended to be exhaustive, and is not a substitute for looking at the 1986 Act and the Transfer Regulations, on which a society should seek its own legal advice. It describes the relevant provisions of the 1986 Act, and the information which must be made available to the Authority and to the society's members, and outlines the procedures to be followed at general meetings, including the voting majorities required to pass the Transfer Resolutions. The chapter also describes the role of the Authority in approving the Transfer Statement which must be sent to the members and in the confirmation procedure, together with its ongoing prudential supervision during the transfer process. The Transfer Summary, which a society may send to its members instead of the Transfer Statement, is also discussed. Except as described in section 3.7, to which section 3.8 also applies, this section is concerned only with voluntary transfers under Section 97 of the 1986 Act.
3.1.2	G	It is for the directors of a society to assess the case for transfer, and they must explain and recommend their decision to the members. However, the Authority's staff are willing to discuss with a society the procedures to be followed and the information required to ensure that the members can reach fully informed decisions. Societies are strongly recommended to consult the Authority early on in the formative stages of transfer proposals. Such consultation will, of course, be treated in the strictest confidence. It will be helpful, also, to have regard to the indicative timetable set out in section 3.9.
3.1.3	G	Societies should consult their own legal advisers about the application of the provisions of the 1986 Act, and the general law, to the particular features of a proposed transfer.
3.1.4	G	This chapter considers each stage of the transfer procedure in chronological order. The remainder of this section gives a synopsis of the relevant requirements of the 1986 Act, which are then discussed in more detail in subsequent sections, as follows:
	(1)	Section 3.2, Preliminary Matters, considers the rationale for a transfer and the handling of public announcements, and gives guidance on certain prudential issues.
	(2)	Section 3.3, Terms of a Transfer, considers the mandatory provisions

			of Section 100 of the 1986 Act concerning the successor company's obligation to treat former shareholders of the society as depositors with it, and the Statutory Cash Bonus. It also considers the mandatory provisions of Sections 102B to D of the 1986 Act, concerning distributions to members who are Trustee Account Holders, the statutory restrictions on distributions to members in Section 100, and the permissive provisions of Sections 100 and 102A. The protective provisions for specially formed successor companies are also discussed.
		(3)	Section 3.4, Information Provided to Members, discusses the form and content of the statutory Transfer Statement and the Transfer Summary, and the accompanying rationale and other statements by the board, and describes the form of application to be made to the Authority for approval of the Transfer Statement.
		(4)	Section 3.5, General Meetings and Resolutions, discusses the register of members and members' entitlement to vote, the arrangements for general meetings, the conduct of voting on the Transfer Resolutions and the scrutineers' report.
		(5)	Section 3.6, Confirmation, describes the form of application to the Authority for confirmation of a transfer, and the procedures which the Authority expects to follow in considering and hearing written and oral representations and in reaching its decision.
		(6)	Section 3.7, Transfers Under Direction, describes the modified procedure to be followed when a society has been directed by the Authority to transfer its business to a company and to proceed by board resolution.
		(7)	Section 3.8, Notification and Dissolution, briefly discusses the process of notification of the vesting date and dissolution of the society.
		(8)	Section 3.9, Timetable, reviews the several stages of a transfer from start to finish.
Statutory Requirements			
3.1.5	G		The provisions of the 1986 Act concerning transfers are in Sections 97 to 102D of, and paragraph 30 of Schedule 2 and Schedule 17 to the 1986 Act, where two types of transfer of business are provided for:
		(1)	to a specially formed company, known as conversion; or
		(2)	to an existing company, known as a takeover.
			The procedures are the same in each case, except that the specification of the turnout required to pass the shareholding members' resolution to approve a takeover is, in effect, higher than is required to approve a conversion. The 1986 Act also provides that a specially formed company shall have qualified protection from takeover for up to five years after the vesting date.

		[Note: A takeover may take the form of a transfer of the business of a society to a subsidiary of the society which is an existing company carrying on business as a going concern, as in the case of Halifax plc (formerly Halifax Syndicated Loans Limited.)]
3.1.6	G	One of the principal purposes of these provisions of the 1986 Act is to ensure that the members are given all the material information they need about the terms of the transfer which they are asked to approve, and proper opportunity to cast their votes. Subsequently, they are given the opportunity to make representations about that process before the transfer is confirmed. The 1986 Act also prescribes certain mandatory terms, and places restrictions on certain permitted terms, of a transfer.
3.1.7	G	The 1986 Act makes no provision for a transfer to be initiated by any means other than a recommendation of an agreed proposal put by the board of a society to its members (see paragraph 11.10 of the Commission's Decision to confirm the transfer of Halifax Building Society to Halifax plc, which related to alternative distribution schemes) and the Transfer Regulations require the board of a society to give particulars, in the Transfer Statement, of the options for the future conduct of the society's business which it considered before deciding to recommend the transfer to the members and of the reasons why it recommends the proposed terms. Each member who is entitled to receive notice of the general meeting at which the Transfer Resolutions are to be moved must also receive (or have made readily available to him if the Transfer Summary is provided) a copy of a statutory Transfer Statement. A transfer must be approved by a shareholding members' resolution and a borrowing members' resolution. The majorities required to pass these resolutions are described in section 3.5.
3.1.8	G	If the terms of a transfer include provision for the payment of compensation to directors or other officers for loss of office or of income attributable to the transfer, then the proposed payments must be authorised by a separate special resolution. If the terms include provision for any director or other officer to receive increased emoluments in consequence of the transfer, then an ordinary resolution approving that provision must be put before a meeting of the society.
3.1.9	G	The 1986 Act specifies certain procedures for the consideration of representations by interested parties concerning confirmation, and the criteria which the Authority must consider before deciding whether or not to confirm a transfer. The matters which the Authority may consider do not include the merits of the transfer proposals, nor the fairness of the terms, which the members will have approved by passing the Transfer Resolutions.
3.1.10	G	The statutory requirements of the 1986 Act are explained and discussed in more detail in subsequent sections of this chapter. However, as is stated in paragraph <i>BSOG</i> 3.1.1, this chapter is not exhaustive and is not a substitute for considering, and taking professional advice on, the primary documents, which include:

the Building Societies Act 1986, as amended by or under other legislation, including:

the Building Societies (Joint Account Holders) Act 1995

the Building Societies (Distributions) Act 1997

the Building Societies Act 1997 and

the Financial Services and Markets Act 2000 (in particular by the

Financial Services and Markets Act 2000 (Mutual Societies) Order 2001)

and the Financial Services and Markets Act 2000 (Consequential Amendments and Repeals) Order 2001

the Building Societies (Transfer of Business) Regulations 1998

(SI 1998/212)

Judgments of the High Court in:

Abbey National Building Society v The Building Societies Commission

[1989] 5 BCC 259

Cheltenham & Gloucester Building Society v The Building Societies

Commission [1994] 4 All ER 65, [1995] Ch 185, and [1994] 3 WLR 1238

The Building Societies Commission v Halifax Building Society and Leeds Permanent Building Society [1995] 3 All ER 193

R v The Building Societies Commission, ex parte Whitmey, unreported,

16 April 1997, Lightman J (relating to the Alliance & Leicester Confirmation Decision).

Building Societies Commission Confirmation Decisions on applications by:

Abbey National Building Society (5 June 1989)

Cheltenham & Gloucester Building Society (5 July 1995)

National & Provincial Building Society (3 July 1996)

Alliance & Leicester Building Society (11 March 1997)

Woolwich Building Society (16 May 1997)

Halifax Building Society (23 May 1997)

Bristol and West Building Society (9 July 1997)

Northern Rock Building Society (18 July 1997)

Birmingham Midshires Building Society (18 March 1999)

Bradford & Bingley Building Society (28 September 2000)

Electronic Communications Order 2003

3.1.11

G

Societies should be aware that this Order modifies various relevant provisions of the 1986 Act. This enables the use of electronic communications between societies, their members and other persons on matters relating to a proposed transfer of business, such as the transfer statement and voting arrangements. The Order requires that societies must obtain consent before using electronic means of communication. The remaining text of this chapter has not been amended to take account of the Order. A society proposing to use electronic communications in relation to a transfer of business will need to take its own legal advice as to how the procedures described in this chapter will have to be adapted. In that event the Authority will also adapt its own procedures appropriately.

3.2	Preliminary Matters	
	Rationale for a Transfer	
3.2.1	G	It is a matter for the board of a society to decide whether to recommend a transfer to its members. The overriding duty of the board is to reach a view having regard to what is in the best interests of the society in the short and long term, including the interests of the members as a whole, both present and future, as members of a building society, both borrowing members and shareholding members. The board of a society may also reasonably consider the interests of customers who are not members, of the staff, of suppliers of goods and services, and of the wider community.
3.2.2	G	The decision of the board to recommend a transfer must be based on a proper evaluation of the issues in relation to a strategic assessment of how the society can best serve its members. One element of that assessment will be the forward business plan of the successor company (including, in the case of a takeover, how the successor company plans to integrate the business of the society) which will be relevant to:
	(1)	the presentation of the case to the members; and
	(2)	the submission to the Banking Regulator for permission to carry on the regulated activities which it will undertake as a result of the transfer.
		Copies of the plan should be provided to the Authority and to the Banking Regulator (if the latter is a different authority in another member state).
3.2.3	G	Neither conversion nor takeover are likely to figure routinely as options in societies' corporate plans. However, a board may develop the society's business in ways which point to the need to consider the transfer option: in which case, a transfer should be foreseen and emerge from the board's strategic plans. If a board is considering the options of conversion or merger with another society, it should, as a matter of prudence, consider how it would respond to a counter proposal and develop appropriate contingency plans.
3.2.4	G	When a board is seriously considering conversion or a takeover, the range of issues which it will need to assess will vary from case to case and is for the board to decide. However, the board will necessarily have regard to its primary duty to reach a view on what is in the best interest of the members, as members of a building society, and not only their short-term interests. It will also be conscious of the requirement to give, in the Transfer Statement, a factual account of the options which it considered and of the reasons why it decided to recommend to the members the terms of any proposed transfer and of the qualifying conditions for any distribution of funds or shares in the successor company in consideration of the transfer.
Public Announcement		
3.2.5	G	A board will usually wish to announce its proposals as soon as possible after it

		<p>has decided to recommend a transfer to the society's members. In particular, the board will no doubt wish to inform the members and staff of the proposed terms so that they do not then operate their accounts, or otherwise act, in ignorance of proposals which would have affected their behaviour. The board will also wish to avoid misleading potential investors and borrowers; and societies with listed PIBS must have regard to the Authority's requirements concerning early disclosure of any information which might affect the price of securities. However, a board may not feel able to make an immediate announcement, perhaps for prudential or commercial reasons, or because it first wishes to settle all the details of the proposed terms. In these circumstances, the board must have contingency plans to make an early announcement to deal with any potentially damaging rumours and to avoid members being misled or left in a state of uncertainty. In considering the timing and terms of an announcement, the board will wish to minimise the risk of destabilising flows of funds.</p>
3.2.6	G	<p>The announcement, particularly information provided directly to members and staff, should make it clear that the proposal is subject to approval by the members and completion of the statutory procedures. It should also be made clear, in the case of a takeover, and if such is the case, that the proposal is subject to completion of due diligence investigations by the acquirer and, in either a conversion or takeover when shares in the successor company are to be issued, that the proposal is subject to the shares being listed on the London Stock Exchange or elsewhere. Boards should be careful to avoid appearing to assume that the outcome is a foregone conclusion, and should identify any matters of substance on which the proposed terms of the transfer remain to be settled. Briefing of staff who will be responsible for responding to enquiries from members and the Press should be considered carefully and prepared in advance of the announcement to avoid any risk of members being unintentionally misled. A free phone helpline may be desirable for members' enquiries about whether they qualify for any distribution under the proposed transfer scheme, but again the staff must be well briefed. It is essential that the announcement, and subsequent information given to members before they are sent the statutory Transfer Statement, or Summary, and in any briefing of the Press, is entirely consistent with what will appear in that Statement. In particular, members should be advised to await the Transfer Summary, and especially the Transfer Statement which will contain full details of the proposals and the information relevant to their decision on how they wish to vote.</p>
3.2.7	G	<p>The Authority is not required to approve the content or wording of announcements or preliminary information sent to members. However, it will be happy to comment on drafts shown to it at an early stage, and may be able to help societies to avoid unintentionally misleading statements.</p>
3.2.8	G	<p>The board should consult the Authority and, if a different body, the Banking Regulator at an early stage in its consideration of transfer proposals, and certainly no later than its decision in principle to seek a transfer. The complexities of the statutory provisions are such that it is necessary to have the proposed transfer terms specified very closely indeed before it is possible for the Authority to take a view on whether the proposals are fully in conformity</p>

		with the 1986 Act. The Banking Regulator will not be in a position, at this early stage, to give positive assurances as to the permission to be given to the successor company. However, a prudent board will seek the views of the Authority, and also, if different, of the Banking Regulator, before it decides to announce its transfer proposals to the members. This preliminary discussion with the Authority will necessarily cover the proposed structure of the successor company or group and a written specification of the transfer terms, particularly the scheme for distribution of any consideration to be offered to the members for the loss of their membership rights in the society, which members and other persons are to benefit, and the criteria for qualification.
3.2.9	G	Should there be a difference of view between the Authority and the society as to whether a scheme, or a particular feature of it, is in conformity with the 1986 Act, it may prove desirable to apply to the High Court for a declaration. It will then be necessary for any preliminary announcement of the board's proposals to make the position clear, and for it to allow sufficient time in its proposed timetable for the application to be heard, and for any appeal.
Prudential Issues		
3.2.10	G	In addition to information about the proposed transfer scheme, the Authority will expect the board to provide it with information about its plans for ensuring the prudent management of the society through to the proposed vesting date. That information will be consistent with what the board itself will require, bearing in mind that it is for the board to exercise due diligence and to be satisfied that the society's business continues to be directed and managed prudently. The information required is:
		(1) the names and responsibilities of senior managers assigned to manage the transfer process;
		(2) an assessment of the systems requirements of the transfer process, together with the specification of work to be done by consultants (e.g. the external auditors/scrutineers) and their report(s);
		(3) contingency plans, with sensitivity and risk assessments, for managing funding and liquidity during the transitional period;
		(4) copies of the business plans of the successor company as submitted in connection with its permission to carry on the regulated activities which it will undertake as a result of the transfer.
3.2.11	G	The Authority will also wish to have a letter from or on behalf of the society's board, which consents to the Authority discussing the society's affairs with the Banking Regulator (if a different body) and the competent authority for listing in the U.K. (if a different body from the Authority and an issue of shares in the successor company is intended to be made in connection with the transfer).
3.2.12	G	A transfer is exceptionally time-consuming for senior management. The Authority will wish to be satisfied that the society has sufficient management resources to cover both the transfer and its day-to-day business within its proposed transfer timetable. It will usually be necessary for the society

		severely to limit new business developments and initiatives during the transitional period. It should also be noted that the requirements for information to be provided to members mean that full disclosure will be required in the Transfer Statement of any negotiations in progress on acquisition or other links during the transfer process. The Banking Regulator must be kept fully informed of any such plans because any changes to the society's business, structure, controls etc. may well be relevant to the terms of its successor company's permission.
3.2.13	G	The Authority will appoint a project team, responsible for operational management of the Authority's functions in relation to the transfer process. The expectation would be that the team will include the Manager responsible for the society's supervision and one of the Authority's legal advisers. Names and contact numbers will be provided to the society. The Authority would strongly advise a society similarly to appoint a project team, headed by a senior manager responsible to the board for management of the whole process and with authority to control the drafting and verification of the Transfer Document, other briefing and information to members, and responses to representations at the confirmation stage. Strong central control under the direction of the board is, in the Authority's view, essential for effective management of a transfer.
3.2.14	G	The society will be expected to provide the Authority with a systems report from its auditors together with an action plan to remedy any shortcomings. The Banking Regulator, if a different body, may have similar requirements. This report is only part of the full information package which the Banking Regulator will (or is likely to) require in connection with the successor company's permission to carry on the regulated activities which it will undertake as a result of the transfer and which will be needed so that the Authority can be satisfied in relation to its requirements up to the vesting date.
3.2.15	G	The society will need to develop plans to deal with a number of possible contingencies; for example, receipt of a counter-offer (whether private or public) during the transfer process, changes in market conditions or financial results which materially affect the information given in the Transfer Statement, failure to obtain the members' approval, delay of the planned vesting date and of any flotation, and greater exposure to liquidity risk during the transitional period. The Transfer Agreement should include provision for its termination if, for any reason, flotation does not take place within a specified period after confirmation, and for the board to decide not to proceed if market conditions or other developments mean that it would not be reasonable to do so having regard to the basis on which it secured the approval of the members. The Authority will wish to see the society's contingency plans.
3.2.16	G	Before it approves the Transfer Statement, the Authority will wish to be satisfied that the successor company is expected to have permission to carry on such regulated activities as will enable it to undertake the business it will have as result of the transfer. It will also ask the Banking Regulator, if different, to confirm that the information given in the draft Transfer Statement appears to be consistent with, and has no material omission of, information available to the Banking Regulator.

3.3	Terms of a Transfer	
3.3.1	G	<p>This section discusses the provisions of the 1986 Act which prescribe the terms of a transfer which must be included in the Transfer Agreement and the restrictions on terms which may be included. It also discusses the formation of, and protective provisions for, specially formed companies and the status of existing companies. Section 97(4) of the 1986 Act provides that in order to transfer its business to a company, inter alia, a society must agree conditionally with its successor in a Transfer Agreement on the terms of the transfer which, in so far as they are “regulated terms” (as defined in Section 97(12)), comply with Sections 99 and 100 of the 1986 Act and with the Transfer Regulations. In the case of a specially formed company, a society must also secure that the articles of association of the successor company have the requisite protective provisions prescribed by Section 101(2) of the 1986 Act.</p>
The Qualifying Day		
3.3.2	G	<p>The choice of Qualifying Day is important because it is a determining factor in deciding which members must have conferred upon them a right to the Statutory Cash Bonus provided by Section 100 of the 1986 Act. It may also be relevant in deciding which members may receive certain rights under a proposed distribution of funds or of shares in the successor company. The Commission’s view was that there can be only one Qualifying Day for these purposes, which must be clearly distinguished from any other “reference dates” which may be chosen by a society for the purposes of its transfer scheme. Subsection (13) of Section 100 defines the Qualifying Day as the day specified in the Transfer Agreement as the qualifying day for the purposes of that subsection. This does not appear to restrict the society’s choice of qualifying day. A number of arguments for such a restriction have been advanced, including that the use of the past tense “which expired with the qualifying day” in subsection (9), read in the context of Section 100 as a whole, indicates that the Qualifying Day must pre-date the Transfer Agreement. The Authority has not been required to express a view on the matter (and see paragraphs 4.20 and 17.4 of the Commission’s Decision to confirm the transfer of the business of Cheltenham & Gloucester Building Society to a subsidiary of Lloyds Bank plc).</p>
3.3.3	G	<p>For completeness, it should be noted that the Authority takes the view that the conditional Transfer Agreement must have been signed by the society and its successor company and commenced (albeit conditionally) before the Authority can approve the Transfer Statement. This is because the Authority must be satisfied, before it approves the Transfer Statement, that the Statement correctly describes the proposed terms of the transfer as provided by the Transfer Agreement, and the Agreement cannot properly be said to exist until it has been signed by the parties concerned. The Transfer Agreement, as is made clear by its definition in Section 97(12) of the 1986 Act, is necessarily conditional, inter alia, on the society’s members’ approval of the Transfer Resolutions under Section 97(4)(c), and confirmation of the transfer by the Authority (which includes confirmation by the Banking Regulator that it expects to authorise the successor company) under Section 98(2) of the 1986</p>

		Act.
Share Accounts		
3.3.4	G	Section 100(2)(a) and (3) of the 1986 Act provide that the terms of a transfer must require the successor company to assume as from the vesting date a liability in respect of a deposit to every member of the society equal to the value of the shares held by such member immediately before the vesting date. In other words, amounts held in share accounts on the eve of the vesting date must become identical amounts held in deposit accounts from the start of the vesting date.
Statutory Cash Bonus		
3.3.5	G	Section 100(2)(b) and (4) of the 1986 Act provide that the terms of a transfer must confer a right to a distribution of funds by way of bonus, whether paid by the society or its successor company, on every member of the society who held shares in the society on the Qualifying Day but was not eligible to vote on the shareholding members' resolution. Where the account is in joint names, see also paragraph <i>BSOG</i> 3.3.12, Schedule 2 to the 1986 Act and the Rules of a society prescribe who is eligible to vote (see section 5). Broadly speaking, members who are not entitled to vote on the resolution are those who are under 18 years of age on the date of the meeting or, if the Rules so provide, those who had less than the qualifying shareholding (usually £100) on the qualifying shareholding date or who ceased to hold shares in the period between the qualifying shareholding date and the voting date. However, the High Court declared in <i>Abbey National Building Society v The Building Societies Commission</i> that, in order to qualify for the Statutory Cash Bonus, in addition to having held shares in the society on the Qualifying Day, a member also must have held shares continuously between the Qualifying Day and the vesting date. In coming to this judgement, the Vice Chancellor found the sequence of tenses used in subsection (4) of Section 100 of the 1986 Act to be illuminating: "It says that a member is ... a qualifying member if he held ... shares in the society on the qualifying day and was not ... eligible to vote ... The subsection is therefore looking at somebody who at a particular point of time is a member and who had certain qualifications in the past... the relevant date for establishing membership is the vesting day ... it is implicit in subsection (4) that the person ... must have been a member on the qualifying day and have remained a member thereafter continuously through until the vesting day". In settling the terms of the declaration, the Vice Chancellor confirmed that when referring to the member remaining a member between the two dates, he intended to mean as a member holding shares.
3.3.6	G	The bonus is to be calculated as that proportion which the society's reserves bear to its total liability to its members in respect of shares, as shown in the latest balance sheet of the society, applied to the value of the shares held by the member on the Qualifying Day. If a Transfer Statement is approved and sent to the members just before, or shortly after, the end of the financial year of the society, it will be important to note that the Annual Report and Accounts for the year will have been published by the vesting date, when qualifying membership has to be established and the bonus is due to be paid. In those

		circumstances, “the latest balance sheet of the society” will be that published in the most recent Annual Accounts. The same considerations may apply when a society publishes half-yearly results.
3.3.7	G	The Authority may direct, however, where it confirms a transfer of a society’s business to an existing company (i.e. only in a takeover), that no Statutory Cash Bonus is paid or that a lesser amount is paid than that referred to in paragraph <i>BSOG</i> 3.3.6, having regard to what is equitable between the members.
Distributions to Members		
3.3.8	G	Section 100(1) of the 1986 Act provides that: “Subject to subsections (2) to (10), the terms of a transfer of business by a building society to the company which is to be its successor may include provision for part of the funds of the society or its successor to be distributed among, or other rights in relation to shares in the successor conferred on, members of the society, in consideration of the transfer”.
3.3.9	G	In respect of rights to shares, Section 100(8) of the 1986 Act provides that: “Where, in connection with any transfer, rights are to be conferred on members of the society to acquire shares in priority to other subscribers, the right shall be restricted to those of its members who held shares in the society throughout the period of two years which expired with the qualifying day; and it is unlawful for any right in relation to shares to be conferred in contravention of this subsection”; and, in respect of a distribution of funds, Section 100(9) of the 1986 Act provides that: “Where the successor is an existing company, any distribution of funds to members of the society, except for the distribution required by subsection (2)(b), shall only be made to those members who held shares in the society throughout the period of two years which expired with the qualifying day; and it is unlawful for any distribution to be made in contravention of the provisions of this subsection”; while, in respect of a transfer to a specially formed company, Section 100(10) of the 1986 Act provides: “The following restrictions apply to any distribution of funds, or any conferring of rights in relation to shares, in connection with the transfer of its business from the society to its successor where the successor is a company specially formed by the society, that is to say-
		(a) no distribution shall be made except that required by subsection (2)(b); and
		(b) where negotiable instruments acknowledging rights to shares are issued by the successor within the period of two years beginning with the

		vesting date, no such instruments shall be issued to former members of the society unless they are also issued, and on the same terms, to all other members of the company;
		and it is unlawful for any distribution of funds to be made in contravention of the provisions of this subsection”.
3.3.10	G	The meanings of subsections (1), (8), (9) and (10) of Section 100 of the 1986 Act have been considered by the High Court in four cases: Cheltenham & Gloucester Building Society v The Building Societies Commission, in relation to distributions of funds, and Abbey National Building Society v The Building Societies Commission, The Building Societies Commission v Halifax Building Society and Leeds Permanent Building Society and R v The Building Societies Commission, ex parte Whitmey in relation to share distributions. These judgments related to specific proposals and may not necessarily be directly relevant in all respects to transfer schemes proposed by other societies in the future. A society must obtain its own advice when formulating proposals for a cash or share distribution scheme.
3.3.11	G	As is explained in paragraph <i>BSOG</i> 3.2.8, the Authority will have to see a fully specified description of the distribution scheme before it can form its own view of whether it is in conformity with the 1986 Act. The Authority would find it helpful if the society enclosed copies of the legal advice it has received when submitting a scheme for consideration.
Joint Share Account Holders		
3.3.12	G	Paragraph 7 of Schedule 2 to the 1986 Act deals with joint shareholders and defines the “representative joint holder” as “that one of the joint holders who is named first in the records of the society.” Paragraphs 7(5) and (5A) of that Schedule provide that, for the purposes of Sections 87 and 93 to 102 of the 1986 Act, the shares shall be treated as held by the representative joint holder alone and, accordingly, joint holders, other than the representative joint holder, shall not be regarded as members of the society by reason only of being a joint holder of those shares. The effect of this provision (but subject to the provisions of Section 102A) is that if, for example, the representative joint holder dies, or the order of names on the account is changed in the two years preceding the Qualifying Day, any rights to a distribution under a transfer scheme, which are conferred on those who have held shares for two years up to the Qualifying Day, cannot devolve upon any other joint account holder, unless that holder is in his or her own right, by virtue of another account holding, a two-year shareholding member.
3.3.13	G	Section 102A, however, provides that, in certain circumstances, second named joint holders, who have themselves held shares in the society continuously during the two year qualifying period, whether as sole or joint holders of shares, may qualify for a right which otherwise could only have gone to a first named holder. Cases which would be covered by the provisions of Section 102A include: the death of the first named holder, including where, for example, a third named joint account holder would move up the scale if both the previous first named and second named holders were killed in the same car accident; the creation of a joint account, for example, on marriage; the division

		of a joint account on divorce or separation, or for any other reason, where the previous first named holder has ceased to hold shares in the society; and when there has been a change in the order of names within an account.
3.3.14	G	Points to note are that Section 102A applies only to joint share account holders (joint borrowers are not affected) and is only relevant where the application of the two year qualifying period prescribed by Section 100 is relevant to a proposed distribution of funds or conferring of rights to shares. The provisions of Section 102A are permissive, not mandatory (see paragraphs 13.2 to 13.5 of the Commission’s Confirmation Decision on the application by National & Provincial Building Society) and are not “relevant requirements” of the 1986 Act (see paragraph <i>BSOG</i> 3.6.17). It is for the society’s board when proposing a transfer scheme to decide whether to incorporate in its distribution scheme none, some, or all of the cases where Section 102A allows membership of a joint account, other than as the first named holder, to count towards the two year qualifying period. Finally, these provisions do not affect the position of the personal representatives or beneficiaries of deceased sole holders of share accounts. Societies should obtain their own advice on all these matters when considering how they wish to construct the terms of a proposed distribution scheme.
Trustee Account Holders		
3.3.15	G	A member who holds funds in a share account, or holds a mortgage account, on trust for another person is not a Trustee Account Holder unless the following conditions are satisfied. Sections 102B to D of the 1986 Act require that, if the terms of a transfer include distributions of funds or of rights to shares to members of the society, then each Trustee Account Holder shall be treated by the society and its successor as not being disentitled from receiving, in addition to any distribution to which he or she may be entitled in any other capacity, a separate distribution in respect of each account which he or she holds in trust for certain categories of beneficiaries (provided that, as holder of that account, he or she meets the conditions for receipt of a distribution under the scheme). An account may be either a share account or a mortgage account of which the Trustee Account Holder may be the sole or representative joint holder. A member may receive only one distribution for each account he or she holds as a Trustee Account Holder (irrespective of the number of account holders or beneficiaries of that account) and a member who holds only one account may receive only one distribution in respect of that account whether as a member or, if he or she so decides, as a Trustee Account Holder. If a person is a qualifying beneficiary of more than one account held by a Trustee Account Holder (referred to in Section 102D(5) as “duplicate accounts”), then only a single distribution is required to be paid in respect of the duplicate accounts whether or not there are other qualifying beneficiaries of those accounts. A change in the identity of the Trustee Account Holder during any qualifying period for a distribution does not affect the entitlement to a distribution in respect of the account. The categories of qualifying beneficiaries of such accounts are persons who cannot reasonably practicably act in relation to the accounts themselves by reason of ill-health or old age or any physical or mental incapacity or

		disability.
3.3.16	G	A society will need to take its own legal advice as to the interpretation of these Sections and whether and, if so, what advice it should give to its members to help them decide whether they are Trustee Account Holders. The Authority will wish to see that advice to help it reach a view on whether the society's proposals appear to it to be lawful, while recognising that only the courts can interpret the law. With that important proviso in mind, the Authority has taken the view that a scheme may provide that a member is a Trustee Account Holder if the funds (or debt) in the relevant account are held either wholly or partly for one or more qualifying beneficiaries. PIBS do not appear to be share "accounts" as described by Sections 102B to D so that a person could not be a Trustee Account Holder in respect of a holding of PIBS.
3.3.17	G	A society is not required to notify its members of these provisions. However, unless it does so, it will not gain the protection of Section 102B(4) which provides that a Trustee Account Holder will not be entitled to a distribution in that capacity if the society has notified him that he must make a statutory declaration and the Trustee Account Holder has not made such a declaration before the date specified in the society's notice to him. Moreover, the Transfer Regulations require that the Transfer Statement must contain a forecast of the amount and proportion of the total consideration which is expected to be distributed to Trustee Account Holders (see paragraph <i>BSOG</i> 3.4.2(3)).
3.3.18	G	It appears to the Authority that it will be desirable for the final date for receipt of statutory declarations from Trustee Account Holders to be shortly before the vesting date so that declarations may take account of any changes in the identity of the account holder or the status of the beneficiary or beneficiaries. Trustee Account Holders must also be able to make an informed judgement as to whether the terms of the distribution scheme are such that making a statutory declaration will be in the best interests of the beneficiary or beneficiaries of an account; they cannot do this until the full terms of the proposed scheme have been published in the Transfer Statement and made available for inspection in the Transfer Agreement. The Authority expects, therefore, that societies will issue notices under section 102B to Trustee Account Holders not later than despatch of notices of the SGM at which the Transfer Resolutions are to be considered, and that the specified date for returning statutory declarations by Trustee Account Holders will be on, or shortly before, the vesting date or, in any event, not less than 1 month after the despatch of the notices. No regulations have been made by the Treasury under Section 102D(11). However, to meet the requirement that the Transfer Statement must contain a forecast of distributions to Trustee Account Holders, and so that it can determine the qualifying conditions for, and estimate the value of distributions to members generally, and individually, particularly if the scheme includes a variable element, the Authority expects that a society will need to write to all its members at least 2 months before the Transfer Statement is expected to be issued advising them of the procedures for dealing with distributions to Trustee Account Holders, perhaps also with the notices envisaged by

		Section 102B(4), and asking them, if appropriate, to register their interest in making statutory declarations as Trustee Account Holders.
The Successor Company		
3.3.19	G	In a conversion, the successor company must be specially formed by the society (and by no others than its nominees) wholly or partly for the purpose of assuming and conducting the society's business in its place and must be a company within the meaning of the Companies Act 1985 or the Companies (Northern Ireland) Order 1986 which is a public company limited by shares (Section 97(12) of the 1986 Act) or a body corporate incorporated in another EEA State with power to offer its shares or debentures to the public (Section 97(13)). Section 98(3) of the 1986 Act provides that the Authority shall not confirm the transfer if there is a substantial risk that the successor will not have such permission under the Act as will enable it to carry on the business which it will have as a result of the transfer. The society must secure that the successor company is formed having articles of association with the "requisite protective provisions" (Section 97(4)(a) of the 1986 Act).
3.3.20	G	The terms of the transfer must include provision to secure that the society ceases to hold any shares in the specially formed successor company by the date on which the society is to dissolve (Section 100(11) of the 1986 Act). The provisions of the 1986 Act concerning the dissolution of the society and the disposal of any shares in its successor are discussed in section 3.8.
3.3.21	G	The "requisite protective provisions" are the provisions of Section 101 of the 1986 Act which require the successor company to ensure that it does not allow one person, or two or more persons acting in concert, to hold more than 15% of the shares of the company during the period from the company's incorporation until 5 years after the vesting date. The purpose of this provision is, clearly, to protect the newly converted bank from takeover. The provisions will cease to apply if the Authority so directs, or if the successor company acquires another financial institution, as defined in Section 101(6), or if the shareholders resolve to that effect by a majority representing at least 75% of the nominal value of shares giving voting rights.
3.3.22	G	For a takeover, an existing company, which is to assume and conduct the society's business in its place, is defined in Section 97(12) and (13) of the 1986 Act as a company within the meaning of the Companies Act 1985 or the Companies (Northern Ireland) Order 1986 which is a public company limited by shares, or a body corporate incorporated in another EEA State with power to offer shares or debentures to the public, "carrying on business as a going concern on the date of the transfer agreement". Section 98(3) provides that the Authority shall not confirm the transfer if there is a substantial risk that the successor will not have such permission under the Act as will enable it to carry on the business which it will have a result of the transfer. The effect of these provisions is that the business of a society may be transferred to a body corporate incorporated in another EEA State which, at the date of the Transfer Agreement, is a going concern and which is acceptable as a deposit taker to the appropriate regulatory authority. To be a going concern, the company must actively be carrying on a business before it can enter into an agreement to

		acquire the business of a society. Conversely, it would not seem possible to use a company which carries on no substantive business, other than employing its capital, simply as a vehicle for taking over a society.
3.3.23	G	The successor company does not need to have the required permission under the Act at the time of the takeover offer or the Transfer Agreement; but it must be carrying on business as a going concern. However, the subsequent obtaining of the necessary permission is a key criterion. An offer will not be credible unless the company has first obtained an indication from the Authority or other EEA competent authority that it is prepared to authorise, or to continue the authorisation of, the successor company, upon transfer on terms which will enable it to carry on the business it will have following the transfer. As a practical matter, the authorities would find it difficult to authorise an institution whose business from the time of authorisation was not predominantly banking or deposit taking and would require to be satisfied that the parent company (if any) as controller was fit and proper.
Compensation For Loss of Office and Increased Emoluments		
3.3.24	G	Any compensation for loss of office or diminution of emoluments attributable to the transfer which is proposed to be paid to directors and other officers must be approved by a separate special resolution, in addition to the Transfer Resolutions required to approve the terms of transfer as a whole (Section 99 of the 1986 Act). Loss of office includes loss of office in any other body held by virtue of the director's or other officer's position in the society. "Compensation" is not defined in the 1986 Act, except to the extent that Section 99(6) says that it includes benefits in kind. In the Authority's opinion, compensation does not include statutory redundancy payments, damages for breach of contract, or other payments, for example, falling due under the terms of a pre-existing contract of employment, or a pre-existing arrangement giving rise to a reasonable expectation. However, it does include any proposed ex-gratia payments or other provision of benefits in money or money's worth. Societies should consider very carefully the extent to which any proposed payment may exceed the amount provided for by statute or contract. In view of the requirement in Section 99(4) that unauthorised payments must be repaid by the recipient, societies are advised to take legal advice on any payments which are not specifically authorised by the terms of a special resolution passed by the members in accordance with Section 99(2)(a). The Treasury has not made any regulations under Section 99(2)(b) and (3).
3.3.25	G	All proposed payments requiring approval by special resolution must be disclosed in the Transfer Statement. In addition, the Authority will require disclosure in the Transfer Statement of any other payments to directors or other officers arising directly from the transfer. So that members are aware of the direct interest of the directors or other officers in a transfer, societies should consider whether the amount, as distinct from the fact, of any statutory or contractual payments should be disclosed where these arise directly from the transfer. More generally, societies need to consider whether any facts relevant to any director or other officer, or to any person(s) connected with any director, should be disclosed where these are material to the decision of the members who are to be asked to vote on the proposed transfer.

3.3.26	G	<p>Increased emoluments are defined by Section 99A of the 1986 Act as an increase in consequence of the transfer, and included in the terms of the transfer, for any director or other officer, whether by way of increased remuneration or the grant of share options or otherwise. The Authority is of the view that this formulation would include the receipt of distributions of funds or of rights to shares in consideration of the transfer which are made to directors or other officers in their capacity as employees or pensioners of the society or any of its subsidiaries. However, this is a matter which can only be conclusively determined by the courts.</p>
3.3.27	G	<p>Any such increase in emoluments is required by Section 99A(2) of the 1986 Act to be put before a meeting of the society in an ordinary resolution approving such provision. However, although such an ordinary resolution must be put to a meeting, it is not required to be passed in order to authorise such increases which will be authorised by the general approval of the transfer and its terms provided by the passage of the Transfer Resolutions. Neither is it required that the ordinary resolution be put before the meeting which is to consider the Transfer Resolutions. However, as is explained below, any proposed increase in emoluments will have to be explained in the Transfer Statement, and the Authority will have to be satisfied that the requisite ordinary resolution was put before a meeting of the society when it considers a society's application for confirmation of a transfer.</p>

3.4	Information provided to Members	
Statutory Requirements		
3.4.1	G	<p>Section 98(1) of and Part I of Schedule 17 to the 1986 Act require a building society which desires to transfer its business to a company to send a statement relating to the proposed transfer to every member entitled to notice of a meeting of the society. This may be either a Transfer Statement or a Transfer Summary, and is to be included in or with the notice of the meeting at which the Transfer Resolutions are to be moved. If a Transfer Summary is sent, then the society must also make the Transfer Statement available forthwith, free of charge, to every member who asks for it. The Treasury has power to make regulations for the purpose of specifying the matters of which Transfer Statements and Transfer Summaries are to give particulars. No Transfer Statement shall be sent or made available unless its contents, so far as they concern the matters so specified, and any other matters which the Authority may require in the case of a particular transfer, have been approved by the Authority. The Transfer Summary, however, is not required to be approved by the Authority.</p>
The Transfer Statement		
3.4.2	G	<p>The Transfer Statement has to contain the particulars of the “prescribed matters” which are set out in Schedule 1 to the Transfer Regulations. It must also include particulars of any other matters which the Authority may require (paragraph 3(1)(b) of Schedule 17 to the 1986 Act). Note that Regulation 3(2) of the Transfer Regulations provides that if a particular matter is not ascertainable at the time, a forecast may be given; for example, of the percentage amount of the Statutory Cash Bonus, or of the division of any distribution of shares or cash among different classes of recipient (see subparagraph (c)). The principal matters which a Transfer Statement must contain can be summarised as follows:</p>
		<p>(1) a factual statement of the strategic options considered by the board and the reasons why it decided to recommend the particular proposals being put to the members. In the case of a takeover, the board must also provide a valuation of the business compared with the consideration which is proposed to be paid by the successor company, and state whether it considers the offer price to be fair and reasonable;</p>
		<p>(2) disclosure of the names of any building societies or companies from which written proposals for merger or takeover were received within the preceding 12 months as required by Regulation 3 of the Transfer Regulations. The fact of the proposal, the name of the proposer and the terms of the proposal must be disclosed, unless the proposer has requested either that the whole matter, or just the terms of the proposal, be treated as confidential. An invitation to discuss a possible merger or takeover would probably not constitute a “proposal”. A society should consider carefully, and take advice on, whether any approach it has received does qualify as a disclosable</p>

			proposal. If no proposals have been received that fact could be stated in the Transfer Statement, for the avoidance of doubt;
		(3)	details of any share and/or cash distribution scheme, as provided by the Transfer Agreement, and showing separately the estimated amount of the benefits (if any) to be conferred on members, Trustee Account Holders, and on others such as employees and pensioners of the society, and giving information about the value of any shares including, if unquoted ordinary shares, an illustrative estimate of the market price of the shares if they had been issued at some specified date within the previous 6 months;
		(4)	the consequences of the transfer for members of the society, including a clear explanation of the potential effects on interest rates and containing, in particular, a factual statement of changes in the factors relevant to the determination of interest rates on retail deposits and loans by the successor company compared with the society (having regard to the need for the company to pay dividends to its shareholders), and including any change in the terms on which deposits are to be held and any changes in the applicable terms of the statutory protection scheme and complaints handling arrangements;
		(5)	the consequences of the transfer for employees of the society, including any changes in the branch structure or economies in head office departments;
		(6)	the financial interests of the directors and other officers arising from, or as a consequence of, the transfer. If directors or other officers have no financial interests in the transfer, either by way of increased emoluments, compensation or other benefits, this should be stated explicitly, for the avoidance of doubt;
		(7)	the main features of the published consolidated annual accounts of the society group for the last 3 financial years and its current financial position, including the amount of the society's reserves, at a date not more than 6 months prior to the date of the Transfer Statement;
		(8)	in the case of a takeover, the main features of the published annual accounts of the successor company group for the last 3 financial years, its current financial position at a date not more than 6 months prior to the date of the Transfer Statement, and key business indicators of the society group and the successor company group for each of the past 3 financial years. If the successor company is a significant subsidiary within a group, the Authority may require corresponding information about the company alone to be given;
		(9)	the future financial prospects of the successor company;
		(10)	the intended range and relative importance of the activities of the successor company and any change proposed following the transfer;

		(11)	in the case of a takeover, the structure and activities of any group to which the successor company belongs;
		(12)	a summary of the provisions of the Transfer Agreement concerning the conditions precedent to its completion and providing for its termination;
		(13)	a statement as to whether the transfer will conflict with any contractual obligations of the society (which would include agency agreements);
		(14)	the total estimated costs and expenses of the transfer, together with (if applicable) the estimated amount of, and the terms on which, fees and disbursements will be paid to advisers, such as merchant bankers, relating to the valuation of the business;
		(15)	responsibility statements by the directors of the society and the successor company, and opinions of the external auditors and any other experts, such as merchant bank advisers;
		(16)	if a Transfer Summary is issued, a statement that the full Transfer Statement will be provided free and on request and how it can be obtained.

The Transfer Summary

3.4.3	G	A Transfer Summary may be sent, instead of the Transfer Statement, in or with the notice of the meeting at which the Transfer Resolutions are to be considered, to every member entitled to that notice. As its title indicates, the Transfer Summary must contain information derived from the Transfer Statement, particulars of which are prescribed by Schedule 2 to the Transfer Regulations: principally, that is, the matters described in paragraph <i>BSOG</i> 3.4.2, in summary form, excepting detailed financial information and terms of the Transfer Agreement. The basic qualifying conditions for a distribution of funds or shares might, for example, be summarised in the form of flow charts. More complex information, such as that relating to successors to deceased members, or second named joint account holders, should also be summarised with affected persons being referred to the Transfer Statement and, perhaps, special leaflets on particular terms.
3.4.4	G	Unlike the Transfer Statement, the Transfer Summary does not have to be approved by the Authority. It is to be compiled by, and on the responsibility of, the directors of the society and of the successor company. If a society decides to send a Transfer Summary, rather than the Transfer Statement, with the notice of the meeting, then the Transfer Summary must contain the directors' responsibility statements and state that it has not been approved by the Authority while the full Transfer Statement, which has been so approved, is on request available free of charge, to any member of the society to whom the Transfer Summary was sent, at any branch or office of the society or by post.

The Transfer Document

3.4.5	G	<p>The Transfer Statement or Transfer Summary does not have to be a separate document. In practice it will usually be convenient to include it in a comprehensive Transfer Document which will also contain the notice of the meeting at which the Transfer Resolutions are to be moved, an explanation of the transfer procedure (including details of the confirmation stage - see section 3.6) and a description of the requirements of the society's Rules concerning entitlement to vote. It may also be convenient to include additional material required by the Authority in connection with a flotation. However, the statutory Transfer Statement or Transfer Summary within the Transfer Document should be clearly identified as such (either by printing it on a different colour of paper or by some other means). An illustrative example of the structure of a Transfer Document containing a Transfer Statement is given in Annex 1 to this chapter. A Transfer Document containing a Transfer Summary should take much the same form (in that case, the Transfer Statement made available to the members on request could be a separate document).</p>
3.4.6	G	<p>If shares in the successor company are proposed to be offered to members, either for subscription or free of charge, the society will need to consider whether and, if so, how it should combine the information relevant to the members' decision on the proposed transfer, and that relevant to the share offer, in one document. The two requirements differ, particularly in extent. Combining the Transfer Statement and share prospectus may run the risk of confusing the issues for some members.</p>
3.4.7	G	<p>The Authority and its staff may be willing, but only if time and its resources permit, to comment informally on material additional to the statutory Transfer Statement which the board proposes to put to the members. The Authority considers that, if asked, it can best help the board and the members by making informal comments at the formative stage. However, it will only comment on the clear understanding that the final decision on what information to put to the members outwith the Transfer Statement is for the board to decide. The Authority is conscious that it may have to assess such additional material in the light of representations on the society's application for confirmation of the proposed transfer, and any comments which it does offer are without prejudice to its position in those proceedings.</p>
3.4.8	G	<p>However, the Authority cannot undertake the additional work of reviewing and commenting upon the draft Transfer Summary. As is noted in paragraph <i>BSOG</i> 3.4.4, the board alone is responsible for ensuring that the Summary fairly and accurately summarises the prescribed information in the Transfer Statement, and that it fulfils the requirements of the 1986 Act and the Transfer Regulations. As with the other information provided to the members in addition to the Transfer Statement, the Authority will review the Transfer Summary at the confirmation stage of the transfer procedure.</p>
Board Statements		
3.4.9	G	<p>The Transfer Regulations, deliberately confine the particulars required to be included in the statutory Transfer Statement to information which is factual and which can be verified by a society and its professional advisers, including</p>

		<p>factual statements of the reasons why the board decided to recommend the transfer and its terms (which may include statements of the board’s belief and opinions, clearly identified as such) and the options it considered for the future conduct of the society’s business, all of which can be verified by reference to the board’s minutes and papers. A board may choose to engage in more general advocacy of the merits or fairness of its proposals elsewhere in the documents sent to members, in which case, the Authority may have to have regard to whether such material is consistent with the information given in the statutory Transfer Statement when it comes to consider an application for confirmation.</p>
3.4.10	G	<p>The whole Transfer Document should be covered by responsibility statements by the directors of the society and the successor company. This may be given along the following lines (either a joint statement or separate statements by each board):</p> <p>“The directors of ... Building Society and the directors of ... accept responsibility for the information relating respectively to the society and the company which is contained in this document. To the best of the knowledge and belief of the directors (who have taken all reasonable care to ensure that such is the case) the information contained in this document is in accordance with the facts and does not omit anything likely to affect the import of such information”.</p>
<p>Application and Authority Approval</p>		
3.4.11	G	<p>It will be helpful to both the society and the Authority for the society to consult the Authority about the outline structure of, and main features to be contained in, the Transfer Document at an early, formative stage. The Authority will also be prepared to consider a full specification of the proposed cash or share distribution scheme. Thereafter, a formal written application for approval of the statutory Transfer Statement must be made to the Authority by, or on behalf of, the board and accompanied by a draft Transfer Statement which should be as complete as is reasonably practicable at that stage, together with the fee prescribed by the current Fees Rules.</p>
3.4.12	G	<p>The Authority will then consider the application and decide whether or not to approve the Transfer Statement. It must satisfy itself that:</p>
		<p>(1) in its opinion, the terms of the transfer scheme described in the Transfer Statement are consistent with the 1986 Act;</p>
		<p>(2) the Transfer Statement contains particulars of the matters required by the Transfer Regulations;</p>
		<p>(3) there is no further material information which it appears to the Authority, on the basis of what it knows at that time, is relevant to the decision of the members and is appropriate to the Transfer Statement (since that Statement carries the explicit approval of the Authority);</p>
		<p>(4) the information in the Transfer Statement is presented clearly, in a balanced way, is consistent with the facts as known to the Authority,</p>

			and is supported by responsibility statements from the directors and by opinions from the society's auditors and advisers.
		For that purpose, the Authority will require supporting documentary information, including, in particular:	
		(5)	the draft Transfer Agreement, which will incorporate a full specification of the transfer distribution scheme (the Transfer Statement by itself being an inadequate basis for considering the legal issues);
		(6)	a description, supported by opinions of the society's auditors and legal advisers, of the terms of the proposed scheme of distributions of funds or shares to members, Trustee Account Holders and others, including the systems and procedures required to make the distributions and copies of the notices and other documents to be used;
		(7)	in the case of a specially formed company, the draft articles of association of the successor company (including the requisite protective provisions);
		(8)	the Rules of the society (6 copies);
		(9)	the full accounts and auditors' reports on which the financial information is based;
		(10)	a checklist of the information required by the Transfer Regulations showing where each item may be found in the draft Transfer Statement.
3.4.13	G	The process of consideration will consist of discussions and correspondence between the Authority and the society, which are likely to lead to the production by the society of one or more redrafts of the Transfer Statement to take account of the Authority's comments, and refinements proposed by the society, to improve the clarity, completeness and drafting of the Statement. Clearly, the time necessary to complete this process will depend upon the quality and completeness of the draft Statement submitted with the first application, the complexity of the proposed terms of the transfer and whether they include any novel features, and whether it proves necessary to apply to the High Court for the determination of any legal issues. The Authority will seek to deal with the process efficiently and expeditiously. However, its speed of response will necessarily be affected by the factors referred to above as well as the commitments and priorities of the Authority's relevant resources. The draft Transfer Statement must also be fully verified, to the satisfaction of the board, which process may be expected to take up to 6 weeks.	
3.4.14	G	The Fees Rules provide that a further fee is payable by the society each time it submits a revised draft Transfer Statement to the Authority for approval. However, the Authority may waive or reduce the additional fee where it is satisfied that the revisions to the original, or previous, draft are not substantial.	
3.4.15	G	When the society has settled on the final draft of a Transfer Statement which the Authority is minded to approve, the society should submit two	

		authenticated copies of the final draft Transfer Statement to the Authority with the following documents:
	(1)	a certified copy of the Transfer Agreement made between the society and the successor company;
	(2)	the Memorandum and articles of association of the successor company;
	(3)	a checklist of the information required to be included in the Transfer Statement pursuant to the Transfer Regulations;
	(4)	certified copy of an opinion from the society's auditors pursuant to paragraph 17 of Part I of Schedule 1 to the Transfer Regulations;
	(5)	certified copies of any other experts' reports or opinions which appear or are referred to in the Transfer Statement;
	(6)	certified copy of an opinion from the successor company's auditors pursuant to paragraph 17 of Part I of Schedule 1 to the Transfer Regulations;
	(7)	statutory accounts of the society and its connected undertakings for the previous 3 financial years, together with a reconciliation between those accounts and the figures appearing in the Transfer Statement;
	(8)	in the case of an existing company, consolidated statutory accounts of the company/group for the previous 3 financial years, together with a reconciliation between those accounts and the figures appearing in the Transfer Statement;
	(9)	certified copy of a letter of consent from the society's auditors relating to the issue of the Transfer Statement;
	(10)	in the case of an existing company, certified copy of a letter of consent from the successor company's auditors relating to the issue of the Transfer Statement;
	(11)	certified copy of a letter of consent from the Banking Regulator relating to the issue of the Transfer Statement with the inclusion of a statement as to the willingness of the Banking Regulator to authorise or, as the case may be, to continue to authorise the successor company on terms which will enable it to carry on the business it will have as a result of the transfer;
	(12)	certified copies of letters of consent from any other experts relating to the issue of the Transfer Statement with the inclusion of any reports or opinions referred to in paragraph <i>BSOG</i> 3.4.15(5);
	(13)	certified copies of responsibility letters signed by the directors of the society (see paragraph <i>BSOG</i> 3.4.10);
	(14)	certified copies of responsibility letters signed by the directors of the

			successor company (see paragraph <i>BSOG</i> 3.4.10);
		(15)	certified copies of the minutes of the boards of the society and the successor company approving the Transfer Statement, the Transfer Agreement and related documents and approving the release of the responsibility letters mentioned in <i>BSOG</i> 3.4.15(13) and <i>BSOG</i> 3.4.15 (14) (respectively) to the Authority;
		(16)	an assurance from the directors of the society concerning the society's register of members and its systems (see paragraph <i>BSOG</i> 3.5.15);
		(17)	a declaration by the directors of the society, and a similar declaration (as appropriate) by the directors of the successor company, along the following lines:
			“We confirm that the statutory Transfer Statement was approved at a meeting of the Board of Directors of the Society held on (.....). The Directors of the Society agreed that copies of the responsibility letter could be made available to the Financial Services Authority in connection with this application. We also confirm that apart from the inclusion of [.....] no other changes have been made to the statutory Transfer Statement from the Pre-Approval proof dated (.....) handed to you on (.....) and that no changes have been made to the Transfer Agreement from the draft dated (.....) and handed to you on (.....).”
			“We hereby request pursuant to our application dated (.....), that the Financial Services Authority approves, in accordance with paragraph 4(3) of Schedule 17 to the 1986 Act, the contents of the statutory Transfer Statement so far as they concern the prescribed matters (as defined in paragraph 1 of that Schedule) and any matter of which particulars are required to be given under paragraph 3(1)(b) of that Schedule.”
3.4.16	G		The Authority's statement of approval of the Transfer Statement will be given as is set out in Annex 1.
3.4.17	G		The Authority's approval of the Transfer Statement will be confirmed by returning to the society one authenticated copy of the Transfer Statement with the Authority's certificate of approval signed by an authorised signatory for the Authority. The society will be asked to give 50 copies of the printed Transfer Document and Transfer Summary, if any, to the Authority when they are available. There is no statutory requirement for copies of the Transfer Statement and Transfer Summary to be placed on the public file of a society but, because they are both public documents, the Authority will arrange for copies of the Transfer Document and Transfer Statement, if printed separately, to be placed on the public file. If a public announcement of the transfer proposal is not to be made until after the Authority has approved the Transfer Statement, or until the Transfer Document is sent to the society's members, the Document and Statement will not be placed on the public file until after the announcement. None of the other documents referred to in paragraph <i>BSOG</i> 3.4.15 above will be placed on the public file.

3.4.18	G	The number of copies of the Transfer Statement to be printed will, of course, depend upon whether a society intends to distribute a Transfer Summary to its members with the notice of the general meeting. In that case, the society must make its own judgement about the number of copies of the full Transfer Statement to be printed, bearing in mind the requirements of paragraph 4(2) of Schedule 17 that sufficient copies must be available at every office or branch of the society and for despatch by mail.
A Note on Style		
3.4.19	G	A Transfer Document is bound to be lengthy and somewhat complex. It has to contain a lot of information, but its complexity will depend to a large extent on the terms of the transfer, particularly the transfer distribution scheme, proposed by the board. Bearing in mind that the purpose of the Transfer Statement is to provide information to the generality of members, it should be written in a clear and concise style and, so far as possible, in plain English. The Authority will be concerned that, because the statutory Transfer Statement is largely concerned with matters of fact, those matters are presented clearly and unambiguously. To the extent that it is necessary to include statements of the opinion or belief of the board, those statements should be clearly identified as such in the Transfer Statement. The board's views on the fairness and merits of the proposed transfer and its terms will form a separate part of the Transfer Document, as discussed in paragraph <i>BSOG</i> 3.4.9. Annex 1 suggests a structure for the Transfer Document which is designed to present its readers with a clear and logical sequence of topics. The Authority suggests that one of the main tasks of the society's project manager (see paragraph <i>BSOG</i> 3.2.13) should be to ensure that the Transfer Document is drafted in a clear and concise style. This will be a great help in achieving the Authority's approval of the Transfer Statement, and the board's verification of the whole Transfer Document, without undue difficulty and within a reasonable timescale.

3.5	General Meetings and Resolutions	
Resolutions and Voting Majorities		
3.5.1	G	This section describes the requirements of the 1986 Act concerning members' entitlement to vote, the register of members and the sending of notices of meetings. It also discusses general meeting arrangements, the resolutions and majorities required and the counting of votes. The directors of a society must satisfy themselves that they observe the general law on meetings, the relevant provisions of the 1986 Act and the society's own Rules. The 1986 Act provides that a transfer must be approved by the requisite Transfer Resolutions in accordance with paragraph 30 of Schedule 2 (Section 97(4)(c)) as follows:
		(1) a borrowing members' resolution passed on a poll by a simple majority of borrowing members qualified to vote and voting (see paragraph 29(1) of Schedule 2 for the definition of a borrowing members' resolution); and
		(2) a shareholding members' resolution (see definition in paragraph 27A of Schedule 2) passed on a poll by a majority of at least 75% of shareholders qualified to vote and voting, and on which:
		(a) in the case of a conversion, not less than 50% of shareholders qualified to vote on a shareholding members' resolution voted; or
		(b) in the case of a takeover, not less than 50% of shareholders qualified to vote on a shareholding members' resolution (or shareholders so eligible who held not less than 90% of the total share balances held on the voting date by all shareholders qualified to vote) voted in favour;
		provided that, in each case, notice has been duly given that the resolution is to be moved as a shareholding members' resolution or a borrowing members' resolution, as the case may be, and, in the case of the shareholding members' resolution, that the resolution will not be effective unless it satisfies the requirements specified in 3.5.1 (2) A member may vote either in person at the meeting or by appointing a proxy, and paragraphs 33(1) and 33A of Schedule 2 provides that the voting on Transfer Resolutions may not be conducted by postal ballot or by electronic ballot.
3.5.2	G	Section 99(2) of the 1986 Act provides (see paragraph <i>BSOG</i> 3.3.24) that, where a society proposes to pay compensation to directors or other officers for loss of office or diminution of emoluments, attributable to the transfer, such compensation must be approved by a special resolution of the society's members; that is, a resolution passed by a majority of at least 75% of members (both shareholding and borrowing members together) qualified to vote and voting (paragraph 27 of Schedule 2 to the 1986 Act). This resolution is separate from the Transfer Resolutions required to approve the other terms of transfer. The Treasury has not made regulations under Section 99(3) of the

		1986 Act to set limits below which compensation may be paid without the authority of a special resolution. Therefore, in every case where compensation is proposed, the members must vote on the proposal as a separate issue from whether they approve the proposed transfer itself. “Other officers” include, in addition to the Chief Executive and Secretary, any persons who exercise managerial functions under the immediate authority of a director or the Chief Executive of a society (see “manager” and “officer” in Section 119 of the 1986 Act).
3.5.3	G	As is described in paragraphs <i>BSOG</i> 3.3.26 and <i>BSOG</i> 3.3.27, if the terms of a transfer include provision for increased emoluments of directors or other officers in consequence of the transfer, an ordinary resolution approving any such provision must be put before a meeting of the society. An ordinary resolution is passed by a simple majority of members (both shareholding and borrowing members voting together) qualified to vote and voting. However, it is not required that the resolution must be put to the same meeting as the Transfer Resolutions, neither is approval of the ordinary resolution required to authorise such increased emoluments which, as terms of the transfer, are authorised by the passage of the Transfer Resolutions. The purpose of Section 99A of the 1986 Act is to give the members an opportunity to express their views on these matters separately from their decision on whether or not to approve the transfer and its terms.
Notice of the Meeting		
3.5.4	G	Paragraph 22 of Schedule 2 to the 1986 Act requires that notice of a meeting shall be given to every member of a society who would be eligible to vote at the meeting. The notice is also to be given to every member who will attain the age of 18 years on or before the date of the meeting, and to every person who becomes a shareholding or borrowing member of the society after the date of the notice but before the date specified by the society as the final date for the receipt of proxy voting forms. Note also that the Transfer Statement or the Transfer Summary, as the case may be, must also be sent to every member entitled to notice of the meeting (paragraphs 2 and 4(1) of Schedule 17 to the 1986 Act).
Entitlement to Vote		
3.5.5	G	Paragraph 5 of Schedule 2 to the 1986 Act provides that no person may be a member of a building society unless he or she is a shareholding member or a borrowing member. A shareholding member is a person who holds a share in the society (that is, an investment in a share account or PIBS). A borrowing member is a person who is indebted to the society in respect of a loan fully secured on land. However, the Rules may provide that borrowing membership is conferred by a loan substantially secured on land, or shall cease if the loan is foreclosed or the land is taken into possession by the society. A minor (that is a person under 18 years of age) may be a member, but may not vote on any resolution.
3.5.6	G	The mandatory provisions of Schedule 2 to the 1986 Act concerning a member’s entitlement to vote on a resolution, which must be reflected in societies’ Rules, are that the member must be a member on the voting date,

		must have been a member at the end of the last financial year before the voting date (paragraph 23(1) of Schedule 2) and must have attained the age of 18 years (paragraphs 5(3) and 34(2) of Schedule 2) on or before the date of the meeting. So far as borrowing members are concerned, the member is not entitled to vote in that capacity if his indebtedness to the society at any relevant time is less than £100 (paragraphs 29(2) and 36 of Schedule 2).
3.5.7	G	However, Schedule 2 specifies the following further provisions, some, none or all of which may be included in a society's Rules with respect to the entitlement of shareholding members to vote on any resolution; a person must (see Schedule 2 paragraphs 23(3) to (5) and 36):
		(1) have a qualifying shareholding (which must not be set higher than £100), in one or more share accounts or PIBS, on the "qualifying shareholding date";
		(2) hold shares on the voting date; and
		(3) have held shares continuously between those two dates.
3.5.8	G	The "qualifying shareholding date" is either: the last day of the financial year preceding the voting date; or, if the voting date falls during that part of a financial year which follows the conclusion of the society's AGM commenced in that year, the first day of the period beginning 56 days before the date of the meeting. Therefore, if a society's Rules, following the BSA Model Rules (Fifth Edition), include the provisions concerning shareholding and continuity of membership, described in paragraph <i>BSOG</i> 3.5.7, and if the voting date is later than the AGM in that year, a person to be entitled to vote on a shareholding members' resolution must:
		(1) have been a shareholding member on the last day of the previous financial year;
		(2) have held shares to the value of at least £100 on the day 56 days before the date of the meeting;
		(3) have held shares continuously from the 56 th day through to the voting date; and
		(4) hold shares on the voting date.
		But note that there is no requirement for continuity of shareholding between 3.5.8(1) and (2) (In contrast, in the case of an ordinary or special resolution, membership at 3.5.8(1) may be satisfied by either borrowing or shareholding membership provided the shareholding member satisfies the other conditions of (2) to (4) in order to vote in his or her capacity as a shareholder.) Note also that a person cannot meet a requirement for "holding shares" on a given date, or during a given period, by relying on his holding of a share account with an overdrawn balance; and a person cannot meet a requirement for being a "member" on a given date (for example, at 3.5.8(1)) by relying on his holding of such a share account.

3.5.9	G	<p>The mandatory provisions of Schedule 2 concerning entitlement to vote on a borrowing members’ resolution are, as noted above, that the member must have been, and be, indebted to the society for at least £100 (whether on one or more accounts) at the end of the last financial year before the voting date, and on the voting date, in respect of an advance fully secured (or, if the Rules permit, substantially secured) on land (paragraphs 5(2), 23(1), 29(2) and 36 of Schedule 2) and have attained the age of 18 years by the date of the meeting (paragraphs 5(3) and 34(2) of Schedule 2). But note that there is no dispensation in the 1986 Act for the Rules to reduce the qualifying amount below £100, nor to provide for a continuity of membership qualification.</p>
3.5.10	G	<p>Schedule 2 makes provision in respect of joint shareholders (paragraph 7) and joint borrowers (paragraph 8). The only person entitled to exercise the right to vote on behalf of the joint shareholders or joint borrowers is the one who is named first in the records of the society, described respectively as the “representative joint holder” or the “representative joint borrower”.</p>
3.5.11	G	<p>A member may vote once only on any resolution, irrespective of the number of accounts he or she may hold. The amount of the balance(s) held on account(s) is not material, except to qualify to vote - see paragraphs <i>BSOG</i> 3.5.6 to <i>BSOG</i> 3.5.8. Thus, a member with several share accounts and/or several mortgage accounts, whether as sole and/or representative joint holder, may vote once only on any resolution. When the membership votes as a whole on an ordinary or a special resolution, each member may vote only once, whether he or she is a shareholding or a borrowing member or both. Where shareholding members and borrowing members vote separately, as on the Transfer Resolutions, members entitled to vote may vote only once, if a shareholding member, on the shareholding members’ resolution and once, if a borrowing member, on the borrowing members’ resolution. A person entitled to vote both as a shareholding member and as a borrowing member may of course, vote once on each resolution.</p>
3.5.12	G	<p>The “voting date” is defined by paragraph 23(6) of Schedule 2 as, for this purpose, either:</p>
		<p>(1) for members who appoint a proxy, the last date specified by the society for the receipt of proxy voting forms, which may not be more than 7 days before the date of the meeting (paragraph 24(6) of Schedule 2). A proxy vote remains valid if the member ceases to be a member after the proxy voting date but before the date of the meeting (paragraph 24(2) of Schedule 2); or</p>
		<p>(2) for all other members, the date of the meeting.</p>
3.5.13	G	<p>The guidance given in the foregoing paragraphs of this section is intended to give a general description of the provisions of the 1986 Act and of the Rules suggested by the BSA Model Rules. Societies are advised to satisfy themselves that they observe the specific provisions of the 1986 Act and of their own Rules.</p>
Register of Members		

3.5.14	G	<p>Every society is required to maintain a register of the names and addresses of its members and whether each member is a shareholding member or a borrowing member or both (Schedule 2, paragraph 13). The register should, so far as possible, be “de-duplicated”; that is, multiple account holders should be identified and their names recorded once only in the register. A society’s systems must also be capable of recognising those members who are eligible to vote by, for example, aggregating share account balances of multiple account holders to check that they have the requisite qualifying shareholding, by checking members’ continuity of shareholding, and by identifying minors (see paragraphs <i>BSOG 3.5.5</i>, <i>BSOG 3.5.6</i> and <i>BSOG 3.5.9</i>). This information is required to ensure that the notice of the meeting is sent to all the members entitled to receive it, and that the scrutineers have adequate systems to validate the votes cast on the Transfer Resolutions.</p>
3.5.15	G	<p>The directors of a society contemplating a transfer must satisfy themselves, in consultation with their external auditors, or other advisers, that the society’s systems are capable of delivering the information described above. The Authority will require an assurance on this point when the society applies for approval of the Transfer Statement. One of the criteria which the Authority has to consider at the confirmation stage is whether some relevant requirement of the 1986 Act or the Rules was not fulfilled (see section 3.6).</p>
3.5.16	G	<p>The problem of avoiding duplication in the register of members is significant for most societies of any size. Societies generally now seek to establish, when new accounts are opened, whether or not the applicant is an existing member and, if so, which accounts are relevant to voting and other membership rights. The task of identifying multiple account holders is complicated by confidentiality requirements. For example, if two accounts are held by a Mr A Smith and a Dr A Smith, both at the same address, the society cannot know (in the absence of other information such as date of birth) whether the two accounts belong to the same person, one opened before and one after he qualified, or by the doctor and his son. A letter of enquiry to one asking about both accounts would risk breaching customer confidentiality. If it is the same person, there is a risk that he will be given the opportunity to vote twice or, if neither account holds more than £100 but they aggregate above that qualifying amount, be denied a vote to which he is entitled. It is good practice for a society, when it has announced its intention to transfer its business, to write to all its members individually setting out the information about them which it holds on its records, inviting them to confirm that the information is correct and to say whether they have received more than one such letter as a shareholder or as a borrower.</p>
3.5.17	G	<p>Where a society identifies a number of accounts which appear to be held by a single member, but it cannot be sure, then it must send separate meeting notices in respect of each account which satisfies the qualifying conditions for entitlement to vote. Where such accounts do not separately entitle the member to vote but would do so if aggregated (by satisfying the £100 minimum shareholding condition) the society may consider it advisable to send separate notices in respect of each account with the warning that, on the information available to it, the society believes that the member is not eligible to vote. However, its systems should identify the possible multiple holding so that, if</p>

		more than one vote is received in respect of that group of accounts, the scrutineers are alerted to the possibility, and can check the proxy forms for evidence of invalid duplicate votes. The voter's declaration suggested by the BSA Model Rules, in conformity with paragraph 34 of Schedule 2 to the 1986 Act, provides some protection against votes being cast by minors, but none against duplicate votes. It is, however, the duty of each society to make sure that its register of members is reliable.
General Meeting Arrangements		
3.5.18	G	Paragraphs <i>BSOG</i> 3.5.19 to <i>BSOG</i> 3.5.25 consider the requirements for sending notices of meetings and Transfer Statements, or Transfer Summaries, to members, and the conduct of meetings at which Transfer Resolutions are to be moved. It is for societies to satisfy themselves that they comply with the relevant requirements of the 1986 Act, their Rules and the general law on meetings.
Notice of Meeting		
3.5.19	G	The statutory requirements concerning notices to members are in paragraph 22 of Schedule 2 to the 1986 Act. Notice of the meeting must be given to each shareholding and borrowing member of the society who would be eligible to vote at the meeting if the meeting were held on the date of the notice (a single date for all notices irrespective of when they are despatched). In addition, notice must also be given to any person who will attain the age of 18 years after the date of the notice but on or before the date of the meeting, and to every person who becomes a shareholding or borrowing member of the society after the date of the notice but before the final date for receipt of proxy voting forms, provided, in each case, that the member will be entitled to vote. Note also that the Transfer Statement or Transfer Summary must be sent in or with the notice to every person entitled to receive it (paragraphs 2 and 4 of Schedule 17 to the 1986 Act). Accidental omission to give notice of a meeting to any person entitled to receive it does not invalidate the proceedings at the meeting. However, "accidental omission" does not include a systemic failure to send notices (e.g. omitting to send notices to new shareholders or borrowers, or omission of a group or class of members from the mailing list arising from a fault in a computer programme), nor all cases of error by management - see also paragraph <i>BSOG</i> 3.5.38.
3.5.20	G	The 1986 Act also provides, in paragraph 21 of Schedule 2, for the length of notice to be given to members. The period of notice given must be not less than 21 days or such longer period as the society's Rules prescribe. The precise procedures for sending notices, the way in which the days are to be counted, and presumed receipt of notices duly sent, will normally be set out in the Rules. Particular points to note are:
		(1) the 21 days' notice expires with the closing date for the receipt of proxy voting forms, not the date of the meeting;
		(2) if reliance is to be placed on a provision in the Rules that notices can be deemed to be served 24 hours after posting, then first class post or equivalent means of delivery should be used. However, it is advisable

		to allow a margin of at least an extra day or two, but more if second class post is used;
		(3) if a society contracts with a commercial mailing firm, it must ensure that the firm is comprehensively instructed about the society's despatch and delivery requirements, and the society should carry out spot checks to satisfy itself that its instructions are being properly carried out. A failure by the contractor may invalidate the meeting, even if the society itself has used its best endeavours to police the operation.
3.5.21	G	The Transfer Statement or Transfer Summary, as the case may be, is required, by paragraph 4(1) of Schedule 17 to the 1986 Act, to be sent "in or with" the notice of the meeting to every member entitled to that notice. As is suggested in section 3.4, it may be expedient to include both in a comprehensive Transfer Document or booklet.
3.5.22	G	Notices and Statements or Summaries need not be sent to any member in whose case the society has reason to believe that communications sent to him at his registered address are unlikely to be received by him (paragraph 14 of Schedule 2 to the 1986 Act). In those circumstances, a society is required to place notices of the meeting prominently in every branch office, or to place advertisements in newspapers circulating in the areas in which the society's members live. Such notices or advertisements must be published at least 21 days before the date of the meeting, and must state where members can obtain copies of the Transfer Summary, the Transfer Statement, the Transfer Resolutions and proxy voting forms (paragraph 35 of Schedule 2 to the 1986 Act).
3.5.23	G	It should be noted, however, that a member's "registered address" may not be the address shown in the society's register of members but a different address to which the member has requested that communications from the society be sent (paragraph 13(4) of Schedule 2 to the 1986 Act).
Conduct of the Meeting		
3.5.24	G	The meeting should be held at a time and place considered by the board to be most convenient for the generality of the society's members. This may not necessarily be the same as the traditional time and place for the AGM. In deciding on this, the board should take account of the geographical location of their members, and the probability that an unusually large number of members may wish to attend a meeting to consider a proposed transfer.
3.5.25	G	Subject to the society's Rules, its chairman will normally chair the meeting. His function as chairman of the meeting is to ensure that all views may be presented and properly discussed. He is unlikely to be able to fulfil that role if he acts also as chief advocate of proposals which are controversial among members. In such cases it might be appropriate to give to another director the tasks of explaining the board's recommendations and of responding to questions from members.
3.5.26	G	A Transfer Resolution cannot be amended at the meeting except in a way which does not change its substance at all. This is because an amendment to

		such a resolution has to be subject to the same procedure and period of notice to members as the resolution itself. If a board decides, after due notice of such a resolution has been sent to the members, that the resolution should be amended, then it will be necessary to submit the amended resolution, with due notice, to a general meeting at a later date, unless of course there is still time to fulfil the notice requirements.
Conduct of the Voting		
3.5.27	G	The conduct of the voting must not only be fair but also be seen to be fair, otherwise the result may be called into question by representers at the confirmation stage. The votes must be counted by independent scrutineers. The board may ask the scrutineers, in advance of the meeting, for a running tally of the number of votes being cast if it thinks it might properly encourage more members to vote if the response is low. However, to ask the scrutineers how the votes are being cast, before the time comes at the meeting to instruct proxies, carries the risk of accusations, however unfounded they may be, and possible challenge at the confirmation stage on the grounds that the board suppressed proxy votes against the Resolutions, or unduly influenced members to vote in favour. A board which asks the scrutineers for a running tally of votes, and which circulates its members with further exhortations to vote, must be prepared to argue its case in the face of such accusations at the confirmation hearing. Any circular to members sent after the Transfer Document was sent to them must, therefore, be very carefully considered.
3.5.28	G	Experience has demonstrated the need for societies to take the greatest care to ensure that they comply strictly with the statutory procedural requirements and their own Rules on meetings and resolutions. The person chairing the meeting should ensure that he or she is well briefed and aware of the Rules and the general law relating to procedural resolutions, such as resolutions to adjourn the meeting. The Authority will require a confirmatory report from the scrutineers on the validity of the voting procedures when the society applies for confirmation (see paragraph <i>BSOG</i> 3.5.34).
3.5.29	G	The procedures for the conduct of proxy voting will normally be provided for in the society's Rules, in conformity with paragraphs 24 and 34 of Schedule 2. The 1986 Act requires that every proxy form sent by a society to its members must enable the member to direct the proxy how to vote (paragraph 24(4A)). In addition, to minimise the risk of the society's proxy voting procedures being misunderstood, the Authority recommends that the design of the proxy form is carefully considered (preferably a self-contained form clearly to be returned intact) and that it should include:
		(1) adequate space to insert the name of a proxy other than the chairman of the meeting, and a statement (which must also appear in the notice of the meeting) that the proxy appointed need not be a member of the society (a reminder that the voting member's own name should not be inserted will also be helpful);
		(2) an explicit statement that if the member does not instruct his proxy to vote for or against the resolution, then the proxy will cast the vote, or

			abstain, as he thinks fit;
		(3)	the declaration, as provided by the Rules, in accordance with paragraph 34 of Schedule 2;
		(4)	full recital of the text of the shareholding members' or borrowing members' resolution(s) or, if this is not practicable (e.g. because of space restrictions), a clear indication that the full text may be found in the notice of the meeting;
		(5)	instructions as to the return of completed proxy forms, including the last effective date for receipt by the society or by the scrutineers. A pre-addressed and pre-paid envelope or other sealed means of return should be provided.
3.5.30	G	The 1986 Act does not require societies to send proxy voting forms to members with notices of meetings. However, the Authority believes that, on a matter as important as a transfer, and bearing in mind the 50% turnout (conversion) and 50% support (takeover) requirements on the shareholding members' resolutions, societies would be well advised to send a proxy voting form to members with the meeting notice. If a society decides, nevertheless, not to send proxy forms to members entitled to vote, then it should make clear to the members that proxy voting forms can be obtained on demand from its branches and/or by application to a central point.	
3.5.31	G	The arrangements for the collection of the proxy forms should be such as to secure confidentiality and to avoid the risk of loss, whether accidental or deliberate. The Rules may provide for return of proxy forms to the scrutineers either directly or to the society's principal office. Where proxy forms are returned to the society's offices, the Authority recommends that the procedures should incorporate the following features:	
		(1)	the proxy form should be enveloped or otherwise sealed so that the members' voting instructions are concealed;
		(2)	the envelope provided should be clearly marked so that the society can readily identify and separate it from other mail without the envelope being opened;
		(3)	staff responsible for receiving and sorting mail should be given specific instructions about the handling of proxy forms and the overriding importance of security;
		(4)	secure storage of proxy forms should be provided up to the point at which they are handed over to the scrutineers;
		(5)	equivalent handling and security procedures should be applied to proxy forms handed in at branches.
3.5.32	G	The Authority suggests that proxy voting forms for shareholders and borrowers should be easily distinguishable, perhaps by colour coding, both as an aid to members who may be entitled to vote in each capacity, and as an aid to the	

		scrutineers counting the votes.	
3.5.33	G	Members may attend the meeting and vote in person. There must, therefore, be satisfactory systems in place in accordance with the Rules to identify and cancel any proxy votes they may previously have returned.	
Scrutineers' Report			
3.5.34	G	The scrutineers are responsible for checking the validity of votes cast in person and by proxy. The scrutineers must be independent of the society and not have a direct interest in the result of the voting. For example, they should not be officers expecting to receive compensation or appointments under the terms of the transfer. It will usually be appropriate to appoint the society's auditors, and it is desirable that they should be appointed not just for the arithmetical count of votes but also to supervise the voting process as a whole so that they are in a position to confirm, after the vote, that all the requirements of the 1986 Act and the society's Rules have been complied with. This would include:	
		(1)	determining and validating member mailing lists for notices of the meeting and Transfer Statements or Transfer Summaries and for Trustee Account Holders (see paragraphs <i>BSOG</i> 3.3.15 and <i>BSOG</i> 3.5.4);
		(2)	despatch procedures;
		(3)	timing of notices and despatch of documents;
		(4)	form and content of proxy voting forms;
		(5)	receipt and custody of completed proxy voting forms;
		(6)	validation of completed proxy voting forms to establish that members are qualified to vote and that forms are properly completed;
		(7)	identification and validation of members attending and voting at the general meeting;
		(8)	voting procedures at the meeting including casting of proxy votes, count of votes cast in person and aggregation of proxy and personal votes cast on the Transfer Resolutions, and on any special resolution required to authorise the payment of compensation to directors or other officers;
		(9)	voting procedures at the meeting, or at another meeting, as the case may be, and the count of votes on any ordinary resolution to approved increased emoluments of directors or other officers (if required).
3.5.35	G	To fulfil the duties outlined above, it is suggested that the scrutineers would need to:	
		(1)	examine the systems and procedures to be employed by the society, before they are implemented, to ensure that they are satisfactory;

		(2)	carry out such checks and tests as they consider necessary during the operation of the procedures as will enable them to be satisfied that the specified procedures are being carried out in practice;
		(3)	provide that where validation functions are carried out by the society's staff this is done under the direction and supervision of the scrutineers;
		(4)	direct and supervise the count of the votes cast both by proxy and personally at the meeting.
3.5.36	G	Validation checks during the counting of votes may be expected to include the following:	
		(1)	only proxy forms which comply with the 1986 Act and the society's Rules have been used;
		(2)	the member is eligible to vote under the 1986 Act and under the society's Rules (NB a proxy vote may still be valid even though the member has ceased to be entitled to attend and vote at the meeting after the closing date for receipt of proxies - see paragraph <i>BSOG</i> 3.5.12 (1));
		(3)	only one proxy form per member eligible to vote is included in the count (separate forms may be sent to and returned by a person eligible to vote on both the shareholding members' resolution and the borrowing members' resolution);
		(4)	minors are excluded and that there is an explicit confirmation by each member voting by proxy that he is aged 18 or over;
		(5)	the proxy form is completed and signed and is otherwise valid (where a proxy form lacks a signature but is otherwise valid, it is usual, if time permits, for the scrutineers to return the form to the member for signature and return in a pre-paid envelope).
3.5.37	G	The scrutineers' initial report will be made to the society at the meeting (which may be adjourned for this purpose). The Authority will require, in support of a society's application for confirmation under Sections 97(4)(d) and 98 of the 1986 Act, a report from the scrutineers on the result of the vote on each Resolution (distinguishing between votes cast in person and by proxy), the total number of members eligible to vote (and the proportion of that number that the votes cast represent), the numbers of invalid votes cast and also confirmation that, in the opinion of the scrutineers, the arrangements for the conduct of the voting were such as to ensure that:	
		(1)	notices of the meeting and Transfer Statements or Transfer Summaries were sent to all those entitled to receive them, in accordance with the 1986 Act and the Rules of the society having regard, inter alia, to the matters referred to in this chapter;
		(2)	the periods of notice given complied with the requirements of the 1986 Act and of the society's Rules, taking into consideration established

			conventions for the counting of days;
		(3)	there were satisfactory procedures to ensure the security of proxy voting forms and to minimise the risk of loss or unauthorised access;
		(4)	there were satisfactory procedures to ensure that the count of votes cast personally at the meeting included only votes cast by members eligible to vote and who had not mandated, or had withdrawn, a proxy vote.
3.5.38	G		In relation to the notice of the meeting, the scrutineers' report may properly have regard to the provision of paragraph 22(3) of Schedule 2 to the 1986 Act that "accidental omission to give notice of a meeting to, or non-receipt of notice of a meeting by, any person entitled to receive notice of the meeting does not invalidate the proceedings at that meeting". It should be noted, however, that there is authority to the effect that "accidental" and "non-receipt" would not cover all cases of "error" on the part of the society, for example an erroneous decision of management not to send notices to particular persons or groups of persons.
3.5.39	G		The Authority would find it helpful if the scrutineers' report would also comment upon any procedural difficulties encountered and, if the numbers of invalid votes appear to be significant, give an analysis of the reasons why votes were found to be invalid (see also section 3.6).

3.6	Confirmation	
3.6.1	G	No transfer can take effect until it has been confirmed by the Authority. This section first describes the form of application and public notice required. It then explains the Authority's view of how the statutory Confirmation Criteria should be interpreted. Finally, it gives guidance on the procedure customarily followed by the Authority when considering confirmation applications and hearing representations. Sections 97(4)(d) and 98(2) of, together with Part II of Schedule 17 to the 1986 Act, provide that when the necessary Transfer Resolutions have been passed the society must apply to the Authority for confirmation of the transfer in such manner as the Authority may direct. The society is also required, by paragraph 7 of Schedule 17, to publish notices of its application in one or more of the London, Edinburgh and Belfast Gazettes as the Authority directs and, if it so directs, in one or more newspapers. The choice of official Gazettes and national or local newspapers will, of course, have regard to the area in which the society's members live.
3.6.2	G	The application should specify the date on which the transfer is intended to take effect and should be accompanied by two authenticated copies of the Transfer Agreement. The scrutineers' report described in section 3.5, and a certified copy of the minutes of the general meeting at which the Transfer Resolutions were moved, together with a transcript of the meeting, must also be enclosed with the application, together with 10 copies each of the Transfer Document and the Transfer Summary (if sent), and copies of all other documents sent to members and any advertising material in connection with the proposed transfer. If a Transfer Summary was sent, the application should also be accompanied by a checklist of the information prescribed by Schedule 2 to the Transfer Regulations showing where each item may be found in the Transfer Summary.
3.6.3	G	A pro forma public notice of application, and pro forma letter of application are at Annex 2. The appropriate fee is payable with the application, and a further fee is payable by the society if there is an oral hearing of the application, as prescribed by the Fees Rules.
The Confirmation Criteria: Statutory Provisions		
3.6.4	G	Section 98(2) and (3) of the 1986 Act provides that the Authority must confirm a proposed transfer unless it considers that any one or more of the following four Confirmation Criteria apply:
		(1) some information material to the members' decision about the transfer was not made available to all the members eligible to vote; or
		(2) the vote on any resolution approving the transfer does not represent the views of the members eligible to vote; or
		(3) there is a substantial risk that the successor will not have –
		(a) such permission under Part IV of the Act or

		(b)	such permission under paragraph 15 of Schedule 3 to the Act (as a result of qualifying for authorisation under paragraph 12 of that Schedule), as will enable it to carry on the business which it will have as a result of the transfer without being taken (by virtue of section 20 of the Act) to have contravened a requirement imposed on it by the Authority under the Act; or
		(4)	some relevant requirement of the 1986 Act or of the Rules of the society was not fulfilled.
		Section 98(4) of the 1986 Act then provides that the Authority shall not be precluded from confirming a transfer of business by virtue only of the non-fulfilment of some relevant requirement of the 1986 Act or the Rules (the Fourth Criterion in 3.6.4(4)) if it appears to the Authority that the failure could not have been material to the members' decision about the transfer, and the Authority gives a direction under that subsection that the failure is to be disregarded. Section 98(7) then provides that a failure to comply with a relevant requirement of the 1986 Act or the Rules shall not invalidate a transfer, once confirmed.	
3.6.5	G	Where the Authority would be precluded from confirming a transfer by reason of any of the defects specified in the Confirmation Criteria, Section 98(5) and (6) of the 1986 Act provides that it may direct a society to remedy the defects. A direction under Section 98(5) may, amongst other things, require a society to:	
		(1)	call a further meeting; for example, to vote again in the light of a revised Transfer Statement containing material information previously omitted or after correction of defects in the systems for sending meeting notices and Transfer Statements or Transfer Summaries and validation of votes;
		(2)	secure the variation of the Transfer Agreement; or
		(3)	secure the alteration of the protective provisions in the articles of association of a specially formed successor company.
		If the Authority is then satisfied, having considered evidence furnished by the society, that the defects have been substantially remedied, it must confirm the transfer. If not, then confirmation must be refused.	
Scope of the Authority's Powers			
3.6.6	G	The Authority's powers in connection with applications for confirmation of a transfer are confined to considerations of whether, in the light of the facts, any of the Confirmation Criteria apply. It is not for the Authority to consider, or make judgements about, the merits of a proposed transfer or the fairness of its terms; these matters are first for the board of a society, and then for its members, to decide. Once the members have approved the transfer and its terms, the Authority has no powers to require a society to make any changes to those terms, although it may direct a society to remedy any failure to comply	

		with a relevant requirement of the 1986 Act as a condition of confirmation.	
3.6.7	G	<p>The Authority has no general power to determine disputes between a society and its members, nor to seek to enforce other legislation or the general law. Disputes concerning services provided by societies in the ordinary course of their business are generally a matter, in the first instance, for a society's internal complaints procedure. They may also fall within the jurisdiction of the Financial Services Ombudsman Scheme. Disputes between a building society and a member of the society, in his or her capacity as a member, in respect of any rights or obligations arising from the Rules of the society or the provisions of the 1986 Act, fall within the jurisdiction of the High Court or, in Scotland, the Court of Session (Section 85 of and Schedule 14 to the 1986 Act).</p> <p>However, the Authority does have power, on the written application of certain members, to direct that the member has the right to obtain names and addresses from the society's register of members. Before it gives such a direction, the Authority is required to be satisfied that the member requires that right for the purpose of communicating with other members of the society on a subject relating to its affairs, and must have regard to the interests of the members as a whole and to all the other circumstances (paragraph 15 of Schedule 2 to the 1986 Act). A fee is payable by the applicant. Chapter 1A of this Guide gives guidance on applications for access to the register of members.</p>	
Purpose of Confirmation			
3.6.8	G	The purpose of the confirmation process is to enable:	
		(1)	interested parties to make representations with regard to the Confirmation Criteria;
		(2)	the society to respond to those representations;
		(3)	the Authority to make such enquiry as it considers necessary to reach informed conclusions on each of the Confirmation Criteria.
3.6.9	G	<p>The Authority, in reaching its view on each of the Confirmation Criteria, has not only to assess the points made to it in representations, and the society's responses, but also to make such further enquiries as it considers necessary. In deciding how far it should pursue such enquiries, the Authority has to have regard to the role and effect of confirmation, and to the mischiefs which it is intended to prevent. The Authority considers that one role of confirmation is to provide a protection to members against the provision to them by the society of information which is inadequate, obscure or misleading, and against voting irregularities: in other words to ensure that the vote represents the informed decision of the members. The Authority would hope that this safeguard would work in the majority of cases by causing the board of a society to take care during the preparation of the Transfer Statement not to put confirmation at risk on this account; otherwise the Authority might find that it had to withhold confirmation at the last stage. In considering the First Criterion, the Authority will have regard to the totality of the information provided to the members by the board of a society, and not exclusively to the Transfer Statement and Transfer Summary.</p>	

3.6.10	G	The task of the Authority is accordingly:	
		(1)	to reach a considered view on each of the Confirmation Criteria;
		(2)	if that view is that none applies, to confirm;
		(3)	if one or more of the First Three Criteria apply, to direct the appropriate remedial action, or to refuse confirmation;
		(4)	if the Fourth Criterion applies, to consider whether it is appropriate to direct that failure be disregarded; if not, to direct the appropriate remedial action or to refuse confirmation.
		<p>In considering the Confirmation Criteria, the Authority may well have to look again at the Transfer Statement, or at issues which were considered in connection with approving that Statement. It may also then have to consider the adequacy of the Transfer Summary. In doing so, it has a duty to consider information and arguments put to it by representers and by the society, which of their nature were not available earlier, as well as those arising from its own consideration of the Criteria. The Authority would clearly only change the view reached at the time of approval of the Transfer Statement if there were good reason to do so. But it is under a duty to examine the Statement and connected issues at the time of confirmation in the light of any new information and arguments which become available. Accordingly, the Authority cannot be bound at the confirmation stage to the view that was taken at the earlier stage as to whether further factual information should be included in the Transfer Statement or as to the accuracy of its contents or the view taken as to the legality of the scheme.</p>	
3.6.11	G	The task of considering each of the Confirmation Criteria would still be necessary even if there were no representations. Without such enquiry and consideration the confirmation process would not properly be carried out. The Authority's view of how the Confirmation Criteria should be interpreted and applied is given in the following paragraphs.	
The First Criterion			
3.6.12	G	This criterion requires the Authority to consider whether some material information was not made available to the members. The Authority's own view, in which it concurs with the view previously adopted by the Commission in its confirmation decisions, can be summarised as follows:	
		(1)	the words "made available to all the members eligible to vote" mean that the criterion is mainly, if not exclusively, directed to the information provided by a society to the generality of its members;
		(2)	the extent of "information ... not made available" can reasonably be assessed by considering how far the totality of information made available falls short of what might be expected to be put to its members by a financial institution of standing and repute seeking to put sufficient information and a fair and balanced assessment of it, and the board's conclusions, to the members to enable them to take an

			informed decision;
		(3)	the words “material to the members’ decision” require the Authority then to focus on whether it is within the bounds of reasonable possibility that the members’ decision would have been different had any deficiency in the information been made good, i.e. whether it could have changed the decisions on voting of sufficient members to lead to a different conclusion. If it is within the bounds of reasonable possibility that the deficiency might have changed the outcome, it is not for the Authority to determine whether it would actually have done so - it should put the decision back to the members. This test requires the Authority to take account both of the size of the vote and of the size of the majority within it;
		(4)	the relevance of a particular piece of information to an investor and to a borrower may well be different. Accordingly, it is necessary to consider materiality separately in relation to the shareholding members’ resolution and the borrowing members’ resolution.
3.6.13	G	The Authority’s approach to determining whether this criterion is met is accordingly:	
		(1)	to review the material put to members, in the light of the representations made and the society’s responses, but also taking points of its own accord;
		(2)	to consider, on the basis of that review, what information relevant to the decision of shareholders, or of borrowers, or both, might reasonably have been expected to be put to members by the board of a society of repute considering its fiduciary duty, and the extent to which (if at all) the information actually put falls short of that;
		(3)	to consider separately in relation to the shareholding members’ resolution and in relation to the borrowing members’ resolution, whether any deficiency so identified was sufficient to amount to “information material to the members’ decision”.
The Second Criterion			
3.6.14	G	This criterion requires the Authority to consider whether the votes on the Transfer Resolutions do not represent the views of the members. The main mischief to which it appears to be directed is a resolution approved by a small and unrepresentative vote.	
The Third Criterion			
3.6.15	G	This criterion is concerned with a matter of fact, to be established by reference to the Banking Regulator if a different body.	
The Fourth Criterion			
3.6.16	G	This criterion requires the Authority to consider whether the relevant	

		requirements of the 1986 Act and the Rules have been fulfilled. The phrase “relevant requirement of this Act or the rules of the society” appears explicitly three times in Section 98 of the 1986 Act:
	(1)	sub-section (3)(d) in the specification of this criterion;
	(2)	sub-section (4) which gives the Authority power to disregard certain non-fulfilments;
	(3)	sub-section (7) which provides that a failure to meet such a relevant requirement shall not invalidate a transfer of business, although such failure by a society without a reasonable excuse is a criminal offence.
		The interpretation of the phrase is also directly relevant to sub-section (5) - the power of the Authority to give the society a direction to remedy defects specified in paragraphs (a) to (d) of sub-section (3).
3.6.17	G	Sub-section (8) defines “relevant requirement”:
		“(8) In this section “relevant requirement”, with reference to this Act or the rules of a society, means a requirement of the applicable provisions of this Act or of any rules prescribing the procedure to be followed by the society in approving the transfer and its terms.”
		Section 97(2) in turn defines “the applicable provisions” other than Section 97 as: “section 98, section 99, section 99A, section 100, section 101, section 102, sections 102B, 102C and 102D, paragraph 30 of Schedule 2 and Schedule 17.”
		It will be noted that Section 102A (joint account holders) of the 1986 Act is not an applicable provision and, thus, not a relevant requirement.
3.6.18	G	The Authority considers that sub-section (8) of Section 98 should be read naturally. The words “prescribing the procedure to be followed by the society in approving the transfer and its terms” apply only to the Rules, in order to specify which of the Rules of the society are “relevant requirements”. They do not apply as a matter of normal construction of the sentence to the “applicable provisions of this Act”; nor is it necessary that they should do so, since those provisions are specified in Section 97(2).
3.6.19	G	In the Authority’s view, the above interpretation of “relevant requirement of the 1986 Act” stems from the natural construction of Sections 98(8) and 97(2) which, in turn, is necessary to give effect to Parliament’s intentions for Section 98(5), (6) and (7). The Authority recognises that this interpretation does not quite fit Section 98(4). The test which the Authority has to apply in the case of sub-section (4) to a non-fulfilment of a relevant requirement of the 1986 Act is: “if it appears to the Authority that it could not have been material to the members’ decision about the transfer”. That test clearly is designed to relate to a failure to meet a procedural

		requirement or to some other failure which might have an effect on the voting.
3.6.20	G	The wording of Section 98 is such that no construction of the phrase is entirely free from difficulty. The Authority's view is that the wording, and the intentions of Parliament, are best met by following the natural construction of sub-section (8), as a result applying a wide interpretation in sub-sections (3), (5) and (7), and implicitly in (6), but only considering that it is open to the Authority to make a direction under sub-section (4) in relation to non-fulfilment of a procedural requirement or other failure to which the test in that sub-section is apposite.
3.6.21	G	The Authority accordingly considers that the relevant requirements are those in:
		(1) sections 97 to 102, and 102B to D of, together with paragraph 30 of Schedule 2 to and Schedule 17 to the 1986 Act;
		(2) the Transfer Regulations; and
		(3) the Rules which prescribe the procedure to be followed; that is, in particular, the Rules concerning: membership; special meetings; notice of meetings; procedure at meetings; entitlement of members to vote on resolutions; appointment of proxies; and joint shareholders and borrowers.
Procedure		
3.6.22	G	The procedure to be followed in confirmation proceedings is prescribed by Part II of Schedule 17 to the 1986 Act. Any interested party has the right to make written and/or oral representations to the Authority with respect to a society's application for confirmation. Written representations are to be copied to the society, which is to be afforded the opportunity to comment on them orally at the hearing of its application or in writing. (The FSA will in general be prepared to use electronic rather than paper-based communication if requested by the society or a prospective representer and some of the following procedures may have to be adapted accordingly.)
Representations		
3.6.23	G	Persons making representations should state why they claim to be interested parties, for example, their category of membership of the society, and the ground or grounds for their representations by reference to the Confirmation Criteria discussed above. Notice of a person's intention to make oral representations must be in writing. Such notices and written representations must reach the Authority at the address, and by the specified date customarily given in the Transfer Document issued to members and subsequently confirmed by notice published in the official Gazettes and newspapers as required by the 1986 Act. Persons who make written representations but subsequently decide also to make oral representations must, nevertheless, give notice of that intention in writing to the Authority by the same date. Representations received out of time will not be considered unless, exceptionally and at the sole discretion of the Authority, they appear to the

		Authority to raise matters of substance relevant to the Confirmation Criteria which are not already under consideration.
3.6.24	G	Representations or notices to the Authority will fall into one of the following three categories:
		(1) written representations only;
		(2) written representations with notice of intention to make oral representations;
		(3) notice of intention to make oral representations only.
3.6.25	G	The Authority will acknowledge the receipt of each representation or notice and will send a copy of the chapter of this Guide on confirmation procedures to each representer. It will send copies of all written representations and notices to the society and will afford it an opportunity to comment on the written representations.
3.6.26	G	The Authority will consider the written representations in category 3.6.24(1) and the society's responses to them in advance of the date set for hearing oral representations. Copies of the society's comments on representations in category 3.6.24(2) will be sent to those who made the representations so that they may concentrate their oral representations on the points which they consider to remain at issue. A person making written representations who also wishes to see the society's response must, therefore, also give notice of intention to make oral representations. The society may, exceptionally, apply to put to the Authority in confidence documents which the society considers to be commercially sensitive: the Authority will decide on the merits of each case whether, and on what terms, to accept them as being confidential. Persons in category 3.6.24(3) will be asked to inform the Authority, in advance of the hearing, of the subject and general grounds of the representations they intend to make, and their responses will be copied to the Society.
3.6.27	G	Interested parties may join together in making collective representations and they may also appoint a person, either one of their number or another, to represent them at the hearing. They should notify the Authority in advance if this is what they intend to do.
Conduct of the hearing		
3.6.28	G	The Authority will usually appoint one or more persons to hear and decide an application on its behalf. In the absence of notices of intention to make oral representations the Authority would expect to decide the application, having regard to the written representations, the society's responses and other information available to it, without the need for a public hearing. If there is a public hearing, an additional fee is payable by the society.
3.6.29	G	The Authority will notify the society and those making oral representations of the time and place of the hearing. If there are a significant number of persons wishing to make oral representations, then the hearing may extend beyond one day and may be adjourned from time to time and from place to place. The

		Authority will try to advise participants of the day when they may expect to make their representations and of when the society's representatives may be expected to respond.
3.6.30	G	The Authority expects that hearings will be in public. Members of the general public and the press will be asked to wait outside at the outset of the hearing. The participants will then be asked if any of them has good reason to object to the admission of the general public and the press (such as, for example, the need to refer to personal financial affairs). The Authority may decide that parts of the hearing shall be in private if that appears to it to be desirable. If there are no reasonable objections, the general public and the press will then be admitted, within the limits of the space available. Only the representatives of the society and those who have given due notice of intention to make oral representations may address the Authority.
3.6.31	G	The procedure will be informal. While all participants will be invited to speak concisely and to avoid repetition, the Authority will be considerate towards those who are not professionally represented. The panel taking the hearing on behalf of the Authority may question the participants as the hearing proceeds. The sequence of events will be broadly as follows:
		(1) any preliminary matters (such as the admission of the public or other procedural questions) will be dealt with;
		(2) the chairman of the Authority panel will introduce the proceedings;
		(3) the representatives of the society will be invited to present the application for confirmation, including a description of the events at the meeting at which the Transfer Resolutions were put to the members, the voting on the Resolutions, and any other matters which they wish to introduce at that stage;
		(4) the other participants will be invited to make their representations; where appropriate the Authority would expect to call them in a list marshalled, so far as possible, by subject matter;
		(5) the representatives of the society will be invited to reply to, or comment on, the points made by the other participants;
		(6) the other participants will be invited to comment on the society's replies insofar as those replies raised new issues.
3.6.32	G	This procedure may be varied according to the circumstances at the hearing, and is intended only as a guide to the probable order of events. The hearing may be adjourned if the Authority considers that necessary to enable facts to be checked or additional information to be obtained.
The Authority's decision		
3.6.33	G	The Authority will not normally give an oral decision at the end of the hearing, but may be expected to reserve its decision to be issued later in writing, setting out its reasons. Copies of the written decision will be sent to the participants,

		and can be purchased by any other person. The Authority will ask the registration team to place a copy on the public file of the society.
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3.7	Transfers under Direction	
3.7.1	G	<p>This section describes the Authority’s powers to direct a society to transfer its business to a company, and to proceed by board resolution, and the modified transfer procedure consequently prescribed by the 1986 Act. Section 42B of the 1986 Act provides that, if the Authority considers it expedient to do so to protect the investments of shareholders or depositors, it may direct a society, inter alia, to transfer its business to a company within a specified time (subsection (1)(b)). In such a case, or where the Authority would have directed a transfer, but for the fact that negotiations were already under way, the Authority may also direct that the approval of the transfer shall be by board resolution rather than the Transfer Resolutions. In these circumstances, because neither a Transfer Statement nor Transfer Resolutions are required, the 1986 Act requires the society instead to send to every member entitled to notice of a meeting a statement (referred to below as a “transfer notification statement”) before it applies for confirmation of the transfer (paragraphs 9 and 10 of Schedule 8A to the 1986 Act). Finally, in these circumstances, the first two Confirmation Criteria concerning information made available to, and the views of, the members (see section 6) are replaced by a single criterion:</p>
		<p style="text-align: center;">“the members or a proportion of them would be unreasonably prejudiced by the transfer;”</p> <p>(paragraph 11 of Schedule 8A to the 1986 Act).</p>
3.7.2	G	<p>Where a society is proceeding under a Section 42B direction by board resolution, the Transfer Statement is replaced by a transfer notification statement and a general meeting of the society is not required. The contents of the transfer notification statement are prescribed by Schedule 3 to the Transfer Regulations. In brief, the members are to be informed that the statement is issued on the responsibility of the directors of the society and the successor company, and:</p>
		<p>(1) that the board, acting under direction of the Authority, has resolved to transfer the business;</p>
		<p>(2) of the confirmation procedure, including the last date for receipt by the Authority of written representations and notices of intention to make oral representations and the expected date of the hearing of the society’s application;</p>
		<p>(3) of the name, address and nature of the successor company, and the proposed vesting date;</p>
		<p>(4) of the consequences for the members, including the loss of membership rights in the society, any changes in the terms and conditions of share and mortgage accounts, and deposit protection schemes;</p>
		<p>(5) the terms of any distribution of funds or shares in the successor company and of the Statutory Cash Bonus; and</p>

		(6)	of the interests of the directors and other officers of the society in the transfer, including any compensation or increase in emoluments to which the Authority has given its consent under paragraphs 7 and 8 of Schedule 8A to the 1986 Act.
3.7.3	G		The transfer notification statement must have been approved by the Authority before it is sent to the members. Applications for approval should, in general, follow the procedure described in paragraphs <i>BSOG</i> 3.4.11 to <i>BSOG</i> 3.4.17, and the final draft of the statement should be accompanied by the relevant documents listed in paragraph <i>BSOG</i> 3.4.15, but as appropriate to the particular case and the less extensive information the statement is required to contain.
3.7.4	G		Section 3.5 (General Meetings and Resolutions) does not apply, except that the directors will need to be satisfied that the society's register of members is correct to enable the society to send transfer notification statements, and notices under Section 102B (Trustee Account Holders) of the 1986 Act, to those to whom they must be sent if the society is to gain the protection of Section 102B(4).
3.7.5	G		When the board has resolved to transfer the business and transfer notification statements have been sent to its members, the society may apply to the Authority for confirmation of the transfer, but using an adaptation agreed with the Authority of the pro forma in Annex 2B. The procedure described in section 3.6 is to be followed, including the publication of notices in the official Gazettes and newspapers and the form of application. However, the lapse of time between each stage of the procedure may be modified according to the particular circumstances of a case, and having regard to the need to protect the investments of shareholders or depositors. While a scrutineer's report will not be required, the Authority will require a report from the society's external auditors on the adequacy of the society's systems to fulfil the requirements of the 1986 Act and the Rules with regard to the sending of transfer notification statements and notices to Trustee Account Holders. This is, of course, relevant to the Authority's consideration of the Fourth Confirmation Criterion.
3.7.6	G		As is noted in paragraph <i>BSOG</i> 3.7.1, the First and Second Confirmation Criteria are replaced, in those circumstances, by a single criterion as to whether the members or a proportion of them "would be unreasonably prejudiced by the transfer". Whether this special criterion applies will be a matter of judgement for the Authority to make in the light of any representations made to it and its own enquiries in respect of the particular case. In making its judgement, the Authority will also have regard to the view it then takes as to whether it should exercise its discretion under Section 100(7) of the 1986 Act to direct that no Statutory Cash Bonus, or a reduced bonus, is to be paid "having regard to what is equitable between the members of the society". It follows also that, in considering the Fourth Criterion, the Authority will take account of the modified procedure.
3.7.7	G		The Fees Rules provide that fees are to be paid to the Authority:
		(1)	with an application for approval of a transfer notification statement

			under paragraph 9(4) of Schedule 8A to the 1986 Act, and a further fee with any subsequent substantial revision;
		(2)	with an application for confirmation under Section 97(4)(d) of, paragraph 6 of Schedule 17 and Schedule 8A to, the 1986 Act; and a further fee if oral representations are to be heard.

3.8	Notification and Dissolution	
3.8.1	G	When the Authority has confirmed a transfer (whether voluntary or under direction) it will notify the Registration team and the society concerned.
3.8.2	G	Section 97(8) of the 1986 Act requires the society to notify the Authority of the vesting date, and it must do so no later than 7 days before that date, and, unless a notice is given under subsection (10), subsection (9) provides that the society shall be dissolved on that date. Subsection (10) provides that, if necessary for the purpose of facilitating the disposal of its shares in its successor, the society may include, in the notice of the vesting date, notice of a later date for the dissolution of the society, and it is on this later date that the society is dissolved. A society which gives such a notice must cease to transact any business as from the notified vesting date, except such as may be necessary to dispose of its shares in its successor.
3.8.3	G	Section 97(7) of the 1986 Act provides that, where a society continues to hold shares in its successor after the vesting date, the consideration for the disposal of those shares, together with any other property, rights or liabilities of the society acquired or incurred after that date, shall be transferred to and vested in the successor company on the date specified for the society's dissolution. All other property, rights and liabilities of the society are to be transferred to the successor company on the vesting date.
3.8.4	G	The registration team will record the relevant date, or dates, notified to the Authority by the society.
3.8.5	G	The society will be dissolved on the vesting date or on the later date for dissolution referred to in paragraph <i>BSOG</i> 3.8.2, and its registration will subsequently be cancelled by the registration team under the provisions of Section 103(1)(a) of the 1986 Act.

3.9	Timetable	
3.9.1	G	The society will need to draw up a project plan covering the key elements in the transfer process and the relationships between them, and specifying when it wishes to receive the necessary clearances from the Authority. The time needed for the process will depend, among other things, on the length of time it takes to settle the final terms of the distribution scheme, the complexity of those terms and whether the scheme raises new legal issues (perhaps requiring resolution by application to the High Court), and the time needed to verify the register of members and the record of Trustee Account Holders. It will also be affected by the facility with which the society and its advisers can develop satisfactory documents and respond to enquiries and representations. The plan and the timetable will, of course, need to cover all that will be required of the society, and the successor company, in relation to the requirements of the Banking Regulator, and of the Authority concerning the listing of any shares in the successor company.
3.9.2	G	It will be helpful for the society to discuss its plans with the Authority during their formative stages, when the Authority will be prepared to give a view on their feasibility. However, although the Authority may agree that a planned timetable appears to be manageable, it cannot undertake to meet any deadlines set by the society. In particular, the Authority cannot be constrained in the proper performance of its statutory functions by, for example, the society's wish to put the Transfer Resolutions to a SGM on or before the date of the AGM in that year, or the planned flotation date. The Authority will be mindful of the need to ensure that there is adequate time, compatible with its other business and commitments, to:
		(1) consider whether the proposed distribution scheme is in conformity with the 1986 Act;
		(2) consider and approve the Transfer Statement, including time to deal with renewed applications if significant changes have to be made;
		(3) give interested parties an opportunity to make considered representations at the confirmation stage, for the society to respond to those representations, and for the Authority to consider all the evidence and arguments, including making any necessary further enquiries of its own; and
		(4) write a reasoned confirmation decision.
3.9.3	G	The likely sequence of events is as follows:

Stage 1	Informal preliminary discussions with the Authority and, if different, the Banking Regulator on both substance and timing of the proposed transfer.
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Stage 2	Public announcement of the transfer proposals. The Authority will be ready to comment on drafts of the announcement and any supporting material, although the terms of the announcement are for the society to decide and the Authority is not required to approve them.
Stage 3	Consultation with the Authority on the outline structure of, and main features to be contained in, the Transfer Statement, and on the full specification of the proposed cash and/or share distribution scheme.
Stage 4	Submission to the Authority of the prudential information described in section 3.2.
Stage 5	Initial application to the Authority, with the appropriate fee, for approval of a full draft of the Transfer Statement, contained within a draft Transfer Document, supported by the material described in paragraph <i>BSOG</i> 3.4.12.
Stage 6	Consideration by the Authority, and discussion with the society and its advisers, of the draft documents, including submission by the society of revised drafts as necessary. At this stage, the Authority's staff will also be ready to comment informally on draft proxy forms and other material proposed to be sent to the members with, or in advance of, the Transfer Document. By this stage also, the society ought to have undertaken any mailing to members which it thinks necessary to verify its register of members (see paragraphs <i>BSOG</i> 3.5.14 to <i>BSOG</i> 3.5.17), and to notify them of the rights of Trustee Account Holders (See paragraph <i>BSOG</i> 3.3.18).
Stage 7	(if necessary) Further application to the Authority, with a further fee, for approval of a significantly revised Transfer Statement (see paragraph <i>BSOG</i> 3.4.14).
Stage 8	Production of printer's proofs of the draft documents. At this stage it will be advisable for the society to determine, perhaps by mailing to a sufficient number of staff, whether the notice and Transfer Document pack (especially if it contains the Transfer Statement) is deliverable through domestic letter boxes.
Stage 9	Informal indication by the Authority that it is satisfied with near-final proofs of the Transfer Statement, and the Transfer Agreement.
Stage 10	Formal submission to the Authority of the final draft of the Transfer Statement, together with the supporting documents described in paragraph <i>BSOG</i> 3.4.15.
Stage 11	Approval by the Authority of the Transfer Statement. One proof copy of the Statement, identified and signed on behalf of the Authority, will be returned to the society.
Stage 12	Printing and distribution of meeting notice and Transfer Document to members of the society in time to be received by them at least 21 days before the last date for receipt of proxy forms for the meeting at which the Transfer Resolutions are to be moved. The Authority would appreciate being provided with a number (to be agreed) of copies of the final printed Transfer Document and any Transfer Summary and of the Transfer Statement if printed separately for distribution on request. Although not required by the 1986 Act, one copy of each will be passed

	to the Registration team to be placed on the public file of the society.
Stage 13	The meeting at which the Transfer Resolutions are moved.
Stage 14	If the Transfer Resolutions are passed, application to the Authority for confirmation and publication of notices of that application in the official Gazettes and newspapers. The application should be accompanied by the requisite fee and the material specified in paragraph <i>BSOG</i> 3.6.2.
Stage 15	Last date for receipt by the Authority of representations with respect to the applications. A minimum of four weeks should be allowed between Stages 14 and 15 and a further four weeks to Stage 16 (with extra time allowed for any public holidays which intervene). Representations will be copied to the society for its comments as and when they are received. The Authority will then require sufficient time before the hearing to consider and assess all the representations and the society's responses, and to make any further enquiries which it may think necessary.
Stage 16	The confirmation hearing.
Stage 17	Notification to the society and representers, and publication, of the Authority's Decision. It is advisable to allow a minimum of four weeks between Stages 16 and 17, again allowing extra time for any public holidays.
Stage 18	Notification by the society to the Authority of the vesting date and, if later, the date of dissolution of the society.
Stage 19	Vesting date and, if later -
Stage 20	Dissolution of the society.

3.9.4	G	When considering the proposed vesting date, the society will no doubt consult its merchant bank advisers as to timing, particularly when shares are to be offered for subscription to raise new capital, having regard to other possible major share offers.
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Annex 1
Illustrative structure for a
TRANSFER DOCUMENT
containing a Transfer Statement

Title page:

Should include a recommendation on the following lines:

“When considering what action you should take, you are recommended to obtain advice from your solicitor, accountant, or other professional financial adviser.”

and the directors’ responsibility statement (short form with cross reference to item B9)

PART A

1. Summary of the Transfer procedure and Special General Meeting

The Transfer procedure
Notice of the SGM
Directions to the SGM venue
Guidance on entitlement to vote

2. Background to, and rationale for, the proposals

Merits of the proposed transfer
Conclusions and Recommendations

PART B: THE STATUTORY TRANSFER STATEMENT

Issued in accordance with Section 98 of and Schedule 17 to the Building Societies Act 1986

(**Note:** If a Transfer Summary is issued it must include a statement that this Transfer Statement will be handed or sent to members forthwith free of charge and on request, and where and how it can be obtained.)

3. Review of Options and Value of Consideration

Introduction - to explain that under the proposed terms of the transfer the business of the society will be transferred to an authorised bank and that approval of the terms of the transfer will include, if such is the case, the distribution of part of the consideration for the transfer to non-members. Should also explain that the transfer is subject to approval by the members, authorisation by the Banking Regulator and confirmation by the Authority, and include a brief explanation of the termination provisions of the Transfer Agreement
Factual statement of strategic options considered
Disclosure of any non-confidential proposals received
Reasons for choice and recommendation of proposed transfer

Reasons for choice and recommendation of terms of the proposed distribution scheme

Valuation of the business and methodology (takeover only)

Estimated value of shares in successor

Analysis of distribution of shares and/or cash as between members, Trustee Account Holders and non-members respectively

Statement that approval of the Transfer Resolution includes approval of distributions to non-members

4. Consequences for shareholders, borrowers and employees

The distribution of shares and/or cash in the successor company

The amount of the society's reserves and Statutory Cash Bonus

Any changes in the terms and conditions of share and deposit accounts, mortgages and loans

Changes in the factors relevant to determining retail interest rates (product pricing)

Comparative average interest rates on retail deposits and loans of the society and the successor company over the previous 3 financial years (takeover only)

Loss of membership rights in the society

The statutory deposit protection scheme (summary of any differences)

Arrangements for settlement of disputes

Consequences for staff, including changes in terms of employment

5. Interests of directors and other officers of the society and successor company

Directors and other officers of the society

Directors and other officers of the company

Interests of directors, officers and employees in the share and/or cash distribution and the Statutory Cash Bonus

Any compensation or increased emoluments under Sections 99 and 99A of the 1986 Act

6. The management, activities and operations of the successor company following the transfer

Management

Activities and operations, including a comparison of their range and relative importance with those of the society and any intended change, together with, in the case of a takeover, comparative business indicators of the society and the successor company for each of the previous 3 financial years

Structure and activities of any group to which the company belongs

Ownership of the society's subsidiaries and interests in other associated bodies

Particulars of any person having an interest in 3% or more of the successor company's equity share capital.

Name, head office and principal objects of the company

The protective provisions in the articles of association in accordance with Section 101 of the 1986 Act (conversion only)

The auditors of the society and of the company

7. Financial information

The consolidated financial position of the society and its subsidiaries at the most recent practicable date, and the Society's reserves at that date and the main features of the published annual group accounts for the last 3 years

In the case of a takeover, the consolidated financial position of the successor company/group at the most recent practicable date and the main features of the published annual group accounts for the last 3 years

The share capital of the successor company

Future financial prospects of the successor company

8. General information

Summary of the terms of the Transfer Agreement concerning conditions precedent and termination

Summary of principal rights which will attach to the ordinary shares in the successor company

Costs and expenses of the transfer (including the fee arrangements for merchant bankers)

Whether the transfer will conflict with any contractual arrangements

9. Opinions, reports and consent letters of auditors and other experts

Auditors' opinions

Other experts' opinions

Consent letters

Director's Responsibility Statement

10. Banking Regulator authorisation

11. Statement of statutory approval by the Financial Services Authority

STATEMENT OF STATUTORY APPROVAL BY THE FINANCIAL SERVICES AUTHORITY

Building Societies Act 1986

(c.53)

Approval by the Financial Services Authority of the Transfer Statement of [] Building Society.

The Financial Services Authority (“the Authority”) in exercise of the power conferred on the Authority by paragraph 4(3) of Schedule 17 to the Building Societies Act 1986 (“the 1986 Act”) and considering that the Transfer Statement of [] Building Society (“the Society”) is in conformity with the applicable provisions of the 1986 Act and the Building Societies (Transfer of Business) Regulations 1998 (SI 1998 No. 212) and appears to be factually consistent with the information provided to the Authority by the Society in connection with the Transfer Statement, which information includes the declarations of responsibility by the directors of the Society and of [] -

HEREBY APPROVES the above Transfer Statement so far as its contents concern the matters required to be approved by the said Schedule.

In this approval expressions used in the 1986 Act have the meanings which they bear in the 1986 Act and “the Transfer Statement” means the statement by the Society a draft of which is initialled for the purpose of identification “[]”.

[date]

[Name]

For and on behalf of the Authority

Notes:

This approval does not extend to any matters not forming part of the Transfer Statement as required by the 1986 Act and the Regulations, whether or not such matters are the subject of cross-reference in the statement as so required.

The giving of this approval is without prejudice to any issues which the Authority may have to consider on an application by the Society for confirmation of the transfer pursuant to Section 98 of the 1986 Act.

PART C: ADDITIONAL INFORMATION

- 12. Definitions**
- 13. List of share accounts of the society**
- 14. Documents available for inspection**
- 15. Accountants' report on the successor company**
- 16. Statutory statement for the last financial year**
- 17. Other**

Annex 2
PRO FORMA:

- A. Notice of Application**
- B. Application to the Authority for confirmation**

Annex 2A

Publication of Notice of application to the Authority for confirmation of a transfer in the London, Edinburgh, or Belfast Gazettes and in any newspapers as directed by the Authority.

BUILDING SOCIETIES ACT 1986

Notice under paragraph 7 of Schedule 17 to the 1986 Act

Notice is hereby given that Building Society, Register No.....B, whose principal office is at, desires to transfer its business to, and that the society has applied to the Financial Services Authority to confirm the transfer.

Any interested party may make written representations to the Authority and/or give notice of intention to make oral representations to the Authority with respect to the application. Written representations and notices of intention to make oral representations should be received by the Authority at 25 The North Colonnade, Canary Wharf, London, E14 5HS by 20....Oral representations will be heard by the Authority on20.. at a time and place to be determined by the Authority.

Annex 2B

Form of application to the Authority for confirmation of transfer of business to a company

To the Financial Services Authority

BUILDING SOCIETIES ACT 1986

APPLICATION UNDER SECTIONS 97(4) AND 98(2) OF, AND PART II OF SCHEDULE 17 TO, THE 1986 ACT FOR CONFIRMATION OF A TRANSFER OF BUSINESS TO A COMPANY

..... **BUILDING SOCIETY, REGISTER NO.....B**

The above-named society desires to transfer its business to on20...
[insert vesting date] and applies to the Authority to confirm the transfer.

In making this application the society declares that:

1. At a meeting of Building Society held on20.. the following resolutions were passed:

A shareholding members' resolution, as required by paragraph 30 of Schedule 2 to the 1986 Act, passed in accordance with paragraph [30(2) or 30(3) as the case may be], that Building Society do transfer its business to in accordance with the terms of the transfer agreement, two copies of which, authenticated by the Secretary of the society, are enclosed with this application.

A borrowing members' resolution, as required by paragraph 30 of Schedule 2 to the 1986 Act that Building Society do transfer its business to in accordance with the terms of the above-mentioned transfer agreement.

2. A transfer statement, in accordance with Schedule 17 to the 1986 Act, approved by the Authority, so far as it concerned matters required by that Schedule to be so approved, was [sent] [made available] to each member of Building Society who was entitled to receive it [, and a transfer summary was sent to those members] in accordance with Schedule 17 to the 1986 Act.

(Seal of the Society making the application)

Annex 3 Index		
Abbey National Building Society	High Court Declaration	<i>BSOG 3.1.10; BSOG 3.3.5; BSOG 3.3.10</i>
Agency Agreements	Contractual Obligations	<i>BSOG 3.4.2(13)</i>
Announcement of Transfer Proposal		<i>BSOG 3.2.5 to BSOG 3.2.9</i>
Application and the Authority's Approval of Transfer Statement		<i>BSOG 3.4.11 to BSOG 3.4.18</i>
Application for Confirmation		<i>BSOG 3.6.1 to BSOG 3.6.3</i>
	Pro Forma Application	<i>BSOG Annex 2B</i>
Articles of Association of Successor Company		<i>BSOG 3.4.15(2)</i>
	Protective Provisions	<i>BSOG 3.1.4 to BSOG 3.1.5; BSOG 3.3.1; BSOG 3.3.19; BSOG 3.3.21; BSOG 3.4.12(7); BSOG 3.6.5(3); BSOG Annex 1</i>
Auditors (see also Scrutineers)		<i>BSOG 3.2.10(2); BSOG 3.2.14; BSOG 3.4.2(15); BSOG 3.4.12(4), BSOG 3.4.12(6) & BSOG 3.4.12(9); BSOG 3.4.15(4), BSOG 3.4.15(6), BSOG 3.4.15(9) & BSOG 3.4.15(10); BSOG 3.5.15; BSOG 3.7.5; BSOG Annex 1</i>
Authority's Approval of Transfer Statement	Information Provided to Members	<i>BSOG 3.4.11 to BSOG 3.4.18</i>
Authority's Powers	Discretionary Powers	<i>BSOG 3.6.4 to BSOG 3.6.7</i>
	Disputes with Members	<i>BSOG 3.6.7</i>
Banking Regulator	Authorisation to accept deposits	<i>BSOG 3.2.2; BSOG 3.2.16; BSOG 3.3.23; BSOG 3.6.4(3); BSOG 3.6.15</i>

	Letter of Consent	<i>BSOG 3.4.15(11)</i>
	Protective Provisions for Successor Company	<i>BSOG 3.3.21</i>
	Systems Report	<i>BSOG 3.2.14</i>
Board Statements and Board Rationale (see also Rationale)	Board's Statements	<i>BSOG 3.4.9 to BSOG 3.4.10; BSOG 3.4.19</i>
	Contractual Obligations Statement	<i>BSOG 3.4.2(13)</i>
	Directors' Declaration	<i>BSOG 3.4.15(17)</i>
	Directors' Recommendation	<i>BSOG 3.4.2(1); BSOG Annex 1</i>
	Responsibility Statement	<i>BSOG 3.4.2(15); BSOG 3.4.4; BSOG 3.4.10; BSOG 3.4.12(4); BSOG 3.4.15(13) to BSOG 3.4.15(14); BSOG 3.7.2; BSOG Annex 1</i>
Borrowing Members	Resolution	<i>BSOG 3.1.7; BSOG 3.5.1(1); BSOG 3.5.9</i>
	Voting entitlement	<i>BSOG 3.5.5 to BSOG 3.5.13</i>
Business Plans of the Successor Company		<i>BSOG 3.2.2; BSOG 3.2.10(4)</i>
Cash Distributions		<i>BSOG 3.3.8 to BSOG 3.3.10; BSOG 3.4.2(3); BSOG Annex 1</i>
Registration team		<i>BSOG 3.4.17; BSOG 3.6.33; BSOG 3.8.1 to BSOG 3.8.2; BSOG 3.8.4 to BSOG 3.8.5; BSOG 3.9.3, Stages 12 & 18</i>
Chairman's (or Board's) Statement		<i>BSOG 3.4.9 to BSOG 3.4.10</i>
Cheltenham and Gloucester Building Society	High Court Declaration	<i>BSOG 3.1.10; BSOG 3.3.2; BSOG 3.3.10</i>
Company	(see Successor Company)	

Compensation to Directors and Other Officers (see also Interests of Directors &c)		<i>BSOG 3.1.9; BSOG 3.3.24 to BSOG 3.3.25; BSOG 3.5.2; BSOG 3.4.2(8); BSOG 3.5.34(8); BSOG 3.7.2(6); BSOG Annex 1</i>
Conditions of a Transfer	(see Terms of a Transfer)	
Confidentiality of Information (see also Disclosure)		<i>BSOG 3.1.2; BSOG 3.4.2(2); BSOG 3.5.16; BSOG 3.5.31; BSOG 3.6.26; BSOG Annex 1</i>
Confirmation	<p>Application</p> <p>Authority's Powers</p> <p>Criteria (see below)</p> <p>Decision</p> <p>Hearing</p> <p>Notice of Application</p> <p>Procedure (see below)</p> <p>Purpose of (see below)</p>	<p><i>BSOG 3.6</i></p> <p><i>BSOG 3.6.1 to BSOG 3.6.3; BSOG Pro Forma Application Annex 2B</i></p> <p><i>BSOG 3.6.6 to BSOG 3.6.7</i></p> <p><i>BSOG 3.6.33</i></p> <p><i>BSOG 3.6.28 to BSOG 3.6.32</i></p> <p><i>BSOG 3.6.1 to BSOG 3.6.3; BSOG Pro Forma Notice Annex 2A</i></p>
Confirmation Criteria	<p>First Criterion</p> <p>Second Criterion</p> <p>Third Criterion</p> <p>Fourth Criterion</p>	<p><i>BSOG 3.6.4 to BSOG 3.6.21</i></p> <p><i>BSOG 3.6.4; BSOG 3.6.9; BSOG 3.6.12 to BSOG 3.6.13</i></p> <p><i>BSOG 3.6.4; BSOG 3.6.14; BSOG 3.7.6</i></p> <p><i>BSOG 3.6.4; BSOG 3.6.15</i></p> <p><i>BSOG 3.6.4; BSOG 3.6.10(4); BSOG 3.6.16 to BSOG 3.6.21; BSOG 3.7.6</i></p>
Confirmation Procedure	Authority's Decision	<i>BSOG 3.6.22 to BSOG 3.6.33</i> <i>BSOG 3.6.33</i>

	Conduct of the Hearing	<i>BSOG 3.6.28 to BSOG 3.6.32</i>
	Representations	<i>BSOG 3.6.23 to BSOG 3.6.27</i>
Confirmation - Purpose of	Scope of the Authority's Powers	<i>BSOG 3.6.8 to BSOG 3.6.11</i> <i>BSOG 3.6.6 to BSOG 3.6.7</i>
	Statutory Provisions	<i>BSOG 3.1.9; BSOG 3.6.4 to BSOG 3.6.5</i>
Contingency Plans		<i>BSOG 3.2.3; BSOG 3.2.5; BSOG 3.2.10(3); BSOG 3.2.15</i>
Contractual Obligations		<i>BSOG 3.4.2(13)</i>
Conversion		<i>BSOG 3.1.5; BSOG 3.2.3 to BSOG 3.2.4; BSOG 3.3.19 to BSOG 3.3.21</i>
Court Declarations (see High Court Declarations)		
Decision by Authority on Confirmation		<i>BSOG 3.6.33</i>
Deduplication of Register		<i>BSOG 3.5.14 to BSOG 3.5.17</i>
Deposit Liabilities of Successor Company		<i>BSOG 3.3.4</i>
Directors'	And Other Officers, Definition	<i>BSOG 3.5.2</i>
	Compensation (see Compensation to Directors &c)	
	Declaration	<i>BSOG 3.4.15(8)</i>
	Emoluments (see Emoluments of Directors &c)	
	Interests (see Interests of Directors &c)	
Disabled Persons		<i>BSOG 3.3.15 to BSOG 3.3.18</i>
Disclosure (see also Confidentiality of		<i>BSOG 3.2.5; BSOG 3.2.12; BSOG 3.3.25; BSOG</i>

Information)	Merger and Transfer Proposals Prudential Issues	3.4.2(2); <i>BSOG Annex 1</i> <i>BSOG 3.4.2(2)</i> <i>BSOG 3.1.4; BSOG 3.2.10 to BSOG 3.2.16</i>
Disputes with Members		<i>BSOG 3.6.7</i>
Dissolution		<i>BSOG 3.8.1 to BSOG 3.8.6</i>
Distribution of Funds (see Cash Distributions)		
Distribution Schemes (see also Terms of Transfer)	Cash Distributions Information Provided to Members Non-Members' Distributions Reasons for Choice of Share Distributions to Members	<i>BSOG 3.3.8 to BSOG 3.3.11; BSOG 3.3.15 to BSOG 3.3.18</i> <i>BSOG 3.3.8 to BSOG 3.3.11; BSOG 3.4.2(3); BSOG Annex 1</i> <i>BSOG 3.4.2(3)</i> <i>BSOG 3.4.2(3)</i> <i>BSOG 3.2.4; BSOG 3.4.2(1); BSOG Annex 1</i> <i>BSOG 3.3.8 to BSOG 3.3.11</i>
	Statutory Cash Bonus	<i>BSOG 3.1.4; BSOG 3.3.2; BSOG 3.3.5 to BSOG 3.3.7; BSOG 3.3.15; BSOG 3.4.2; BSOG 3.7.2(5); BSOG 3.7.6; BSOG Annex 1</i>
Duplicate Accounts (see also Deduplication of Register)	Trustee Account Holders	<i>BSOG 3.3.15</i>
Electronic Communications Order 2003		<i>BSOG 3.1.11</i>
Emoluments of Directors and Other Officers		<i>BSOG 3.1.8; BSOG 3.3.24; BSOG 3.3.26 to BSOG 3.3.27; BSOG 3.4.2(6); BSOG 3.5.2 to BSOG 3.5.3;</i>

		<i>BSOG 3.5.34(9); BSOG 3.7.2(6)</i>
General Meetings (see also Voting)	<p>Conduct of Meeting</p> <p>Notice of Meeting</p> <p>Postal Ballots</p> <p>Proxy Voting</p> <p>Scrutineers' Report</p> <p>Voting Conduct</p>	<p><i>BSOG 3.5</i></p> <p><i>BSOG 3.5.24 to BSOG 3.5.26</i></p> <p><i>BSOG 3.5.4; BSOG 3.5.19 to BSOG 3.5.23</i></p> <p><i>BSOG 3.5.1</i></p> <p><i>BSOG 3.5.12(1); BSOG 3.5.29 to BSOG 3.5.33</i></p> <p><i>BSOG 3.5.34 to BSOG 3.5.36</i></p> <p><i>BSOG 3.5.27 to BSOG 3.5.33</i></p>
Halifax Building Society and Leeds Permanent Building Society	<p>High Court Declaration</p>	<i>BSOG 3.1.10; BSOG 3.3.10</i>
Hearing		<i>BSOG 3.6.28 to BSOG 3.6.32</i>
High Court Declarations	<p>Abbey National Building Society</p> <p>Cheltenham and Gloucester Building Society</p> <p>Halifax Building Society and Leeds Permanent Building Society</p>	<p><i>BSOG 3.2.9</i></p> <p><i>BSOG 3.1.10; BSOG 3.3.5; BSOG 3.3.10</i></p> <p><i>BSOG 3.1.10; BSOG 3.3.2; BSOG 3.3.10</i></p> <p><i>BSOG 3.1.10; BSOG 3.3.10</i></p>
Information Provided to Members (see also Confidentiality of Information)		<i>BSOG 3.4; BSOG 3.6.26</i>
	<p>Application and Authority's Approval</p>	<i>BSOG 3.4.11 to BSOG 3.4.18; BSOG 3.6.10</i>
	<p>Board Statements and Board Rationale</p>	<i>BSOG 3.4.9 to BSOG 3.4.10</i>
	<p>Transfer Statement</p>	<i>BSOG 3.4.2</i>

	Transfer Summary	<i>BSOG 3.4.3 to BSOG 3.4.4; BSOG 3.6.10</i>
Interests of Directors and Other Officers (see also Compensation to Directors &c)		<i>BSOG 3.1.9; BSOG 3.3.25; BSOG 3.4.2(6); BSOG 3.7.2(6); BSOG Annex 1</i>
Joint Share Account Holders		<i>BSOG 3.3.12 to BSOG 3.3.14</i>
Joint Shareholders and Borrowers	Voting Entitlement	<i>BSOG 3.5.5 to BSOG 3.5.13</i>
Leeds Permanent Building Society and Halifax Building Society	High Court Declaration	<i>BSOG 3.1.10; BSOG 3.3.10</i>
Mailing of Transfer Statement		<i>BSOG 3.4.1; BSOG 3.5.21 to BSOG 3.5.23; BSOG 3.9.3, Stage 8</i>
Management of the Transfer Process	Prudential Issues	<i>BSOG 3.1.4; BSOG 3.2.10 to BSOG 3.2.16</i>
Meetings (see General Meetings)		
Membership Records of Society		<i>BSOG 3.5.14 to BSOG 3.5.17</i>
Memorandum of Successor Company		<i>BSOG 3.4.15(2)</i>
Merger Proposals	Disclosure of	<i>BSOG 3.4.2(2)</i>
Minors		<i>BSOG 3.5.5; BSOG 3.5.14; BSOG 3.5.17; BSOG 3.5.36(4)</i>
Multiple Accounts		<i>BSOG 3.5.14; BSOG 3.5.16 to BSOG 3.5.17</i>

Notice of Application for Confirmation	Pro Forma Notice of Application Annex 2A	<i>BSOG 3.6.1 to BSOG 3.6.3</i>
Notice of Meeting		<i>BSOG 3.5.4</i>
Notification and Dissolution		<i>BSOG 3.8.1 to BSOG 3.8.6</i>
Officers of a Society Definition		<i>BSOG 3.5.2</i>
Postal Ballots		<i>BSOG 3.5.1</i>
Product Pricing for a plc		<i>BSOG 3.4.2(4); BSOG Annex 1</i>
Proxy Voting		<i>BSOG 3.5.29 to BSOG 3.5.33</i>
Prudential Issues for Conversion		<i>BSOG 3.2.10 to BSOG 3.2.16</i>
Public Announcement		<i>BSOG 3.2.5 to BSOG 3.2.9</i>
Purpose of this Chapter		<i>BSOG 3.1.1 to BSOG 3.1.4</i>
Qualifying Day		<i>BSOG 3.3.2 to BSOG 3.3.3</i>
Qualifying Shareholding		<i>BSOG 3.3.5; BSOG 3.5.7(1); BSOG 3.5.14</i>
Qualifying Shareholding Date		<i>BSOG 3.3.5; BSOG 3.5.7(1); BSOG 3.5.8</i>
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Register of Members	Members' Access to	<i>BSOG 3.4.15(16); BSOG 3.5.14 to BSOG 3.5.17</i> <i>BSOG 3.6.7</i>
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Remuneration of Directors and Other Officers		<i>BSOG 3.1.8; BSOG 3.3.24; BSOG 3.3.26 to BSOG 3.3.27; BSOG 3.4.2(6); BSOG 3.5.2 to BSOG 3.5.3; BSOG 3.5.34(8); BSOG</i>

		3.7.2(6)
Representations		<i>BSOG 3.6.23 to BSOG 3.6.27</i>
Resolutions (see also Voting)	Borrowing Members'	<i>BSOG 3.5</i> <i>BSOG 3.1.7; BSOG 3.5.1(1); BSOG 3.5.9</i>
	Ordinary	<i>BSOG 3.1.8; BSOG 3.3.27; BSOG 3.5.3; BSOG 3.5.8; BSOG 3.5.11; BSOG 3.5.34(9)</i>
	Shareholding Members'	<i>BSOG 3.1.5; BSOG 3.1.7; BSOG 3.3.5; BSOG 3.5.1(2); BSOG 3.5.7 to BSOG 3.5.8; BSOG 3.5.10</i>
	Special Resolution	<i>BSOG 3.1.8; BSOG 3.3.24 to BSOG 3.3.25; BSOG 3.5.2; BSOG 3.5.8; BSOG 3.5.11; BSOG 3.5.34(8)</i>
Responsibility Statement		<i>BSOG 3.4.2(15); BSOG 3.4.4; BSOG 3.4.10; BSOG 3.4.12(4); BSOG 3.4.15(13) to BSOG 3.4.15(14); BSOG Annex 1</i>
Risk Assessment		<i>BSOG 3.2.10(3)</i>
Rules of Society	As Relevant Requirements	<i>BSOG 3.6.21</i>
	Voting Entitlement	<i>BSOG 3.5.5 to BSOG 3.5.13</i>
Scrutineers	Appointment	<i>BSOG 3.5.34</i>
	Conduct of Voting	<i>BSOG 3.5.14; BSOG 3.5.17; BSOG 3.5.27 to BSOG 3.5.33</i>
	Report	<i>BSOG 3.1.4; BSOG 3.2.10(2); BSOG 3.5.22; BSOG 3.5.34 to BSOG 3.5.39; BSOG 3.6.2; BSOG 3.7.5</i>

Share Accounts	Liability of Successor Company	<i>BSOG 3.3.4</i>
Share Distributions to Members		<i>BSOG 3.3.8 to BSOG 3.3.18; BSOG 3.4.6</i>
Shareholding Members	Resolution	<i>BSOG 3.1.7; BSOG 3.5.1(2); BSOG 3.5.7</i>
	Voting Entitlement	<i>BSOG 3.5.5 to BSOG 3.5.13</i>
Shares in Successor Company	Disposal of (by Society)	<i>BSOG 3.3.19 to BSOG 3.3.22; BSOG 3.3.20; BSOG 3.8.2; BSOG 3.8.3</i>
Special Resolution	Compensation to Directors and Other Officers	<i>BSOG 3.1.8; BSOG 3.3.24; BSOG 3.3.25; BSOG 3.5.2; BSOG 3.5.8; BSOG 3.5.11; BSOG 3.5.34(8); BSOG 3.1.8; BSOG 3.3.24; BSOG 3.7.2(6)</i>
Staff Implications		<i>BSOG 3.4.2(5)</i>
Statutory Cash Bonus	Calculation of Eligibility for	<i>BSOG 3.3.5 to BSOG 3.3.7; BSOG Annex 1; BSOG 3.3.6; BSOG 3.3.5</i>
Statutory Requirements		<i>BSOG 3.1.6 to BSOG 3.1.11; BSOG 3.4.1; BSOG 3.6.4 to BSOG 3.6.5</i>
Style of Transfer Statement		<i>BSOG 3.4.19</i>
Subsidiaries of a Society		<i>BSOG 3.3.26; BSOG Annex 1</i>
Successor Company	Activities	<i>BSOG 3.3.19 to BSOG 3.3.23; BSOG 3.4.2(10) to BSOG 3.4.2(11); BSOG Annex 1</i>

	Authorisation to accept deposits	<i>BSOG 3.3.19; BSOG 3.3.22; BSOG 3.3.23</i>
	Business Plans	<i>BSOG 3.2.2; BSOG 3.2.10(4)</i>
	Deposit Liabilities	<i>BSOG 3.3.4</i>
	Financial Prospects	<i>BSOG 3.4.2(9)</i>
	Incorporation	<i>BSOG 3.3.19 to BSOG 3.3.23</i>
	Protective Provisions for	<i>BSOG 3.1.4 to BSOG 3.1.5; BSOG 3.3.1; BSOG 3.3.19; BSOG 3.3.21; BSOG 3.4.12(7); BSOG 3.6.5(3); BSOG Annex 1</i>
	Shares held by Society	<i>BSOG 3.3.23; BSOG 3.8.2 to BSOG 3.8.3</i>
Systems		<i>BSOG 3.2.10(2); BSOG 3.2.14; BSOG 3.4.12(6); BSOG 3.4.15(16); BSOG 3.5.14</i>
	Membership Records	<i>BSOG 3.5.14 to BSOG 3.5.17</i>
	Report	<i>BSOG 3.2.14</i>
Takeover		<i>BSOG 3.1.5; BSOG 3.2.3 to BSOG 3.2.4; BSOG 3.3.22 to BSOG 2.3.23</i>
	Disclosure of Proposals	<i>BSOG 3.4.2(2)</i>
Terms of a Transfer		<i>BSOG 3.3</i>
	Compensation for Loss of Office	<i>BSOG 3.3.24</i>
	Distributions to Members	<i>BSOG 3.3.8 to BSOG 3.3.11</i>
	Increased Emoluments	<i>BSOG 3.3.26</i>
	Joint Account Holders	<i>BSOG 3.3.12 to BSOG 3.3.14; BSOG 3.4.3; BSOG 3.6.17</i>
	Qualifying Day	<i>BSOG 3.3.2 to BSOG 3.3.3</i>
	Share Accounts	<i>BSOG 3.3.4</i>
	Statutory Cash Bonus	<i>BSOG 3.3.5 to BSOG 3.3.7</i>

	Successor Company	<i>BSOG 3.3.19 to BSOG 3.3.23</i>
	Trustee Account Holders	<i>BSOG 3.3.15 to BSOG 3.3.18</i>
Timetable for Transfer		<i>BSOG 3.1.2; BSOG 3.1.4; BSOG 3.2.9; BSOG 3.2.12; BSOG 3.4.13; BSOG 3.9.1 to BSOG 3.9.4</i>
Transfer Agreement		<i>BSOG 3.3.1; BSOG 3.3.18; BSOG 3.3.22 to BSOG 3.3.23; BSOG 3.4.2(3) & BSOG 3.4.2(12); BSOG 3.4.3; BSOG 3.4.12(5); BSOG 3.4.15(1), BSOG 3.4.15(15) & BSOG 3.4.15(17); BSOG 3.6.2; BSOG 3.6.5b; BSOG 3.9.3; BSOG Annex 1; BSOG Annex 2B</i>
	Contingency Arrangements	<i>BSOG 3.2.15</i>
	Signing of	<i>BSOG 3.3.3</i>
Transfer Document		<i>BSOG 3.4.5 to BSOG 3.4.8</i>
Transfer Regulations		
	Auditors' Reports and Opinion	<i>BSOG 3.4.15(6); BSOG 3.4.15(9)</i>
	Transfer Statement	<i>BSOG 3.4.2</i>
Transfer Scheme (see Distribution Schemes)		
Transfer Statement (see also Timetable for Transfer)		<i>BSOG 3.4.1 to BSOG 3.4.2; BSOG 3.9.2 to BSOG 3.9.3</i>
	Approval	<i>BSOG 3.4.11 to BSOG 3.4.18</i>
	Compensation to Directors and Other Officers	<i>BSOG 3.3.24</i>
	Mailing of	<i>BSOG 3.4.1; BSOG 3.5.21 to BSOG 3.5.23; BSOG 3.9.3, Stage 8</i>
	Prescribed Matters to be Covered	<i>BSOG 3.4.2; BSOG 3.4.15(17)</i>

	Pro Forma Statement Annex A Part B - Style of	<i>BSOG 3.4.19</i>
Transfer Summary		<i>BSOG 3.4.3 to BSOG 3.4.4; BSOG 3.6.10</i>
Transfer Terms (see Terms of a Transfer)		
Transfer Under Direction		<i>BSOG 3.7.1 to BSOG 3.7.7</i>
Trustee Account Holders		<i>BSOG 3.1.4; BSOG 3.3.15 to BSOG 3.3.18; BSOG 3.4.2(3); BSOG 3.4.12(6); BSOG 3.5.34(1); BSOG 3.7.4 to BSOG 3.7.5; BSOG 3.9.1; BSOG 3.9.3, Stage 6</i>
Verification		<i>BSOG 3.2.13; BSOG 3.4.18</i>
Vesting Date		<i>BSOG 3.1.4; BSOG 3.7.2 to BSOG 3.7.3; BSOG 3.8.2; BSOG 3.8.5; BSOG 3.9.4</i>
Voting (see also General Meetings and Resolutions)	Conduct	<i>BSOG 3.5.27 to BSOG 3.5.33</i>
	Date	<i>BSOG 3.5.12</i>
Voting - Entitlement	Borrowing Members	<i>BSOG 3.5.5 to BSOG 3.5.13</i>
	Continuity of Membership	<i>BSOG 3.5.9</i>
	Joint Shareholders and Joint Borrowers	<i>BSOG 3.5.10</i>
	Majority	<i>BSOG 3.5.1 to BSOG 3.5.3</i>
	Multiple Accounts	<i>BSOG 3.5.11; BSOG 3.5.14; BSOG 3.5.16 to BSOG 3.5.17</i>
	Shareholding Members	<i>BSOG 3.5.7 to BSOG 3.5.8</i>

4.1	Introduction	
4.1.1	G	This annex is for the guidance of those making written representations to the Authority and/or those participating in oral confirmation hearings. It sets out the procedures which the Authority intends to follow.
4.1.2	G	The 1986 Act provides that when a society has approved the transfer of its business to a plc by passing the transfer resolutions, it must then obtain confirmation by the Authority of the transfer and its terms (Section 97(4) of the 1986 Act). If the Authority confirms the transfer, then all the property, rights and liabilities of the society, except any shares in its successor company, transfer on the vesting date to the successor company (Section 97(6) of the 1986 Act), which date is specified in or determined by the transfer agreement between the society and the successor company.
4.2	The role of confirmation	
4.2.1	G	The criteria to which the Authority has to have regard are limited. It is not within the Authority's power to make any judgment about the merits or fairness of the proposals which the members have approved.
4.2.2	G	Section 98(2) and (3) of the 1986 Act provide that the Authority must confirm a transfer unless it considers that:
		(1) some information material to the members' decision about the transfer was not made available to all the members eligible to vote; or
		(2) the vote on any resolution approving the transfer does not represent the views of the members eligible to vote; or,
		(3) there is a substantial risk that the successor will not have –
		(a) such permission under Part IV of the Financial Services and Markets Act 2000, or
		(b) such permission under paragraph 15 of Schedule 3 to that Act (as a result of qualifying for authorisation under paragraph 12 of that schedule), as will enable it to carry on the business which it will have as a result of the transfer without being taken (by virtue of section 20 of that Act) to have contravened a requirement imposed on it by the Authority under that Act; or
		(4) some relevant requirement of the 1986 Act or the rules of the society was not fulfilled.
4.2.3	G	These are the only grounds on which the Authority may refuse confirmation, or direct the society to remedy any defects. If the Authority finds that there are defects it may direct the society to take steps to remedy them. If the Authority is then satisfied that the defects have been substantially remedied, it must confirm the transfer; if not, it must refuse confirmation (Section 98(5) and (6))

		of the 1986 Act).
4.2.4	G	In the case of the ground mentioned in paragraph <i>BSOG</i> 4.2.2(4), the Authority may direct that non-fulfillment of some relevant requirement of the 1986 Act or of the rules of the society is to be disregarded, if it appears to the Authority that the failure could not have been material to the members' decision (Section 98(4) of the 1986 Act). "Relevant requirement" in this context means a requirement of the provisions of the 1986 Act applicable to the transfer of a society's business (which are Sections 97 to 102 and 102B to D, paragraph 30 of Schedule 2, Schedule 17 and the Transfer Regulations made under the 1986 Act) and any Rules prescribing the procedure to be followed by the society in approving the transfer and its terms (that is, generally, the rules concerning: membership; special meetings; notice of meetings; procedure at meetings; entitlement of members to vote on resolutions; appointment of proxies; and joint shareholders and borrowers).
4.2.5	G	The 1986 Act provides that any accidental omission to give the notice of the meeting to, or non-receipt of the notice by, a person entitled to receive it does not invalidate the proceedings at the special general meeting (Schedule 2, paragraph 22(3)).
4.3		Purpose of the hearing
4.3.1	G	The purpose of the hearing is to enable interested parties to make representations, and to enable the Authority to make such enquiry as it considers necessary, both of the society and of those making representations, in order to reach an informed view. The Authority will examine all the representations, whether written or oral, in relation to the four statutory criteria described in paragraph <i>BSOG</i> 4.2.2. In the light of that examination, and consideration of all the representations and the society's response, the Authority will make its decision.
4.4		Making representations to the Authority
4.4.1	G	Any interested party has the right to make written and oral representations to the Authority with respect to the society's application for confirmation. Those making written representations and those giving notice of intention to make oral representations should state clearly why they claim to be interested parties (e.g. the category of their membership of the society). Those making written representations should also identify the ground or grounds, in paragraph <i>BSOG</i> 5.2.2, to which their representations are directed and it will be helpful if those giving notice of intention to make oral representations will do likewise.
4.4.2	G	Written representations, or written notice of a person's intention to make oral representations, or both, must be addressed to the Financial Services Authority and must reach the Authority at 25 The North Colonnade, Canary Wharf, London E14 5HS by the date quoted in the transfer documentation issued to members. Unwritten representations and notice (for example by telephone) cannot be accepted. Persons who make written representations but subsequently decide also to make oral representations must, nevertheless, give notice of that intention, in writing, to the Authority at the above address by the same date (paragraph 7 of Schedule 17 to the 1986 Act). The Authority will in

		<p>general be prepared to use electronic rather than paper-based communication for notices and written representations if requested by the society or a prospective representer. A specific electronic address will be provided for that purpose, and some of the relevant procedures may have to be adapted accordingly.</p>
4.4.3	G	<p>Representations or notices to the Authority will fall into one of the following three categories:</p>
		<p>(1) written representations only;</p>
		<p>(2) written representations with notice of intention to make oral representations;</p>
		<p>(3) notice of intention to make oral representations only.</p>
4.4.4	G	<p>The Authority will send copies of all written representations to the society, and will afford it an opportunity to comment on them (paragraph 8 of Schedule 17 to the 1986 Act). The Authority will consider the written representations in categories <i>BSOG</i> 4.4.3(1) and <i>BSOG</i> 4.4.3(2), and the society's responses to them. A synopsis of the representations (probably in the form of a summary of each of the main points made and the numbers of persons making each point) and the society's responses may be made available to those participating in the oral hearing. This is intended to inform those making oral representations of the points already under consideration by the Authority with a view to avoiding unnecessary repetition.</p>
4.4.5	G	<p>Copies of the society's comments on representations in category <i>BSOG</i> 4.4.3(2) will be sent to those who made the representations in time for the oral hearing so that they may concentrate their oral representations on the points which they consider to remain at issue. A person making written representations who wishes to see the society's comments must, therefore, also give notice of intention to make oral representations. Any documents referred to in the society's comments will be made available by the society for inspection at a specified place which will be notified to those making oral representations. (The society may, exceptionally, apply to put to the Authority in confidence documents which the society considers to be commercially sensitive: the Authority will decide on hearing argument whether, and on what terms, to accept them as being confidential). Persons in category 4.4.3(3) will be asked to inform the Authority, in advance of the oral hearing, of the subject and general grounds of the representations they intend to make; the Authority will copy any response to the society.</p>
4.4.6	G	<p>Interested parties may join together in making collective representations and they may also appoint a person, either one of their number or another, to represent them at the oral hearing. They should notify the Authority in advance if this is what they intend to do. The Authority will notify this to the society.</p>
4.5		<p>Panel taking the hearing</p>

4.5.1	G	A Panel will be appointed by the Authority to consider and decide the application on its behalf. The panel will conduct the oral hearing if one is required.
4.6	Time and place	
4.6.1	G	Oral hearings will normally start at about mid-morning on the date quoted in the transfer documentation sent to members and at a place which will be notified to the participants. If there is a significant number of persons wishing to make oral representations, then the hearing may extend beyond one day and may be adjourned from time to time and from place to place. The Authority will try to advise participants of the day when they may expect to make their representations, and of when the society's representatives may be expected to respond.
4.7	Procedure at the hearing	
4.7.1	G	The Authority expects that oral hearings will be held in public. Members of the general public and the press will be asked to wait outside at the commencement of the hearing. The participants will then be asked if any of them has good reason to object to the admission of the general public or the press (such as, for example, the need to refer to personal financial affairs). Unless an objection by a participant is upheld by the Authority, the press and the general public will then be admitted, within the limits of the space available. However, the Authority may decide that parts of the hearing shall be in private if that appears to it to be desirable.
4.7.2	G	The procedure will be informal. All participants will be expected to speak concisely and avoid repetition. The Authority will be considerate towards those who are not professionally represented. Members of the Panel taking the hearing may question the participants. The sequence of events will be broadly as follows:
		(1) any preliminary matters (such as the admission of the public or other procedural questions) will be dealt with;
		(2) the chairman of the Panel will introduce the proceedings;
		(3) the representatives of the society will be invited to speak to the application, including a description of the events at the meeting at which the transfer resolutions were put to the members, a statement of the voting on the resolutions, and any other matters which they wish to introduce at that stage;
		(4) the other participants will be invited to speak to their representations. The Authority expects to call them in a list marshalled, so far as possible, by subject matter;
		(5) the representatives of the society will be invited to reply to, or comment on, the points made by the other participants;

		(6)	the other participants will be invited to comment on the society's replies.
4.7.3	G		This procedure may be varied according to the circumstances at the hearing, and is intended only as a guide to the probable order of events. The hearing may be adjourned if the Authority considers that necessary to enable facts to be checked or additional information to be obtained.
4.8	The Authority's decision		
4.8.1	G		At the end of the oral hearing, the Authority will reserve its decision. A copy of its written decision, including its findings on the points made in representations, will be published and copies will be sent to the society, and to those making written and/or oral representations.

**COMPLAINTS SOURCEBOOK (CONSUMER CREDIT RULES)
INSTRUMENT 2006**

Powers exercised

- A. The Financial Services Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):
- (1) section 138 (General rule-making power);
 - (2) section 156 (General supplementary powers);
 - (3) section 226 (Compulsory jurisdiction);
 - (4) section 234 (Industry Funding);
 - (5) paragraph 13 of Schedule 17 (The Ombudsman Scheme); and
 - (6) section 157 (Guidance)
- B. The rule-making powers listed above are specified for the purpose of section 153(2) (Rule-making instruments) of the Act.

Commencement

- C. This instrument comes into force on 6 April 2007.

Amendments to the Handbook

- D. The Glossary of definitions is amended in accordance with Annex A to this instrument.
- E. The Dispute Resolution: Complaints sourcebook (DISP) is amended in accordance with Annex B to this instrument.
- F. The Fees manual (FEES) is amended in accordance with Annex C to this instrument.

Citation

- G. This instrument may be cited as the Complaints Sourcebook (Consumer Credit Rules) Instrument 2006.

By order of the Board:

23 November 2006

Annex A

Amendments to the Glossary of definitions

In this Annex, any definition which is not underlined is an existing definition also hereby made for the purpose of the Compulsory Jurisdiction.

consumer credit activity

any one of the following activities carried on by a *licensee* or *firm*:

- (a) providing credit or otherwise being a creditor under a *regulated consumer credit agreement*;
- (b) the bailment or (in Scotland) the hiring of goods or otherwise being an owner under a *regulated consumer hire agreement*;
- (c) credit brokerage in so far as it is the effecting of introductions of:
 - (i) individuals desiring to obtain credit to persons carrying on a consumer credit business; or
 - (ii) individuals desiring to obtain goods on hire to persons carrying on a consumer hire business;
- (d) in so far as they relate to *regulated consumer credit agreements* or *regulated consumer hire agreements*;
 - (i) debt-adjusting;
 - (ii) debt-counselling;
 - (iii) debt-collecting; or
 - (iv) debt administration;
- (e) the provision of credit information services; or
- (f) the operation of a credit reference agency;

where at the time of the act or omission complained of:

- (g) the *licensee* or *firm* was:
 - (i) covered by a standard licence under the Consumer Credit Act 1974 (as amended); or
 - (ii) authorised to carry on an activity by virtue of section 34(A) of that Act; and
- (h) the activity was carried on in the course of a business of a type specified in accordance with section 226A(2)(e) of the *Act*;

and expressions used in the Consumer Credit Act 1974 (as amended) have the same meaning in this definition as they have in that Act.

regulated consumer credit agreement

in accordance with section 8 of the Consumer Credit Act 1974 (as amended) an agreement between an individual "the debtor" and any other person "the creditor" by which the creditor provides the debtor with credit of any amount and which is not an exempt agreement for the purposes of that Act;

and expressions used in that Act have the same meaning in this definition.

regulated consumer hire agreement

in accordance with section 15 of the Consumer Credit Act 1974 (as amended) an agreement made by a person with an individual "the hirer" for the bailment or (in Scotland) the hiring of goods to the hirer, being an agreement which

- (a) is not a hire-purchase agreement, and
- (b) is capable of subsisting for more than three months, and
- (c) is not an exempt agreement;

and expressions used in that Act have the same meaning in this definition.

Annex B

Amendments to the Dispute Resolution: Complaints sourcebook (DISP)

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

2.4.3 R ...

(2) The following are not *eligible complainants*:

- (a) (in the *Compulsory Jurisdiction*), an individual, business, charity or trustee, who was an *intermediate customer* or *market counterparty* in relation to the *firm* in question at the time of the act or omission, and in respect of the activity, which is the subject of the complaint;
- (b) (in the *Compulsory Jurisdiction*, the *Consumer Credit Jurisdiction* and the *Voluntary Jurisdiction*), a *firm*, *licensee* or *VJ participant* whose complaint relates in any way to an activity which the *firm* itself has *permission* to carry on or which the *licensee* or *VJ participant* itself conducts, and which is subject to the *Compulsory Jurisdiction*, the *Consumer Credit Jurisdiction* or the *Voluntary Jurisdiction* of the *Financial Ombudsman Service*

...

2.4.11 R The relationships with the *firm*, *licensee* or *VJ participant* relevant for *DISP* 2.4.10R(2)(a) are:

- (1) the complainant has given the *firm*, *licensee* or *VJ participant* a guarantee or security for a mortgage ~~or~~ loan, actual or prospective *regulated consumer credit agreement*, or an actual or prospective *regulated consumer hire agreement*, or any linked transaction as defined in the Consumer Credit Act 1974 (as amended); or
- (5) ... ~~or~~ or
- (6) the complainant is a *person* about whom information relevant to his financial standing is or was held by the *firm*, *licensee* or *VJ participant* in operating a credit reference agency, as defined by section 145(8) of the Consumer Credit Act 1974 (as amended); or
- (7) the complainant is a *person* from whom the *firm*, *licensee* or *VJ participant* has sought to recover payment under a *regulated consumer credit agreement* or *regulated consumer hire agreement* in carrying on debt-collecting as defined by section 145(7) of the Consumer Credit Act (1974) (as amended).

...

2.6.1 R The *Ombudsman* can consider a complaint under the *Compulsory Jurisdiction* only if it relates to an act or omission by a *firm* in the carrying on of one or more of the following activities (unless the provision described in *DISP 2.6.3G* applies):

...

(6) consumer credit activities;

...

Sch 4.1 G 3 The following powers and related provisions in the *Act* have been exercised by the *FOS Ltd* to make the rules in *DISP*:

...

(7) Section 226A(7) (Consumer Credit Jurisdiction)

(8) Section 229 (Awards)

(9) Schedule 17 paragraph 16B,D

4.2	G		Table: The powers to make rules relating to the new ombudsman scheme are shared between the <i>FSA</i> and the <i>Financial Ombudsman Service (FOS Ltd)</i> . <i>FOS Ltd's</i> rules are subject to <i>FSA</i> consent or approval. The rules made exclusively by <i>FOS Ltd</i> are:	
			<u>DISP 1</u>	<u>1.1.1 BR</u>
				<u>1.1.1 DR</u>
			DISP 2	2.6.9R
				2.6.11R
				<u>2.6.8 A-BR</u>

Annex C

Amendments to the Fees manual

In this Annex, underlining indicates new text.

5.2.2

5.2.2 G Section 234 ...

(1) the establishment of the Financial Ombudsman Service

FEES 5 ANNEX 1

...

Part 3: Case fees – firms

**PRUDENTIAL REQUIREMENTS FOR INSURERS (AMENDMENT)
INSTRUMENT 2006**

Powers exercised

- A. The Financial Services Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 ("the Act"):
- (1) section 138 (General rule-making power);
 - (2) section 150(2) (Actions for damages);
 - (3) section 156 (General supplementary powers); and
 - (4) section 157(1) (Guidance).
- B. The rule-making powers listed above are specified for the purpose of section 153(2) (Rule-making instruments) of the Act.

Commencement

- C. This instrument comes into force as follows:
- (1) The amendments in Annex A to the Glossary of definitions come into force on 31 December 2006.
 - (2) The remainder of this instrument comes into force on 30 December 2006.

Amendments to the Handbook

- D. The Glossary of definitions is amended in accordance with Annex A to this instrument.

Amendments to FSA Instruments

- E. Annex B (Chapters 1 and 2 of GENPRU) to the General Prudential Sourcebook Instrument 2006 (FSA 2006/40) is amended in accordance with Annex B to this instrument.
- F. Annex B (Text of INSPRU) to the Prudential Sourcebook for Insurers Instrument 2006 (FSA 2006/42) is amended:
- (1) by substituting for INSPRU 7.1 the version of INSPRU 7.1 set out in Annex C to this instrument;
 - (2) by deleting INSPRU 7 Annex 1G; and
 - (3) otherwise in accordance with Annex D to this instrument.

G. The General Prudential Sourcebook (Transitional Provisions and Schedules) Instrument 2006 (FSA 2006/51) is amended as follows:

(1) Paragraph C (Commencement) is amended by substituting for subparagraph (1) the following:

"(1) The following provisions of the General Prudential Sourcebook (GENPRU) come into force on 31 December 2006:

(a) GENPRU TP 1 to GENPRU TP 6, GENPRU TP 10 to GENPRU TP 13 and GENPRU TP 15;

(b) Schedules 1 to 6 to GENPRU."; and

(2) Annex A (Chapter TP of GENPRU and GENPRU Schedules) is amended in accordance with Annex E to this instrument.

H. Annex A (Amendments to the Glossary) to the CRD (Consequential Amendments) Instrument 2006 (FSA 2006/53) is amended in accordance with Annex F to this instrument.

Citation

I. This instrument may be cited as the Prudential Requirements for Insurers (Amendment) Instrument 2006.

By order of the Board
15 December 2006

Annex A

Amendments to the Glossary of definitions

In this Annex, underlining indicates new text and striking through indicates deleted text. Where new definitions are being inserted, the text is not underlined.

Part 1: New definitions

Insert the following new definitions in the appropriate alphabetical position:

<i>ICA</i>	<i>individual capital assessment.</i>
<i>individual capital assessment</i>	(in <i>INSPRU</i> and <i>COB</i> 6.12) an assessment by a <i>firm</i> of the adequacy of its capital resources undertaken as part of an assessment of the adequacy of the <i>firm's</i> overall financial resources carried out in accordance with <i>GENPRU</i> 1.2.

Part 2: Amended definitions

Amend the following definitions as shown:

<i>realistic excess capital</i>	(in relation to a <i>with-profits fund</i>) the excess, if any, of the realistic value of assets for the with profits fund over the sum of the realistic value of liabilities and the risk capital margin for that fund, calculated in accordance with <u>has the meaning set out in PRU 7.4.32R.</u>
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Annex B

Amendments to Annex B (Chapters 1 and 2 of GENPRU) to the General Prudential Sourcebook Instrument 2006 (FSA 2006/40)

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

...

- 1.3.41 R (1) For the purposes of *GENPRU* and *INSPRU*, an *insurer* or a *UK ISPV* must apply *GENPRU* 1.3.14R to *GENPRU* 1.3.34R (Marking to market, Marking to model, Independent price verification, Adjustments or reserves) to account for:
- (a) investments that are, or amounts owed arising from the disposal of:
 - ...
 - (iv) *units in UCITS schemes, non-UCITS retail schemes, recognised schemes and any other collective investment scheme falling within paragraph(1)(A)(d)(iv) of GENPRU 2 Ann 7Rthat invests only in *admissible assets (including any derivatives or quasi-derivatives held by the scheme)*; and*
 - (b) ...
- (2) ...

...

- 2.1.18 R The *CRR* for any *insurer* to which this *rule* applies (see *GENPRU* 2.1.19R and *GENPRU* 2.1.20R) is the higher of:
- (1) the *MCR* in *GENPRU* 2.1.~~25~~24AR; and
 - (2) the *ECR* in *GENPRU* 2.1.38R.

...

- 2.1.24 R Subject to *GENPRU* 2.1.26R, for an *insurer* carrying on *general insurance business*, the *MCR* in respect of that business is the higher of...

- 2.1.24A R Subject to *GENPRU* 2.1.26R, for an *insurer* carrying on *long-term*

insurance business to which GENPRU 2.1.18R applies the MCR in respect of that business is the higher of:

(1) the base capital resources requirement for long-term insurance business applicable to that firm; and

(2) the long-term insurance capital requirement.

2.1.25 R Subject to GENPRU 2.1.26R, for an insurer carrying on long-term insurance business, but to which GENPRU 2.1.18R does not apply, the MCR in respect of that business is the higher of:

(1) the base capital resources requirement for long-term insurance business applicable to that firm; and

(2) the sum of:

(a) the long-term insurance capital requirement; and

(b) the resilience capital requirement.

2.1.27 G ... The resilience capital requirement is an FSA requirement for regulatory basis only life firms that is additional to the EC minimum requirement for long-term insurance business.

...

2.1.38 R For an insurer carrying on long-term insurance business the ECR in respect of that business is the sum of:

(1) the long-term insurance capital requirement; and

~~(2) the resilience capital requirement; and~~

~~(3) the with-profits insurance capital component.~~

...

Admissible assets in insurance

- (1) (1A) Investments that are, or amounts owed arising from the disposal of:
- ...
- (d) *units* in:
- (i) *UCITS schemes*;
- (ii) *non-UCITS retail schemes*;
- (iii) *recognised schemes*; and
- (iv) any other collective investment scheme where the insurer's investment in the scheme is sufficiently small to be consistent with a prudent overall investment strategy, having regard to the investment policy of the scheme and the information available to the insurer to enable it to monitor the investment risk being taken by the scheme that invests only in admissible assets (including any derivatives or quasi-derivatives held by the scheme);
- ...
- (2B) Debts and claims
- ...
- (3C) Other assets
- ...
- (e) for *long-term insurance business* only, reversionary interests.
- * ~~A firm~~ An insurer may treat amounts recoverable from an *ISPV* as an *admissible asset* if it obtains a *waiver* under section 148 of the *Act*. The conditions that will need to be met, in addition to the statutory tests under section 148(4) of the *Act*, before the *FSA* will consider granting such a *waiver* are set out in *INSPRU* 1.6.13G to *INSPRU* 1.6.18G.
- (2) Subject to (3), where an asset would, but for this paragraph, be capable of falling into paragraph (1)(A)(d) above and one or more other categories in paragraph (1) above, that

asset is only capable of falling into paragraph (1)(A)(d).

(3) Where an asset would, but for this paragraph, be capable of falling into paragraph (1)(A)(f) above and one or more other categories in paragraph (1) above, that asset is only capable of falling into paragraph (1)(A)(f).

...

Annex C

INSPRU 7.1

The following section is all new text, and is not underlined. This replaces the previous version of INSPRU 7.1

7.1 Individual Capital Assessment (ICA)

Application

7.1.1 R *INSPRU 7.1* applies to an *insurer* unless it is:

- (1) a *non-directive friendly society*; or
- (2) a *Swiss general insurer*; or
- (3) an *EEA-deposit insurer*; or
- (4) an *incoming EEA firm*; or
- (5) an *incoming Treaty firm*.

7.1.2 R Subject to *INSPRU 7.1.3R*, *INSPRU 7.1* applies to *managing agents* and to the *Society* in accordance with:

- (1) for *managing agents*, *INSPRU 8.1.4R*; and
- (2) for the *Society*, *INSPRU 8.1.2R*.

7.1.3 R *Managing agents* must carry out assessments of capital adequacy for each *syndicate* they manage by reference to all *open syndicate years* taken together.

Purpose

7.1.4 G *Principle 4* requires a *firm* to maintain adequate financial resources. *GENPRU 2* deals specifically with the adequacy of the *capital resources* element of a *firm's* financial resources.

7.1.5 G The adequacy of a *firm's capital resources* needs to be assessed both by the *firm* and the *FSA*. In *GENPRU 2.1*, the *FSA* sets minimum *capital resources requirements* for *firms*.

- 7.1.6 G The *FSA* also assesses whether the minimum *capital resources requirements* are appropriate by reviewing:
- (1) a *firm's* own assessment of its capital needs; and
 - (2) the processes and systems by which that assessment is made.
- 7.1.7 G In assessing whether the minimum *capital resources requirements* are appropriate, the *FSA* is principally concerned with capital resources as calculated in accordance with *GENPRU 2.2.17R*. However, in carrying out its own assessment of its capital needs, a *firm* may take into account other capital available to it (see *GENPRU 1.2.30R* and *GENPRU 1.2.36R*), although it should be able to explain and justify its reliance on these other forms of capital.
- 7.1.8 G There are two main aims in this section:
- (1) to enable *firms* to understand the issues which the *FSA* would expect to see assessed and the systems and processes which the *FSA* would expect to see in operation for *ICAs* by *firms* to be regarded as thorough, objective and prudent; and
 - (2) to enable *firms* to understand the *FSA's* approach to assessing whether the minimum *capital resources requirements* of *GENPRU 2.1* are appropriate and what action may be taken if the *FSA* concludes that those requirements are not appropriate to a *firm's* circumstances.

General approach

- 7.1.9 G The *rules* in *GENPRU 1.2* require a *firm* to identify and assess risks to its being able to meet its liabilities as they fall due, to assess how it intends to deal with those risks and to quantify the financial resources it considers necessary to mitigate those risks. To meet these requirements, a *firm* should consider:
- (1) the extent to which capital is an appropriate mitigant for the risks identified; and
 - (2) assess the amount and quality of capital required.
- 7.1.10 G *GENPRU 1.2.42R* requires a *firm* to carry out stress tests and scenario analyses for each of the major sources of risk identified in accordance with *GENPRU 1.2.30R*. A *firm* may also approach the assessment of the adequacy of its capital resources in another way. The method should be

proportionate to the size and nature of its business.

- 7.1.11 G In accordance with *GENPRU* 1.2.60R, these assessments must be documented so that they can be easily reviewed by the *FSA* as part of the *FSA's* assessment of the adequacy of the *firm's capital resources*.
- 7.1.12 G The *FSA* may ask for the results of these assessments to be provided to it together with a description of the processes by which the assessments have been made, the range of results from each stress test or scenario analysis performed and the main assumptions made. The *FSA* may also carry out a more detailed examination of the details of the *firm's* processes and calculations.
- 7.1.13 G Based upon this information and other information available to it, the *FSA* will consider whether the *capital resources requirement* applicable to the *firm* is appropriate. Where relevant, the *firm's ECR* will be a key input to the *FSA's* assessment of the adequacy of the *firm's capital resources*. For *firms* carrying on *general insurance business*, the *ECR* is calculated in accordance with *INSPRU* 1.1.72CR. For *realistic basis life firms*, the *ECR* forms part of the *CRR* and is calculated in accordance with *GENPRU* 2.1.38R.
- 7.1.14 G *Firms* that are required to calculate an *ECR* may wish to note that the *ECR* as calculated is based upon the assumptions that a *firm's* business is well diversified, well managed with assets matching its liabilities and good controls, and stable with no large, unusual, or high risk transactions. *Firms* may find it helpful to assess the extent to which their actual business differs from these assumptions and therefore what adjustments it might be reasonable to make to the *CRR* or *ECR* to arrive at an adequate level of *capital resources*.

Methodology of capital resources assessment

- 7.1.15 R Where a *firm* is carrying out an assessment of the adequacy of its overall financial resources in accordance with *GENPRU* 1.2, the assessment of the adequacy of the *firm's* capital resources must:
- (1) reflect the *firm's* assets, liabilities, intra-group arrangements and future plans;
 - (2) be consistent with the *firm's* management practice, systems and controls;
 - (3) consider all material risks that may have an impact on the *firm's* ability to meet its liabilities to *policyholders*; and

- (4) use a valuation basis that is consistent throughout the assessment.

Representative of the firm's characteristics

- 7.1.16 G The *ICA* should reflect both the *firm's* desire to fulfil its business objectives and its responsibility to meet liabilities to *policyholders*. This means that the *ICA* should demonstrate that the *firm* holds sufficient capital to be able to make planned investments and take on new business (within an appropriate planning horizon). It should also ensure that if the *firm* had to close to new business (if it has not already done so), it would be able to meet its existing commitments. The costs of writing new business, the expenses incurred in servicing all liabilities, including liabilities to non-*policyholders*, and the nature of intra-group arrangements and *reinsurance* arrangements should be considered as part of the assessment as well as the costs that would be incurred in the event of closure to new business.
- 7.1.17 G Where a *firm* has not already closed to new business, the *ICA* should be made on the basis that the *firm* closes to new business after an appropriate period. This period should allow for the time it would take for the *firm* to identify the need for closure and to implement the necessary action.
- 7.1.18 G Where including new business would increase the capital resources by more than any increase in the capital required, or reduce the capital required by more than any reduction in available capital, new business should be excluded. To the extent that including new business increases the required capital, a *firm* should consider whether it is appropriate to include the additional amount within the *ICA*.
- 7.1.19 G Any contract that the *firm* is legally obliged to renew should be considered part of the *firm's* existing liabilities and not treated as new business. Such contractual obligations include multi-year *general insurance contracts* and the exercise of options by long-term *policyholders*.
- 7.1.20 G For a *firm* to discharge its financial obligations to *policyholders*, it will incur certain expenses, including payments to the *firm's* own staff, contributions to any pension scheme and fees to outsourcing suppliers or service companies. All of these expenses, and risks associated with these payments, should be considered when carrying out the *ICA*. When considering the appropriate level of expenses in a projection, the *firm* should consider the acceptability of the service provided to *policyholders* and the resources required by the senior management to manage the *firm*.
- 7.1.21 G Where a *firm's* liabilities include payments which are subordinated to liabilities to *policyholders*, these payments do not need to be included within the *ICA*. However, the *ICA* should include all payments that must be made to avoid putting *policyholders'* interests at risk, including any payment on which a default might trigger the winding up of the *firm*. For example, if the principal of a loan could be recalled on default of a coupon payment, coupon

payments over the lifetime of *policyholder* liabilities should be included in the *ICA*. As a further example, declared dividends should be treated as a liability. However, planned dividends that have not been declared need not be included in the *ICA*.

Intra-group capital considerations

- 7.1.22 G It is common for *firms* whose corporate *group* consists of a number of separate legal entities to have intra-group transactions in place. Capital and risk may originate within the *firm* and be passed to another company or may originate in another company and be passed to the *firm*. The *ICA* should consider the underlying effect of intra-group arrangements.
- 7.1.23 G Risks may exist within the individual legal entity from these intra-group transactions. Intra-group transactions should not be treated differently from external transactions just because they are intra-group. However, some intra-group transactions may carry less credit risk than the equivalent external transactions if the *firm* has access to more information regarding the financial position of an internal *reinsurer*. In assessing intra-group risks, consideration should be given, but should not be limited, to:
- (1) future defaults on intra-group *reinsurance* arrangements: *Firms* should consider, for example, a test akin to the credit risk assessment undertaken on external *reinsurance* assets held or future anticipated recoveries; in other cases it may be more appropriate to perform a more explicit assessment of the *group* counterparty's own capital position, to inform the *firm's* exposure to default;
 - (2) non-recoverability on intra-group loans: Even though these transactions occur within the same *group*, there is a risk that an entity may default on such intra-group payments; and
 - (3) non-payment of future internal dividends or transfers: Many entities or funds within a *group* rely on these payments as a means to maintaining their solvency position. There is a risk that the entity paying the dividend or making the transfer may not be able to do so, and *ICAs* performed for separate regulated legal entities or funds within a *group* should consider these risks as appropriate.
- 7.1.24 G A *firm's* capital should normally be restricted to resources within the *firm*. Where the *firm* is relying on resources outside the direct control of the *firm*, these should only be included to the extent that the *firm* has a right to call on those resources and the provider has the ability to provide those resources without recourse to the assets of the *firm* itself, in the circumstances considered as part of the *ICA*.

Consistency with a firm's practice, systems and controls

- 7.1.25 G The *ICA* should reflect the *firm's* ability to react to events as they occur. When relying on prospective management actions, *firms* should understand the implications of taking such actions, including the financial effect, and taking into consideration any preconditions that might affect the value of management actions as risk mitigants.
- 7.1.26 G The *ICA* should assume that a *firm* will continue to manage its business having regard to the *FSA's* Principles for Businesses. In particular, a *firm* should take into account how the *FSA's* Principles for Businesses may constrain its prospective management actions, for example, *Principle 6* (Treating Customers Fairly).
- 7.1.27 G *Firms* should also consider whether their systems and controls provide sufficient information to permit senior management to identify the crystallisation of risks in a timely manner so as to provide them with the opportunity to respond and allow the *firm* to obtain the full value of the modelled management action. *Firms* should also analyse the wider implications of the management actions, particularly where they represent significant divergence from the business plan and use this information to consider the appropriateness of taking this action.
- 7.1.28 G Where the *ICA* assumes that the *firm* may move capital from one part of its business to another across legal or geographical boundaries, the *firm* should explain the mechanisms that it would apply and satisfy itself that it could achieve the necessary capital movements in times of distress (see *GENPRU* 1.2.51R). The *firm* should also consider any associated costs or restrictions in the amount of capital that would be able to be relocated.

Considering all material risks

- 7.1.29 G The *ICA* should give the required level of confidence that the *firm's* liabilities to *policyholders* will be paid. The *ICA* should consider all material risks which may arise before the *policyholder* liabilities are paid (including those risks set out in *GENPRU* 1.2.30R).
- 7.1.30 G *Firms* should not ignore risks simply because they relate to events that occur with an expected likelihood beyond the confidence level. However, the capital required in the face of these tail events may be reduced for the purpose of carrying out the *ICA*. For example, while an A-rated bond may be assumed not to default within the required confidence level, allowance should be made for the devaluation of that bond through a more likely downgrade or change in credit spreads or other method which reflects that this investment includes a default risk to the *firm*.
- 7.1.31 G Notwithstanding *INSPRU* 7.1.30G, risks which have an immaterial effect on the *firm's* financial position or only occur with an extreme probability may be excluded from the *ICA*.

- 7.1.32 G The number of *claims*, the amount paid and the timing of a *firm's* liabilities may be uncertain. The *ICA* should consider risks which result in a change in the cost of those liabilities.
- 7.1.33 G The assets that a *firm* holds will include assets to back both the liabilities and any capital requirement. These assets carry risk, both in their own right and to the extent that they do not match the liabilities that they are backing. The risk associated with these assets should be considered over the full term for which the *firm* expects to carry the liabilities.
- 7.1.34 G Where the *firm* is relying on systems and controls in order to mitigate risks, the *firm* should consider the risk of those systems and controls failing at the confidence level at which the *ICA* is being carried out.
- 7.1.35 G If a *firm* summarises cash flows over part of the lifetime of the portfolio using a balance sheet but is exposed to risks which emerge after the balance sheet date, then these longer-dated risks may be captured by adjusting the assumptions used in the closing balance sheet.

Valuation basis

- 7.1.36 G The valuation of the assets and of the liabilities should reflect their economic substance. A realistic valuation basis should be used for assets and liabilities taking into account the actual amounts and timings of cash flows under any projections used in the assessment.
- 7.1.37 G In carrying out the *ICA*, wherever possible the value of assets should be marked to market. Where marking to market is not possible, the *ICA* should use a method suitable for assessing the underlying economic benefit of holding each asset.
- 7.1.38 G The methods and assumptions used in valuing the liabilities should contain no explicit margins for risk, nor should the approach be optimistic. The valuation of liabilities should be consistent with the valuation of assets. To the extent the market price includes an implicit allowance for risk, this should be included within the valuation.
- 7.1.39 G The methodology used to place a value on an asset or a liability following a risk event should be consistent with the methodology used prior to the risk event.
- 7.1.40 G Approximate valuation methods may be used by the *firm* for minor lines of business or to capture less material types of risk. However, the *firm* should avoid methods which under-estimate the risk in aggregate.
- 7.1.41 G The *firm* should carry out a broad reconciliation of key parts of any balance

sheet used in the *ICA* with the corresponding entry from audited results.

ICA submitted to FSA: confidence level

- 7.1.42 R Where the *FSA* requests a *firm* to submit to it a written record of the *firm's* assessments of the adequacy of its capital resources carried out in accordance with *INSPRU* 7.1.15R, those assessments must include an assessment comparable to a 99.5% confidence level over a one year timeframe that the value of assets exceeds the value of liabilities, whether or not this is the confidence level otherwise used in the *firm's* own assessments.
- 7.1.43 G In considering the value of liabilities for the purpose of *INSPRU* 7.1.42R, *firms* should have regard to the guidance in *INSPRU* 7.1.21G, *INSPRU* 7.1.26G and *GENPRU* 1.2.27G to *GENPRU* 1.2.29G.
- 7.1.44 G The *FSA* requires *firms* to submit a capital assessment calibrated to a common confidence level, as set out in *INSPRU* 7.1.42R, to enable the *FSA* to assess whether the minimum *capital resources requirements* in *GENPRU* 2.1 are appropriate. This then allows the *FSA* to give a consistent level of *individual capital guidance* across the industry.
- 7.1.45 G If a *firm* selects a longer time horizon than one year it may choose to use a lower confidence level than 99.5%. In such a case, the *firm* should be prepared to justify its choice and explain why this confidence interval is appropriate and how it is comparable to a 99.5% confidence level over a one year timeframe. An assessment based on a longer timeframe should also demonstrate that there are sufficient assets to cover liabilities at all future dates. This may be illustrated by future annual balance sheets.

Measurement

- 7.1.46 G In determining the strength of the *ICA*, a *firm* should consider all risks in aggregate making appropriate allowance for diversification such that the assessment meets the required confidence level overall. The *firm* should be able to describe and explain each of the main diversification benefits allowed for.
- 7.1.47 G For risks that can be observed to crystallise over a short period of the order of a year, the confidence level may be measured with reference to the probability distribution for the impact of the risks over one year. For example, catastrophic events such as hurricanes can be measured in this way by estimating the ultimate capital cost.
- 7.1.48 G For risks that are not observable over a short period (such as long-tailed liability business or annuitant mortality), the confidence level may be measured with reference to the probability distribution for the emergence of

that risk over the lifetime of the liabilities.

Documenting ICAs submitted to the FSA

- 7.1.49 R The written record of a *firm's individual capital assessments* carried out in accordance with *INSPRU 7.1.15R* submitted by the *firm* to the *FSA* must:
- (1) in relation to the assessment comparable to a 99.5% confidence level over a one year timeframe that the value of assets exceeds the value of liabilities, document the reasoning and judgements underlying that assessment and, in particular, justify:
 - (a) the assumptions used;
 - (b) the appropriateness of the methodology used; and
 - (c) the results of the assessment; and
 - (2) identify the major differences between that assessment and any other assessments carried out by the *firm* using a different confidence level.
- 7.1.50 G A *firm's* management should determine their own risk appetite or confidence level and a risk measure that they believe is suitable for the management of the business. The *FSA* expects that the *firm's* capital resources assessment under *GENPRU 1.2* which it uses in the management of its business may well be at a different confidence level than the 99.5% one required by *INSPRU 7.1.42R* for a number of reasons, for example, because its view of capital adequacy is different, or to satisfy the demands of rating agencies, or to meet the proposition to *policyholders* as to the strength of the *firm*. A *firm* will maintain its own written assessment of the adequacy of its financial resources, as required by *GENPRU 1.2*, through the written record requirement of *GENPRU 1.2.60R*.
- 7.1.51 G *INSPRU 7.1.49R(2)* recognises that a *firm* may carry out a number of different assessments of the adequacy of its capital resources, using different confidence levels, in reaching its overall assessment of the adequacy of its financial resources under *GENPRU 1.2*. The purpose of asking the *firm* to identify the major differences between those assessments and the assessment documented under *INSPRU 7.1.49R(1)* is to enable the *FSA* better to understand the *firm's* approach to capital adequacy and risk management in running its business. Understanding the written record made under *GENPRU 1.2.60R* is therefore key to the *FSA's* understanding of the *firm's* risk and capital management processes.
- 7.1.52 G The written record of any other assessment by the *firm* required by *GENPRU 1.2.60R* is not itself part of the submission to the *FSA*, but the

FSA is interested in the connection between that other assessment, as documented in the written record required by *GENPRU* 1.2.60R, and the assessment documented under *INSPRU* 7.1.49R(1) in terms of the *firm's* compliance with *GENPRU* 1.2, and the use of capital measures within the *firm*.

- 7.1.53 G For the purpose of the written record submitted to the *FSA*, the submitted comparison should include:
- (1) A description of any direct difference in the strength of the *firm's* own assessment compared to the assessment submitted to the *FSA*. This is likely to be expressed as a different confidence level to the assessment undertaken to a 99.5% confidence level or the targeting of a defined margin about the 99.5% assessment.
 - (2) A description of any major differences in the definition of the assets or liabilities, the management actions used, the risks considered or the valuation methodology and assumptions included within the assessment.
- 7.1.54 G Some *firms* may not undertake an assessment at a separate confidence level because they consider that a 99.5% confidence level is appropriate to manage their business and meets the requirements of *GENPRU* 1.2. In the case of these *firms*, no analysis of the major differences is required to be submitted.

Justifying assumptions used

- 7.1.55 G *Firms* should provide evidence to support the choice of assumptions used within the *ICA*.
- 7.1.56 G Where the choice of assumptions is supported by data, the *firm* should consider the relevance of that data to the *firm's* current and future circumstances and the robustness of any estimates derived.
- 7.1.57 G Where the choice of assumptions is supported by expert judgement, the *firm* should consider the nature and value of the expertise being used to support this judgement and any biases that may exist. Where possible, the *firm* should use data to test and support these expert judgements.

Approach taken for significant assumptions

- 7.1.58 G *Firms* should be able to demonstrate how they have identified the most financially significant assumptions and calculate the sensitivity of the *ICA* to changes in these assumptions. The choice of assumption may be decided using the results of sensitivity testing.

- 7.1.59 G *Firms* may seek to justify their assumptions by considering the process used to determine those assumptions from relevant data. Alternatively, where historical data is either limited or not considered to be indicative of likely future experience, *firms* may justify their assumptions by reference to the suitability of the calibration for the purpose of the *ICA*. However, relatively more attention should be given to the justification where the choice of assumption has a more significant effect on the *ICA*.
- 7.1.60 G Where there is a concentration of business from a single source (for example, a single sales channel or cedant), consideration should be given to the greater impact of a risk crystallising, compared to that for a well-diversified portfolio.

Justification of prospective management actions

- 7.1.61 G Where projection of the value of assets and liabilities reflects the *firm's* prospective management actions, the *firm* should justify the choice of prospective management actions and the assumptions used.
- 7.1.62 G Where the prospective management action is identical to those used in another regulatory assessment of solvency (e.g. calculation of the *WPICC* for *realistic basis life firms*), no further justification is required.
- 7.1.63 G Where the prospective management action is not similar to those used in another regulatory assessment of solvency, or uses different assumptions, the *firm* should show the financial impact of the management action.

Regular review of assumptions

- 7.1.64 G *Firms* should regularly review key parameters, both to ensure their continued applicability and to reduce uncertainty over the current level of capital required. *Firms* using assumptions that are very different from past experience should present robust arguments in support of the differences.

Methodology

- 7.1.65 G The methodology used within the *ICA* should allow the *firm* to quantify the financial effect of material risks at the required confidence level. The methodology used should also reflect the nature of the *firm's* business and be consistent with the way in which the *firm* identifies and manages risk.
- 7.1.66 G *Firms* should be able to explain their rationale for choosing their approach to risk and assessment of capital required. There are no simple classifications of approach to risk and capital assessment, so the rationale should be considered in the context of a number of defining characteristics in the structure of the capital model.

- 7.1.67 G Generally, larger *firms* would be expected to take a more sophisticated approach to capital modelling than smaller ones.

Stress tests and scenario analyses

- 7.1.68 G A *firm* may choose to carry out the assessment of the adequacy of capital resources through the use of stress testing and scenario analysis (noting that *GENPRU* 1.2.42R requires stress tests and scenario analyses to be undertaken to determine the overall adequacy of a *firm's* financial resources). Where used, such testing should reflect the potential range of outcomes for the risks being quantified, consistent with the prescribed confidence level for the *ICA*.
- 7.1.69 G The overall assessment of capital required may require the aggregation of results from the stress and scenario testing. The *firm* should explain its choice of aggregation approach and its understanding of the implications of combining the individual risks. The *firm* should be satisfied that the resultant capital provides the required degree of confidence, given the variability of the underlying risks and the uncertainty associated with modelling those risks. A useful component of this process is the characterisation and explanation of a range of possible circumstances that could give rise to a loss of this magnitude.

Documenting the results

- 7.1.70 G The conclusion of the *ICA* should consider whether the *firm* has adequate capital to meet its assessment of the required capital. Furthermore, the *firm* should consider any implications for its approach to risk management arising from the work carried out. The *ICA* should be supported by an explanation of the material sources of risk and financial impact of the management actions that the *firm* may take to manage those risks. Where possible, the reasonableness of the results should be supported by considering other evidence of the capital needed.
- 7.1.71 G The objective of capital modelling is to consider all possible outcomes, however unlikely any one outcome might be, and set capital as protection against all but the most extreme losses. It is therefore important to focus not only on the assumptions and methodology used to quantify individual risks, but also on the approach to aggregating the capital required for each risk.
- 7.1.72 G However the risks have been aggregated to give the *firm's* capital requirement, checks should be made as to the reasonableness of the outcome. It should be possible to characterise scenarios, or combinations of loss events, that would result in a loss of similar magnitude to that indicated by the *ICA*. *Firms* should consider a range of scenarios that could give rise to such a loss.

- 7.1.73 G The results of the *ICA* should be supplemented by analysis of the sources of the risks to which the *firm* is exposed, discussion of the events which are most likely to threaten the financial stability of the *firm* and the potential mitigating actions which are available to senior management.

Additional guidance for Lloyd's

- 7.1.74 G Responsibility for:
- (1) managing the risks associated with the *insurance business*; and
 - (2) holding the *capital resources* that support those risks;
- is divided between *managing agents* and the *Society*. To clarify the respective responsibilities of *managing agents* and the *Society* for ensuring the adequacy of financial resources, the *FSA* distinguishes between the *managing agents'* responsibility to carry out capital adequacy assessments of the *capital resources* held at *syndicate* level for each *syndicate* that they manage, and the *Society's* responsibility to carry out an assessment for each *member*.
- 7.1.75 R In carrying out *ICAs* in respect of the *insurance business* carried on through each *syndicate* (the *syndicate ICA*), *managing agents* must consider the risks, controls and the financial resources relevant to each *syndicate*.
- 7.1.76 R When carrying out the *syndicate ICA*, *managing agents* must not take into account risks to which a *member* may be exposed or controls from which a *member* may benefit:
- (1) because that *member* carries on *insurance business* through another *syndicate* or more than one *syndicate year* (whether or not managed by the same *managing agent*); or
 - (2) because that *member's* financial resources include *funds at Lloyd's* or *central assets*.
- 7.1.77 R The *Society* must have regard to *syndicate ICAs* in arriving at its own capital assessment for each *member*.
- 7.1.78 G In assessing the adequacy of the *capital resources* supporting the *insurance business* of each *member*, the *Society* should consider the risks, controls and financial resources relevant to the totality of the *member's insurance business*, including:
- (1) the adequacy of *syndicate ICAs*;

- (2) the *member's* share of *syndicate ICAs*;
- (3) adjustments in respect of risks and controls relating to *funds at Lloyd's, central assets* and the interaction of risks underwritten by the *member* through different *syndicates* and in respect of different *syndicate years*; and
- (4) the ongoing validity of any relevant assumptions it makes.

7.1.79 G In taking account of a *syndicate ICA* under *INSPRU 7.1.77R*:

- (1) if the *Society* considers a *syndicate ICA* to be adequate, it should use the *managing agent's* risk and capital assessments in carrying out its *ICA* in relation to any *member* of that *syndicate*, or it should be able to justify why it will not; and
- (2) if the *Society* considers a *syndicate ICA* to be less than adequate, the *Society* should increase the *syndicate ICA* so that it is adequate for the purpose of carrying out its *ICA* in relation to the *members* of that *syndicate*.

7.1.80 G The assessment of capital adequacy for a *member* will rarely equal the proportionate share of a *syndicate ICA* (or sum of those shares, where the *member* participates on more than one *syndicate*) as attributed to that *member*, because, in determining the capital assessments for each *member*, the *Society* may make adjustments to take account of:

- (1) risks and controls associated with *funds at Lloyd's* and *central assets*, which can increase the assessment for that *member*;
- (2) diversification effects, including as a result of *members'* participations on more than one *syndicate year*, which can reduce the assessment for that *member*; and
- (3) its own assessment of *syndicate* risks, which can be higher than the *managing agent's* and so increase the assessment for that *member*.

7.1.81 G *Capital resources* to meet each *syndicate ICA* could be:

- (1) held within a *syndicate* and managed by the *managing agent*; or
- (2) held and managed by the *Society*; or
- (3) not needed in full, because of effects such as diversification that the *Society* takes into account.

- 7.1.82 G The *balancing amount* is a function of the relationship between the *syndicate ICA* and the amount of assets held within the *syndicate*. As illustrations:
- (1) if the *syndicate* holds no *capital resources* (but its liabilities are fully covered by relevant assets), the *balancing amount* equals the *syndicate ICA* (as there are no *capital resources* at *syndicate* level, all the *capital resources* must be held as *funds at Lloyd's* or *central assets*);
 - (2) if *capital resources* held at *syndicate* level are negative (i.e. if relevant assets do not fully cover liabilities for the *syndicate*), the *balancing amount* should be higher than the *syndicate ICA* by an amount corresponding to the negative *capital resources* held by *managing agents* on behalf of the *syndicate*; and
 - (3) conversely, if a *syndicate* holds positive *capital resources* for the *syndicate*, the *balancing amount* should be lower than the *syndicate ICA* by a corresponding amount.
- 7.1.83 R *Managing agents* must periodically notify the *Society* of the *syndicate ICA* and the *balancing amount* in respect of each *syndicate*.
- 7.1.84 R For the purpose of assessing the adequacy of *capital resources* held as *funds at Lloyd's* and *central assets*, the *Society* must have regard to *balancing amounts* notified to it by *managing agents*.
- 7.1.85 R After notification of a *balancing amount* by a *managing agent*, the *Society* must:
- (1) confirm to the *managing agent* that *capital resources* held as *funds at Lloyd's* and *central assets* are adequate to support the *balancing amount*; or
 - (2) notify the *managing agent* that it cannot give that confirmation.
- 7.1.86 G *Managing agents* should submit *syndicate ICAs* and notify *balancing amounts* to the *Society* as part of the annual capital-setting process at *Lloyd's*. The submission of the *syndicate ICA* and the notification of the *balancing amount* should be made in good time for the *Society* to review them and place appropriate reliance on them when it determines the capital assessments for each *member*.
- 7.1.87 G When communicating the *syndicate ICA* and *balancing amount* for each *syndicate* to the *Society*, *managing agents* should agree with the *Society* an allocation of the *syndicate ICA* between *syndicate years*. The purpose of the allocation is to ensure that there is an appropriate matching of assets to risk

and liabilities and an equitable treatment between the *members* reflecting the provision of capital in each *syndicate year*.

- 7.1.88 G For the purposes of complying with their obligations under *INSPRU*, *managing agents* may assume that any *balancing amount* confirmed by the *Society* under *INSPRU* 7.1.85R is supported by *capital resources* held as *funds at Lloyd's* and *central assets*.
- 7.1.89 R If a *managing agent* has, at any time, a significant doubt about the adequacy of a *syndicate ICA* or *balancing amount* with respect to *syndicate* risks and controls, it must notify the *Society* immediately.
- 7.1.90 R If the *Society* has, at any time, a significant doubt about the adequacy of any *member's capital resources* held by it in support of any *balancing amount*, it must notify the relevant *managing agent* immediately.

FSA assessment process – all firms

- 7.1.91 G In assessing the adequacy of a *firm's capital resources*, the *FSA* draws on more than just a review of the submitted *ICA*. Use is made of wider supervisory knowledge of a *firm* and of wider market developments and practices. When forming a view of any *individual capital guidance* to be given to a *firm*, the review of the *firm's ICA* along with the ARROW risk assessment and any other issues arising from day-to-day supervision will be considered.
- 7.1.92 G The *FSA* will take a risk-based and proportionate approach to the review of a *firm's ICA*, focusing on the *firm's* approach to dealing with the key risks it faces. Any *individual capital guidance* given will reflect the judgements reached through the ARROW review process as well as the review of the *firm's ICA*.
- 7.1.93 G A *firm* should not expect the *FSA* to accept as adequate any particular model that the *firm* develops or that the results from the model are automatically reflected in any *individual capital guidance* given to the *firm* for the purpose of determining adequate *capital resources*. However, the *FSA* will take into account the results of any sound and prudent model when giving *individual capital guidance* or considering applications for a *waiver* under section 148 of the *Act* of the *capital resources requirement* in *GENPRU* 2.1.
- 7.1.94 G Where the *FSA* considers that a *firm* will not comply with *GENPRU* 1.1.26R (adequate financial resources, including *capital resources*) by holding the *capital resources* required by *GENPRU* 2.1, the *FSA* may give the *firm* *individual capital guidance* advising it of the amount and quality of *capital resources* which the *FSA* considers it needs to hold in order to meet that *rule*.

- 7.1.95 G In giving *individual capital guidance*, the FSA seeks a balance between delivering consistent outcomes across the *individual capital guidance* it gives to all *firms* and recognising that such *guidance* should reflect the individual features of the *firm*. Comparison with the assumptions used by other *firms* will be used to trigger further enquiry. Debate will be sought where good arguments are made for a particular result that differs markedly from those of a *firm's* peers. The FSA also takes account of the quality of the wider risk management around the development of the numbers used in the ICA. The aim is to deliver *individual capital guidance* that comes closest to ensuring that there is no significant risk that a *firm* is unable to pay its liabilities as they fall due.
- 7.1.96 G Following an internal validation process, the FSA will write to the Board of the *firm* being assessed providing both quantitative and qualitative feedback on the results of the FSA's assessment. This letter will notify the *firm* of the *individual capital guidance* considered appropriate. The letter will include reasons for any capital add-ons identified, where applicable.
- 7.1.97 G If a *firm* considers that the *individual capital guidance* is inappropriate to its circumstances, then the *firm* should inform the FSA that it does not intend to follow that *guidance*. Informing the FSA of such an intention would be expected if a *firm* is to comply with *Principle 11* (Relations with regulators).
- 7.1.98 G The FSA expects most disagreements about the adequacy of capital will be resolved through further analysis and discussion. The FSA may consider the use of its powers under section 166 of the *Act* (Reports by skilled persons) to assist in such circumstances. If the FSA and the *firm* still do not agree on an adequate level of capital, then the FSA may consider using its powers under section 45 of the *Act* to, on its own initiative, vary a *firm's Part IV permission* so as to require it to hold capital in accordance with the FSA's view of the capital necessary to comply with GENPRU 1.2.26R. SUP 7 provides further information about the FSA's powers under section 45.
- 7.1.99 G Where a *firm* considers that the *capital resources requirements* of GENPRU 2.1 require the holding of more capital than is needed for the *firm* to comply with GENPRU 1.2.26R then the *firm* may apply to the FSA for a *waiver* of the requirements in GENPRU 2.1 under section 148 of the *Act*. In addition to the statutory tests under section 148, in deciding whether to grant a *waiver* and, if granted, its terms, the FSA will consider the thoroughness, objectivity and prudence of a *firm's ICA* and the extent to which the *guidance* in this section has been followed. The FSA will not grant a *waiver* that would cause a breach of the minimum capital requirements under the *Insurance Directives* or *Reinsurance Directive*.

Annex D

Other amendments to Annex B (Text of INSPRU) to the Prudential Sourcebook for Insurers Instrument 2006 (FSA 2006/42)

In this Annex, underlining indicates new text and striking through indicates deleted text. Where a block of new text is inserted, this is indicated and the new text is not underlined.

...

- 1.1.11 G These requirements are dealt with in the part of this section headed "Capital requirements for insurers" (see *INSPRU* 1.1.43G to *INSPRU* 1.1.91R). That part of this section also contains *rules* about the calculation of ~~the insurance-related capital requirement, which forms part~~ of the *enhanced capital requirement* for firms carrying on *general insurance business*, including the calculation of the insurance-related capital requirement. The calculation of the asset-related capital requirement, which also forms part of the calculation of the ECR for firms carrying on general insurance business, is set out in *INSPRU* 2.2.

...

- 1.1.43 G (1) ...
- (2) For non-life firms the *MCR* represents the *minimum capital requirement* (or margin of solvency) prescribed by the *Insurance Directives*. *GENPRU* 2.1.24R provides that, for a firm carrying on *general insurance business*, the *MCR* in respect of that business is the higher of the *base capital resources requirement* for *general insurance business* applicable to that firm and the *general insurance capital requirement*. *GENPRU* 2.1.24AR provides that, for a firm carrying on long-term insurance business which is a realistic basis life firm, the *MCR* in respect of that business is the higher of the base capital resources requirement for long-term insurance business applicable to that firm and the long-term insurance capital requirement. *GENPRU* 2.1.25R provides that, for a firm carrying on *long-term insurance business* which is a *regulatory basis only life firm*, the *MCR* in respect of that business is the higher of the *base capital resources requirement* for *long-term insurance business* applicable to that firm and the sum of the *long-term insurance capital requirement* and the *resilience capital requirement*. As specified in *GENPRU* 2.1.14R, a firm carrying on both *general insurance business* and *long-term insurance business* must apply *GENPRU* 2.1.13R (referred to in paragraph (1) above) separately to

its *general insurance business* and its *long-term insurance business*.

(3) ...

...

1.1.66 R ...

(c) to account for *premiums* and *claims* which arose from *contracts of insurance* that have been transferred to the *firm* from another body as if they were receivable by or payable ~~to~~by the *firm*.

...

1.1.69 G Conversely, *INSPRU* 1.1.66R(2)(c) requires a *firm*, for the purpose of calculating its *GICR*, to account for *contracts of insurance* transferred to it by another body as if it had been responsible for those contracts from inception and not merely from the date of transfer. All amounts of *premiums* and *claims* that arose from those contracts are included even where they arose prior to the date of transfer and were, in fact, receivable by or payable ~~to~~by the other body.

...

Insert after *INSPRU* 1.1.72R the following new text, *INSPRU* 1.1.72AG to *INSPRU* 1.1.72DG, which is not underlined:

Enhanced capital requirement for general insurance business

1.1.72A G This section sets out the requirement for *firms* carrying on *general insurance business*, other than *non-directive insurers*, to calculate their *ECR*. The *ECR* for *firms* carrying on *general insurance business* is an indicative measure of the *capital resources* that a *firm* may need to hold based on risk sensitive calculations applied to its business profile. For *firms* carrying on *general insurance business*, the *FSA* will use the *ECR* as a benchmark for its consideration of the appropriateness of the *firm's* own capital assessment. For *firms* where an *ECR* is not calculated, the *MCR* will provide a benchmark for the *firm's* own capital assessment.

1.1.72B R A *firm* carrying on *general insurance business*, other than a *non-directive insurer*, must calculate the amount of its *ECR*.

1.1.72C R A *firm* to which *INSPRU* 1.1.72BR applies must calculate its *ECR* in respect of its *general insurance business* as the sum of:

(1) the *asset-related capital requirement*; and

(2) the *insurance-related capital requirement*; less

(3) the *firm's equalisation provisions*.

- 1.1.72D G Details of the calculation of the *asset-related capital requirement* are set out in *INSPRU 2.2.10R* to *INSPRU 2.2.16R*. Details of the calculation of the *insurance-related capital requirement* are set out in *INSPRU 1.1.76R* to *INSPRU 1.1.79R*.

Insurance-related capital requirement (~~general insurance business only~~)

- 1.1.73 G ~~*INSPRU 7.1.11R* requires firms carrying on general insurance business, other than a non-directive insurer, to calculate their *ECR* as the sum of the *asset-related capital requirement* and the *insurance-related capital requirement* less the *firm's equalisation provisions*. The *ECR* for firms carrying on general insurance business is an indicative measure of the *capital resources* that a firm may need to hold based on risk sensitive calculations applied to its business profile. For firms carrying on general insurance business, the FSA will use the *ECR* as a benchmark for individual capital guidance for a firm carrying on general insurance business. Details of the calculation of the *asset-related capital requirement* are set out in *INSPRU 2.2*. Details of the calculation of the *insurance-related capital requirement* are set out in *INSPRU 1.1.76R* to *INSPRU 1.1.79R*.~~
[intentionally blank]

...

- 1.1.80 G *GENPRU 2.1.13R* requires an insurer to maintain *capital resources* equal to or in excess of its *capital resources requirement*. *GENPRU 2.1.18R* defines the *capital resources requirement* for a firm to which that rule applies (a *realistic basis life firm*) as the higher of the *MCR* and the *ECR*. For other firms carrying on long-term insurance business (*regulatory basis only life firms*), the *capital resources requirement* is equal to the *MCR*. Except where the *base capital resources requirement* is the higher requirement, the *MCR* in respect of long-term insurance business is the sum of the long-term insurance capital requirement (*LTICR*) and the *resilience capital requirement* or, in the case of a *realistic basis life firm*, the *LTICR* (see *GENPRU 2.1.24AR*, *GENPRU 2.1.25R* and *GENPRU 2.1.26R*). *GENPRU 2.1.36R* defines the *LTICR* as the sum of the *insurance death risk, health risk and life protection reinsurance, expense risk, and market risk capital components* (see *INSPRU 1.1.81R* to *INSPRU 1.1.91R*). Rules and guidance about the *resilience capital requirement* are set out in *INSPRU 3.1.9G* to *INSPRU 3.1.26R*.

...

- 1.2.19 G Further detailed rules and guidance on margins for adverse deviation are included in *INSPRU 1.2.32G* to *INSPRU 1.2.89G*. In particular, the cross-references for the different assumptions used in calculating the *mathematical*

reserves are as follows:

...

(4) persistency (~~INSPRU 1.2.73G to 1.2.76R~~ and *INSPRU 1.2.77G*); and

...

...

1.2.22 R (1) ...

(2) Approximations or generalisations may be made:

(a) in the case of non-attributable expenses, in relation to a group of contracts with the same or similar expense risk characteristics, provided that the *mathematical reserves* in respect of such expenses established by the *firm* in relation to that group of contracts have a minimum value of at least zero; and

(b) in any other case, where they are likely to provide the same, or a higher, result than a determination made in accordance with (1).

(3) ...

(4) For the purpose of (2), non-attributable expenses are expenses which are not directly attributable to a particular *long-term insurance contract*.

1.2.23 G *INSPRU 1.2.22R to INSPRU 1.2.89G set out rules and guidance for the separate prospective valuation of each contract. These may be applied instead to groups of contracts where the conditions set out in INSPRU 1.2.22R(2)(a) or (b) are satisfied. Guidance on non-attributable expenses and the application of INSPRU 1.2.22R(2)(a) is provided in INSPRU 1.2.54AG.*

~~Contracts not to be treated as assets~~Negative mathematical reserves

1.2.24 R (1) ~~A *firm* must not treat a *long-term insurance contract* as an asset.~~

(2) ~~(1) does not apply to a *pure reinsurer* in respect of a *contract of insurance* which does not have a *guaranteed surrender value* and falls within:~~

- (a) ~~its life protection reinsurance business; or~~
 - (b) ~~its permanent health reinsurance business.~~
- (3) ~~Notwithstanding (2), the total *mathematical reserves* established by a *pure reinsurer* must have a minimum value of at least zero.~~

A firm may calculate a negative value for the *mathematical reserves* in respect of a *long-term insurance contract* provided that:

- (1) this is based on assumptions which meet the general requirements for prudent assumptions as set out in *INSPRU* 1.2.10R and *INSPRU* 1.2.13R;
- (2) the contract does not have a *surrender value* which at the *actuarial valuation date* is guaranteed; and
- (3) the total *mathematical reserves* established by the *firm* have a minimum value of at least:
 - (i) where the *firm's long-term insurance contracts* include *linked long-term* contracts, the sum of the *surrender values* of all its *linked long-term* contracts at the *actuarial valuation date*; and
 - (ii) in any other case, zero.

1.2.25 G ~~A separate prospective valuation for each contract may identify contracts for which the value of future cash inflows exceeds that of outflows, that is, the contracts have an asset value, rather than liability value. However, the *Consolidated Life Directive* requires that no contract should be valued at less than its guaranteed *surrender value*. As a result, no contract with a guaranteed *surrender value* to which the *Consolidated Life Directive* applies should be treated as an asset. Although the *Reinsurance Directive* does not require this treatment of contracts with guaranteed *surrender values* to be applied to *pure reinsurers*, the *FSA's* policy is that there should be equal treatment in this respect. *Pure reinsurers* may therefore treat as an asset a contract written as part of carrying on *life protection reinsurance business* or *permanent health reinsurance business* provided that this is based on assumptions which meet the general requirements for prudent assumptions as set out in *INSPRU* 1.2.10R and *INSPRU* 1.2.13R and it is not written on terms that provide for a guaranteed *surrender value*. This does not, however, allow a *pure reinsurer* to establish total *mathematical reserves* which are negative.~~

A separate prospective valuation for each contract may identify contracts for which the value of future cash inflows under and in respect of the contract

exceeds that of outflows. In these circumstances, the firm may calculate the mathematical reserves for that contract as having a negative value and that value is available to off-set mathematical reserves for other contracts which have a positive value when establishing the overall mathematical reserves. However, the Consolidated Life Directive requires that no contract should be valued at less than its guaranteed surrender value (see INSPRU 1.2.62AG). As a result, no contract with a guaranteed surrender value to which the Consolidated Life Directive applies should be valued as if it were an asset. Although the Reinsurance Directive does not require this treatment of contracts with guaranteed surrender values to be applied to pure reinsurers, the FSA's policy is that there should be equal treatment in this respect. INSPRU 1.2.62R makes further provision relating to the mathematical reserves to be established in respect of such contracts. When considering the impact that the amount payable on surrender may have on the valuation of a contract, a firm should have regard to INSPRU 1.2.71R.

Avoidance of future valuation strain

1.2.26 R (1) ...

(2) ...

(3) Subject to (4), (1) may be applied to a group of similar contracts instead of to the individual contracts within that group.

(4) (1) must be applied to a group of contracts in relation to which mathematical reserves in respect of non-attributable expenses are established for that group of contracts in accordance with INSPRU 1.2.22R(2)(a), instead of to the individual contracts within that group.

...

1.2.30 G All cash flows are to be valued using prudent assumptions in accordance with generally accepted actuarial practice. Cash flows may be omitted from the valuation calculations provided the reserves obtained as a result of leaving those cash flows out of the calculation are not less than would have resulted had all cash flows been included (see INSPRU 1.2.22R(2)(b)). ...

...

1.2.39 G The valuation method for future premiums in INSPRU 1.2.38R retains the difference, if any, between the gross premium and the net premium as an implicit margin available to finance future bonuses, expenses and other costs. It thus helps to protect against the risk that adequate resources may not be available in the future to meet those costs. Where expenses are not directly attributable to a particular contract, a firm may establish

mathematical reserves in respect of such expenses in relation to a group of contracts with the same or similar expense risk characteristics in accordance with INSPRU 1.2.22R(2)(a).

...

1.2.54 G ...

1.2.54A G (1) A firm should attribute to an individual contract at least those expenses which are directly attributable to that contract including expenses which vary with the volume of business for that type of contract. Commission payments, charges to a fund on a 'per policy' basis and investment management fees are generally directly attributable. For expenses of the fund which are calculated directly based on actual expenses (and not calculated in accordance with a management services agreement), the attributable expenses will also include those costs which vary with the volume of business for that product, for example, salaries and accommodation costs of staff in a processing centre, printing and postage of communications to policyholders and associated computer services.

(2) Non-attributable expenses may include overheads which are relatively insensitive to the volume of business for the type of contract in question and an apportionment of group overheads. Examples of expenses that firms may consider non-attributable include salaries of head office staff involved in monitoring products and drafting standard communications to policyholders and allocated overheads for centralised functions such as human resources, finance and IT. Where non-attributable expenses arise in relation to a homogeneous risk group of contracts sharing the same or similar expense risk characteristics, a firm may determine the reserve for those expenses at the level of that risk group, provided that the reserve so established has a minimum value of at least zero (see INSPRU 1.2.22R(2)(a)). In identifying its homogeneous risk groups, a firm should consider all risks that impact on the level of expenses borne by contracts including persistency risk and expense inflation risk. For example, business that is subject to bulk lapse risk, such as any large group contract that would give rise to a reduction in surplus on lapse, should be considered as forming a homogeneous risk group of its own. A firm must document and justify its approach to identifying homogeneous risk groups in accordance with the record-keeping requirements of INSPRU 1.2.20R. This approach to reserving for expenses ensures that prudent reserves are established in respect of both directly attributable and non-attributable expenses arising in relation to the firm's long-term insurance business.

1.2.54B G In valuing cash flows in respect of commissions, a firm may wish to take into account any contractual arrangements for the "clawback" or repayment of commissions already paid in the event of voluntary discontinuance of a

contract of insurance. In deciding how to treat such arrangements in determining the mathematical reserves for a contract of insurance, the firm must use assumptions which meet the general requirements for prudent assumptions as set out in INSPRU 1.2.10R and INSPRU 1.2.13R. For example, the firm should establish prudent margins for adverse deviation in respect of the credit risk of the intermediary by whom the commission would be repayable.

...

1.2.56 G The provision for future expenses, whether implicit or explicit, should include a prudent margin for adverse deviation in the level and timing of expenses (see INSPRU 1.2.13R to INSPRU 1.2.19G). The margin should cover the risk of underestimating expenses whether due to, for example, initial under-calculation or subsequent increases in the amount of expenses. In setting the amount of the margin, the *firm* should take into account the extent to which:

- (1) an appropriately validated method based on reliable data is used to allocate expenses ~~by product type, by distribution channel and~~ as between attributable and non-attributable expenses or between acquisition and non-acquisition expenses and by product type, by distribution channel or by homogeneous risk group, as appropriate;

...

...

1.2.62 R ...

1.2.62A G A contract has a guaranteed surrender value where the policy wording states that a surrender value is payable and either provides for a minimum amount payable on surrender or sets out a method for calculating such an amount. For example, where a unit-linked contract provides for a surrender value equal to the value of the units allocated to the contract, the firm must establish mathematical reserves for that contract greater than or equal to the value of the units allocated at the valuation date.

...

1.2.64 G The *firm* should provide for the benefit which the *firm* anticipates the *policyholder* is most likely to choose. ~~Except for the "option" of voluntary discontinuance in the case of regulatory basis only life firms (see INSPRU 1.2.74R),~~ past experience may be used as a guide, but only if this is likely to give a reasonable estimate of future experience. For example, past experience of the take-up of a cash payment option instead of an annuity would not be a reliable guide, if, in the past, market rates exceeded those

guaranteed in the annuity but no longer do so. Similarly, past experience on the take-up of options may not be relevant in the light of the assumptions made in respect of future interest rates and mortality rates in the valuation of the benefits.

...

- 1.2.73 G ~~INSPRU 1.2.76R and INSPRU 1.2.77G apply to the valuation of the with-profits insurance liabilities of realistic basis life firms. INSPRU 1.2.76AR and INSPRU 1.2.77G apply to the valuation of liabilities arising from the life protection reinsurance business and permanent health reinsurance business of pure reinsurers. INSPRU 1.2.74R and INSPRU 1.2.75G apply to the valuation of all other liabilities. [intentionally blank]~~
- 1.2.74 R ~~Except as permitted by INSPRU 1.2.76R and INSPRU 1.2.76AR, a firm must not make any allowance in the calculation of the mathematical reserves for the voluntary discontinuance of any contract of insurance if the amount of the mathematical reserves so determined would, as a result, be reduced. [intentionally blank]~~
- 1.2.75 G ~~The rate of voluntary discontinuance (that is, lapse, surrender or paying up) is often difficult to predict and may be volatile especially in the short term during stressful economic conditions. Depending upon the circumstances and contract terms, voluntary discontinuance may increase or decrease the firm's liability. In effect, INSPRU 1.2.74R requires a firm to assume that there will be no voluntary discontinuance if assuming voluntary discontinuance would reduce the liability. This protects against the risk that arises from volatility in the rate of voluntary discontinuance. In addition, there is the risk of assets not being realisable when needed due to the rates of discontinuance exceeding expected levels. [intentionally blank]~~
- 1.2.76 R ~~A realistic basis life firm may make assumptions about voluntary discontinuance rates in the calculation of the mathematical reserves for its with-profits insurance business provided that those assumptions meet the general requirements for prudent assumptions as set out in INSPRU 1.2.10R and INSPRU 1.2.13R.~~
- 1.2.76A R ~~A pure reinsurer may make assumptions about voluntary discontinuance rates in the calculation of the mathematical reserves in respect of contracts of insurance falling within:~~
- ~~(1) its life protection reinsurance business; or~~
 - ~~(2) its permanent health reinsurance business;~~
- ~~provided that those assumptions meet the general requirements for prudent~~

assumptions as set out in ~~INSPRU 1.2.10R~~ and ~~INSPRU 1.2.13R~~.

...

- 1.3.7 R (1) The *with-profits insurance capital component* for a *firm* is the aggregate of any amounts that:
- (a) result from the calculations specified in (2) and (3); and
 - (b) are greater than zero.
- (2) Subject to (3), in relation to each *with-profits fund* within the *firm*, the *firm* must deduct B from A, where:
- (a) A is the amount of the *regulatory excess capital* for that fund (see *INSPRU 1.3.23R*); and
 - (b) B is the ~~amount~~ sum of:
 - (i) the *realistic excess capital* for that fund (see *INSPRU 1.3.32R*);
 - (ii) the value, in the most adverse scenario required by *INSPRU 1.3.43R(3)*, of future internal transfers from the fund to shareholders or another of the *firm's* funds in respect of the future distribution of surplus between *policyholders* and shareholders; and
 - (iii) an amount not exceeding the value, in the most adverse scenario required by *INSPRU 1.3.43R(3)*, of any other future internal transfers from the fund to a *non-profit fund* in respect of expense-related charges to the extent that the future receipt of the amount transferred is not already taken into account in the calculation of the *firm's capital resources* or in establishing its *technical provisions*.
- (3) Where a capital instrument that can be included in the *firm's capital resources* in accordance with *GENPRU 2.2* has been attributed wholly or partly to a *with-profits fund* and that instrument meets the requirements of *GENPRU 2.2.271R*, the *firm* must add to the amount calculated under (2) for that fund the result, subject to a minimum of zero, of deducting D from C where:
- (a) C is the outstanding face amount of the instrument to the extent attributed to the fund; and
 - (b) D is the realistic value of the instrument to the extent attributed to the fund in the single event that determines the *risk capital margin* under *INSPRU 1.3.43R*.

1.3.7A G Future internal transfers from a *with-profits fund* are included in the *realistic value of liabilities* (see *INSPRU 1.3.105R*, *INSPRU 1.3.119R*, *INSPRU 1.3.128R* and *INSPRU 1.3.165R*). *INSPRU 1.1.27R* ensures that sufficient assets are maintained in a *with-profits fund* to meet those future internal transfers. In calculating the *WPICC*, the economic value to the *firm* of those future transfers in the most adverse scenario required in calculating the *risk capital margin* (see *INSPRU 1.3.43R*) should be recognised. In the case of internal transfers to a *non-profit fund* in respect of expense-related charges, those transfers may only be recognised to the extent that those cash flows have not already been taken into account in calculating the *firm's capital resources* or *technical provisions*. In effect, the future asset of the shareholders or another of the *firm's funds* is available to offset the corresponding liability of the *with-profits fund* and should, therefore, subject to the limitation in *INSPRU 1.3.7R(2)(b)(iii)*, be treated as capital arising from that fund which is available to reduce the amount of the *WPICC*.

...

1.3.23 R A *firm* must calculate the *regulatory excess capital* for each of its *with-profits funds* by deducting B from A, where:

(1) ...

(2) B is the sum of:

(a) the *regulatory value of liabilities* of the fund (*INSPRU 1.3.29R*); and

(b) the *long-term insurance capital requirement* in respect of the fund's *with-profits insurance contracts*; ~~and~~

(c) ~~the *resilience capital requirement* in respect of the fund's *with-profits insurance contracts*.~~

...

1.3.24 R (1) ...

(2) Where *non-profit insurance contracts* are written in a *with-profits fund*, the amount representing those contracts is the sum of:

(a) the *mathematical reserves* in respect of the *non-profit insurance contracts* written in the fund; and

(b) ~~the following amounts, to the extent that each of them is covered by the fund's *long term admissible assets*:~~

(i) an amount in respect of the *non-profit insurance contracts* written in the fund which represents an appropriate allocation of the *firm's long-term insurance capital requirement*, to the extent that it is covered by the fund's long-term admissible assets; and

(ii) ~~an amount in respect of the *non-profit insurance contracts* written in the fund which represents an appropriate allocation of the *firm's resilience capital requirement*.~~

...

1.3.27 G ~~In calculating the amount of a *firm's resilience capital requirement* allocated to the *non-profit insurance contracts* in the *with-profits fund*, the *firm* should calculate the amount of resilience capital that would be required if that business were in a stand-alone company owning the assets allocated. The *resilience capital requirement* for the *with-profits insurance business* should also be calculated as if it were a stand-alone company. An allocation of the *firm's total resilience capital requirement* should then be made in a manner that would produce a result materially consistent with an allocation in proportion to the amounts calculated for each part of the business as stand-alone entities. [intentionally blank]~~

...

1.3.33 R (1) ...
(2) ...
(3) For the purposes of (2):
(a) ...
(b) ...

and D is equal to the sum of:

(v) the *long-term insurance capital requirement* in respect of any *non-profit insurance contracts* written in a *non-profit fund* of B;

(vi) where B is a *regulatory basis only life firm*, the amount of the *resilience capital requirement* in respect of any *non-profit insurance contracts* written in a *non-profit fund* of B;

(vii) any part of the *with-profits insurance capital component* of B, or of B's *long-term insurance capital requirement* or where B is a *regulatory basis only life firm*, *resilience capital requirement* in respect of B's *with-profits insurance contracts*, that is not covered from the assets of the *with-*

profits fund from which it arises after deducting from those assets the amount calculated under (iv); and

(viii) any assets of B that back its regulatory capital requirements and that are valued in (iii) in the calculation of the present value of future profits of *non-profit insurance business* written by B.

(4) ...

...

1.3.38 G In calculating the present value of future profits (or losses) for *non-profit insurance business* required by *INSPRU* 1.3.33R(1)(c), to the extent that the *long-term insurance capital requirement* ~~is and the resilience capital requirement are~~ covered by the *with-profits fund's long-term admissible assets*, a *firm* may take into consideration any release of ~~these items~~ this item as the relevant *policies* go off the books.

...

1.3.39B G In determining current market yields for the purpose of *INSPRU* 1.3.37R(4), a *firm* is required to have regard to IFRS 4 as if it were being applied to determine the value under that standard for the first time, that is, without reference to existing practices. Paragraph 27 of the standard is likely to be of particular relevance. In general, a *firm* should not only include an allowance for future investment margins if its assumptions are limited to no more than a risk-free rate and the discount rate is set consistently until they are earned. In particular, a *firm* should not include an allowance for capital growth in determining current market yields for equities and real estate investments. However, this does not preclude a *firm* from using a replicating portfolio of assets to determine the discount rate for the liability with suitable adjustments for differences in their characteristics (for the example of annuity business, see *INSPRU* 1.3.39G). In setting assumptions for future investment returns, a *firm* should also consider sections BC134 to BC144 of the Basis for Conclusions in IFRS 4.

...

1.3.65 G In relation to the *market risk* scenarios in *INSPRU* 1.3.68R and *INSPRU* 1.3.73R, the effect of *INSPRU* 1.3.52R and *INSPRU* 1.3.58R is that a *firm* may reflect management actions and must make a realistic assessment of *policyholder* actions in projecting the assets and liabilities in its calculation of the *risk capital margin* for a *with-profits fund* within the *firm*. ~~This contrasts with the position for calculating the resilience capital requirement for the *firm* (*INSPRU* 3.1.9 G to *INSPRU* 3.1.26R).~~

...

1.3.108 G ~~*INSPRU 1.3.105R(7) requires firms to provide fully for shareholder transfers. Such transfers do not therefore count as capital in the with profits fund. However, a firm may apply under section 148 of the Act for a waiver from this requirement. In exercising its discretion under section 148 of the Act, the FSA will have regard (among other factors) to whether a firm has put in place undertakings satisfactory to the FSA, including that future transfers will not be paid out of the firm by way of dividend. [intentionally blank]*~~

...

1.4.9 G However, *firms* are permitted to include *equalisation provisions* within their financial resources when demonstrating compliance with non-Directive capital requirements. Hence *equalisation provisions* are deducted from the available *capital resources* of a *firm* for the purpose of meeting its *minimum capital requirement* for *general insurance business*; but, in the calculation of a *firm's enhanced capital requirement* for *general insurance business* under ~~*INSPRU 7.1.11R*~~*1.1.72CR*, its *equalisation provisions* (if any) are added back to its *capital resources*.

...

1.5.44 R For the purposes of *INSPRU 1.5.42R*, a *non-EEA direct insurer* (except a *UK-deposit insurer*) must calculate a *UK MCR*:

- (1) for *long-term insurance business*, in accordance with *GENPRU 2.1.36R*~~*INSPRU 1.1.81R*~~ to ~~*INSPRU 1.1.91R*~~ but only in relation to business carried on by the *firm* in the *United Kingdom*;
- (2) for *general insurance business*, in accordance with *GENPRU 2.1.34R*~~*INSPRU 1.1.45R*~~ to ~~*INSPRU 1.1.72R*~~ but only in relation to business carried on by the *firm* in the *United Kingdom*.

...

1.5.46 R For the purposes of *INSPRU 1.5.42R*, a *UK-deposit insurer* must calculate an *EEA MCR*:

- (1) for *long-term insurance business*, in accordance with *GENPRU 2.1.36R*~~*INSPRU 1.1.81R*~~ to ~~*INSPRU 1.1.91R*~~ but only in relation to business carried on by the *firm* in all *EEA States*, taken together;
- (2) for *general insurance business*, in accordance with *GENPRU 2.1.34R*~~*INSPRU 1.1.45R*~~ to ~~*INSPRU 1.1.72R*~~ but only in relation to

business carried on by the *firm* in all *EEA States*, taken together.

...

2.1.22 R ...

(3) ...

(c) ...

(i) ...

(ii) 1% for that part of the exposure arising from *shares* and other variable yield participations, bonds, *debt securities* and other *money market instruments* and capital market instruments from the same *counterparty* that are not dealt in on a *regulated market*, or ~~any a~~ beneficial interest in a ~~collective investment scheme which is not a UCITS scheme, a non-UCITS retail scheme or a recognised scheme~~ to which *INSPRU 2.1.39R* applies; the limit for that part of the exposure arising from *debt securities* (other than hybrid securities) issued by the same *regulated institution* is increased to 5%;

(iii) ...

...

(e) 10% for the aggregate of all *counterparty* exposures and asset exposures that fall within (c)(ii) above or (j) below, whether or not they arise from *persons* who are closely related, but excluding amounts that are in excess of the limit in (c)(ii) above or, in the case of an asset exposure, (j) below;

...

(h) 10% for the asset exposure (including an exposure arising from a reversionary interest) arising from any one piece of land or building, or a number of pieces of land or buildings close enough to each other to be considered effectively as one investment;

(i) 5% for the asset exposure arising from a beneficial interest in any single non-UCITS retail scheme or recognised scheme which does not fall within the *UCITS Directive*; and

(j) 1% for the asset exposure arising from a beneficial interest in any single collective investment scheme which does not fall

within the UCITS Directive and is not a non-UCITS retail scheme or a recognised scheme.

(4) In (3) a *firm's* business amount means the sum of:

(a) ...

(b) ...

(c) ...

(ii) in the case of a *firm* carrying on *long-term insurance business*, the amount of its *long-term insurance capital requirement* and, where it is a *regulatory basis only life firm*, the amount of its *resilience capital requirement*.

...

...

2.1.39 R For the purposes of *INSPRU 2.1.20R* and *INSPRU 2.1.22R*, ~~a UCITS scheme, a non-UCITS retail scheme, a recognised scheme or any other collective investment scheme that invests only in admissible assets (including any derivatives or quasi-derivatives held by the scheme)~~ is to be treated as closely related to the issuer of the units in that scheme units in a collective investment scheme that does not fall within the UCITS Directive must be treated as a counterparty exposure to the issuer of the units in that scheme if the issuer and those units are to be regarded as constituting a single risk because they are so interconnected that, if the issuer were to experience financial problems, this would be likely to affect the value of the units.

2.1.39A G Where the value of units in a collective investment scheme other than one falling within the UCITS Directive would be likely to be adversely affected by financial problems experienced by the issuer of those units, for the purposes of INSPRU 2.1.20R and INSPRU 2.1.22R, the units must be treated as a counterparty exposure to the issuer, with the result that the exposure is subject to the limit in INSPRU 2.1.22R(3)(c)(ii). In all other cases, the units would fall to be treated as an asset exposure, with the result that they are subject to the relevant limit under INSPRU 2.1.22R(3)(i) or (j).

Meaning of closely related

2.1.40 R For the purposes of *INSPRU 2.1*, a group of *persons* is closely related if it consists solely of two or more ~~natural or legal persons~~ *persons* who, unless it is shown otherwise, constitute a single risk because as between any two of

them one or other of the following relationships apply:

- (1) one of them, directly or indirectly, has control, as defined in *INSPRU* 2.1.41R, over the other or they are both controlled by the same third party; or
- (2) there is no relationship of control as defined in *INSPRU* 2.1.41R but they are to be regarded as constituting a single risk because they are so interconnected that, if one of them were to experience financial problems, the other would be likely to encounter repayment difficulties.

...

3.1.7 G *INSPRU* 3.1 addresses the impact of *market risk* on *insurance business* in the ways set out below:

- (1) Any firm that carries on *long-term insurance business* which is a regulatory basis only life firm must comply with the *resilience capital requirement*. This requires the firm to hold capital to cover *market risk*. The *resilience capital requirement* is dealt with in *INSPRU* 3.1.9G to *INSPRU* 3.1.26R.

...

...

Resilience capital requirement (only applicable to the long-term insurance business of regulatory basis only life firms only)

3.1.9 G The *resilience capital requirement* forms part of the calculation of the *capital resources requirement* for regulatory basis only life firms. *GENPRU* 2.1.23R specifies that the *CRR* for a regulatory basis only life firm is equal to the *MCR* in *GENPRU* 2.1.25R. The *resilience capital requirement* forms part of the *MCR* for a regulatory basis only life firm (see *GENPRU* 2.1.25R(2)(b). ~~all firms carrying on long-term insurance business. GENPRU 2.1.18R to GENPRU 2.1.23R set out the different elements of this calculation. These include the *Minimum Capital Requirement* and the *Enhanced Capital Requirement*. The *resilience capital requirement* forms part of both of these requirements (see *GENPRU* 2.1.25R(2) and *GENPRU* 2.1.38R(2)).~~

3.1.10 R (1) A regulatory basis only life firm ~~that carries on long-term insurance business~~ must calculate a *resilience capital requirement* in accordance with (2) to (5).

...

...

- 3.1.14 G ~~The *resilience capital requirement* requires firms to assume different adverse *market risk* scenarios for equities, real estate and fixed interest securities (see *INSPRU* 3.1.16R and *INSPRU* 3.1.23R) to those required by *INSPRU* 1.3.68R (UK and certain other assets) and *INSPRU* 1.3.73R (non-UK assets) in relation to the calculation of the *risk capital margin* for a *with-profits fund* by a *realistic basis life firm* calculating its *with-profits insurance capital component*. [intentionally blank]~~

...

- 3.1.28 R (1) The rates of interest required by *INSPRU* 1.2.33R to be used by a firm for the calculation of the present value of a *long-term insurance liability* must not exceed 97.5% of the risk-adjusted yield (see *INSPRU* 3.1.30R to *INSPRU* 3.1.48G) that is expected to be achieved on:
- (1a) the assets allocated to cover that liability;
 - (1b) the reinvestment of sums expected to be received from those assets (see *INSPRU* 3.1.45R to *INSPRU* 3.1.48G); and
 - (1c) the investment of future *premium* receipts (see *INSPRU* 3.1.45R to *INSPRU* 3.1.48G).
- (2) (1) does not apply to a *long-term insurance contract* in respect of which the firm has calculated a negative value for the *mathematical reserves* in accordance with *INSPRU* 1.2.24R.

...

- 3.1.29A G ~~*INSPRU* 3.1.28R applies only~~ applies to a *long-term insurance contract* in respect of which a firm has calculated *mathematical reserves* with a positive value that are treated as liabilities. Where a firm treats a *long-term insurance contract* as an asset A firm may, however, also have *long-term insurance contracts* where the value of future cash inflows under and in respect of the contract exceeds that of outflows, allowing the firm to calculate a negative value for the *mathematical reserves* for that contract (see *INSPRU* 1.2.24R).~~;~~
~~in~~ In calculating the present value of future net cash flows under and in respect of the that contract, the firm must include margins for adverse variation in accordance with *INSPRU* 1.2.13R. These margins should include margins for *market risk* and, where relevant, credit risk. For those margins to be sufficiently prudent as required by *INSPRU* 1.2.13R, the rate of interest used may need to be higher than that which would apply under

INSPRU 3.1.28R.

...

- 8.1.7 G ... *INSPRU 7.1* contains *rules* and guidance on the assessment of capital adequacy for *firms* and *INSPRU 7.1.57R*~~7.1.74G~~ to *INSPRU 7.1.70R*~~7.1.90R~~ provide for the application of *INSPRU 7.1* to the *Society* and *managing agents*.

...

INSPRU TP

Transitional provisions

...

6 Admissible assets

Application

- 6.1 R *INSPRU TP 6* applies to an *insurer* which is not a *pure reinsurer*.

Duration of transitional

- 6.2 R *INSPRU TP 6* applies until 30 December 2007.

GENPRU 2 Annex 7R

- 6.3 R (1) In determining whether its assets are *admissible assets*, instead of applying *GENPRU 2 Ann 7R*, a *firm* may elect to treat as an *admissible asset* an asset that would have been an *admissible asset* for the purposes of the *Integrated Prudential Sourcebook (PRU)* as it was in force on 30 December 2006.
- (2) (1) does not apply when determining whether a *derivative* or *quasi-derivative* is an *approved derivative* or *approved quasi-derivative*.
- (3) If a *firm* applies (1) to any of its assets, it must do so for all of its assets except *derivatives* and *quasi-derivatives*.

Annex E

Amendments to Annex A (Chapter TP of GENPRU and GENPRU Schedules) to the General Prudential Sourcebook (Transitional Provisions and Schedules) Instrument 2006 (FSA 2006/51)

In this Annex, underlining indicates new text.

TP Transitional provisions

...

15 Admissible assets

Application

15.1 R GENPRU TP 15 applies to an insurer which is not a pure reinsurer.

Duration of transitional

15.2 R GENPRU TP 15 applies until 30 December 2007.

GENPRU 2 Annex 7R

15.3 R (1) In determining whether its assets are *admissible assets*, instead of applying GENPRU 2 Ann 7R, a firm may elect to treat as an *admissible asset* an asset that would have been an *admissible asset* for the purposes of the Integrated Prudential Sourcebook (PRU) as it was in force on 30 December 2006.

(2) (1) does not apply when determining whether a *derivative* or *quasi-derivative* is an *approved derivative* or *approved quasi-derivative*.

(3) If a firm applies (1) to any of its assets, it must do so for all of its assets except *derivatives* and *quasi-derivatives*.

Annex F

Amendments to Annex A (Amendments to the Glossary) to the CRD (Consequential Amendments) Instrument 2006 (FSA 2006/53)

In this Annex, underlining indicates new text and striking through indicates deleted text. Where different amendments are to be substituted for those currently set out in Annex A, this is indicated below.

...

Part 1B (New definitions taking effect on 1 January 2007)

*supervisory review and
evaluation process*

the FSA's assessment of the adequacy of certain firms' capital, as more fully described in *BIPRU 2.2.9G* and *INSPRU 7.1.8G*7.1.12G.

...

Part 2A (Revised definitions taking effect on 31 December 2006)

...

Substitute for the amendments to the definition of admissible asset the following:

admissible asset

(1) (~~in LLD~~ for the purpose of the rules in GENPRU and INSPRU as they apply to members of the Society of Lloyd's, the Society and managing agents) an asset that, subject to paragraphs (2) and (3) of GENPRU 2 Ann 7R, falls into one or more categories in paragraph (1) of GENPRU 2 Ann 7R as modified by ~~LLD 19.3.19R~~ GENPRU 2.3.34R.

(2) otherwise:

(a) (in relation to an insurer which is not a pure reinsurer) an asset that, subject to paragraphs (2) and (3) of GENPRU 2 Ann 7R, falls into one or more categories in paragraph (1) of GENPRU 2 Ann 7R; or

(b) ...

...

*enhanced capital
requirement*

(1) (in relation to a *firm* carrying on *general insurance business*)
the amount calculated in accordance with *PRU*
~~2.3.11R~~INSPRU 7.1.11R~~INSPRU 1.1.72CR~~.

(2) ...

...

**INTERIM PRUDENTIAL SOURCEBOOK FOR INSURERS
(AMENDMENT NO 10) INSTRUMENT 2006**

Powers exercised

- A. The Financial Services Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):
- (1) section 138 (General rule-making power);
 - (2) section 141 (Insurance business rules);
 - (3) section 150(2) (Actions for damages);
 - (4) section 156 (General supplementary powers);
 - (5) section 157(1) (Guidance); and
 - (6) section 340 (Appointment).
- B. The rule-making powers listed above are specified for the purpose of section 153(2) (Rule-making instruments) of the Act.

Commencement

- C. This instrument comes into force on 31 December 2006.

Amendments to the Handbook

- D. The Interim Prudential sourcebook for Insurers (IPRU(INS)) is amended in accordance with the Annex to this instrument.

Citation

- E. This instrument may be cited as the Interim Prudential Sourcebook for Insurers (Amendment No 10) Instrument 2006.

By order of the Board
15 December 2006

Annex

Amendments to the Interim Prudential sourcebook for Insurers (IPRU(INS))

In this Annex, underlining indicates new text and striking through indicates deleted text. Where a new section of text is inserted, this is indicated and the new text is not underlined.

INTERIM PRUDENTIAL SOURCEBOOK FOR INSURERS

...

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VOLUME ONE

...

VOLUME TWO

Appendices to the Rules

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Appendix 9.1 Balance sheet and profit and loss account (Forms ~~9-17~~ 1 to 3 and 10 to 19) (rules 9.12 and 9.13)

...

Chapter 3
LONG-TERM INSURANCE BUSINESS
CONTENTS

...

Part II

Linked Long-Term Contracts

...

3.7 ...
(3) Benefits payable under any *linked long-term contract* must not be determined by reference to -

 ...
(d) property of any of the descriptions specified in Part I of **Appendix 3.2**, other than the property specified in paragraph 5(a), which has the effect of a *derivative contract* other than a *permitted derivative contract*.

...

Chapter 9

FINANCIAL REPORTING

...

Deposit of accounts etc. with the FSA

9.6 (1) ...

- (2) In (1), the reference to the **required copies** is to -
- (a) five printed copies of the document; or
 - (b) one printed copy of the document and one copy of it in an electronic form which may be readily used or translated by the *FSA* sent by email to insurancereturns@fsa.gov.uk. The title of the email must be:

<firm name> FSA returns <dd/mm/yyyy>.

The printed copies must be sent to Insurance Returns, The Financial Services Authority, PO Box 35747, London E14 5WP (and must not be addressed to the *insurer's* normal supervisory contact).

...

- (6) There must be deposited with every revenue ‘account’ and ‘balance sheet’ of an *insurer* any statement or report on the affairs of the *insurer* made or submitted:
- (a) to the *insurer's* shareholders or *policy holders*; or
 - (b) to the *insurer's with-profits policyholders* under *COB* 6.11.8G, *COB* 6.11.9R or *SUP* 4.3.16AR(4),

in respect of the *financial year* to which the ‘account’ and ‘balance sheet’ relate.

The *insurer* may either send a printed copy or an electronic copy of these reports. The requirements in (2) above as to postal address, email address and email title apply.

...

...

Additional information on general insurance business: major facultative reinsurers

- 9.26 (1) ...
- (2) (a) ...
 - (b) in relation to which, in respect of any *reinsurer* (a **major facultative reinsurer**) the aggregate amounts in (1)(d) and (f) ~~(e)~~ exceeds the sum of 4,000 Euro and 1% of the *insurer's* liabilities arising from its *general insurance business*, net of *reinsurance ceded*.

...

PART V

GROUP CAPITAL ADEQUACY

...

9.42

...

- (4) An ~~insurer~~ *insurer* must submit the reports in rule 9.40(1) and in rule 9.40(1A) to the *FSA* no later than 4 months from the end of:
- (a) the *financial year in question*; or
 - (b) the *financial year* of the relevant parent, where the report is provided as at the end of its *financial year* under (1)(a).

The *insurer* must send one printed copy and one electronic copy to the appropriate addresses set out in rule 9.6(2) above. The electronic copy must be sent by email and the title of the email must be:

<firm name> group capital adequacy <dd/mm/yyyy>.

- (5) ...

...

PART VI

ENHANCED CAPITAL REQUIREMENT

9.44 ...

- (3) An *insurer* must deposit a printed copy of the report with the ~~FSA~~ *FSA* within 2 months and 15 days of the *financial year end* ~~end~~ unless, in addition to depositing a printed copy, an *insurer* also deposits an electronic copy, then the period of deposit is within 3 months of the *financial year end* ~~end~~. The copies must be sent to the appropriate addresses set out in rule 9.6(2) above.

...

- (5) The electronic copy deposited under (3) above must be in an electronic form which may be readily used or translated by the *FSA* and must be sent by email to the appropriate address set out in rule 9.6(2) above. The title of the email must be:

<firm name> Form ECR1 <dd/mm/yyyy>

...

9.46 An electronic copy that is not a completed Form ECR1 spreadsheet file template from the *FSA* website that can be accessed by Microsoft Excel is unlikely to be readily used or translated by the *FSA*. ~~Electronic copies may be sent on disk or by e-mail to eersubmissions@fsa.gov.uk.~~

...

...

Chapter 11

DEFINITIONS

PART I

DEFINITIONS

11.1 ...

<i>home foreign business</i>	<i>general insurance business</i> carried on in the United Kingdom primarily relating to risks situated outside the United Kingdom, but excluding <i>insurance business</i> in category numbers 330, 340, and 350, 500, 600 and 700 and <i>insurance business</i> where the risk commences in the United Kingdom
------------------------------	------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------

...

...

ANNEX 11.1

CLASSES OF LONG-TERM INSURANCE BUSINESS

Number	Description	Nature of business
...		
VII	Pension fund management	Effecting or carrying out- (a) <i>pension fund management contracts contracts</i> ; or (b) contracts of the kind mentioned in (a) that are combined with <i>contracts of insurance</i> covering either conservation of capital or payment of a minimum interest.
...		

...

ANNEX 11.3

DESCRIPTIONS OF FSA GENERAL INSURANCE BUSINESS REPORTING CATEGORIES

Part I

Categories to which *contracts of general insurance business* are to be allocated for the purpose of reporting in the *return*

Category Number	FSA general insurance business reporting category	Map to classes of business in Annex A of 73/239/EE C
...		
262	<p>Consequential loss (i.e. business interruption) <i>Contracts of insurance</i> (other than treaty reinsurance contracts) against risks of loss to the persons insured attributable to interruptions of the business carried on by them, or to the reduction of the scope of the business so carried out, which result from perils insured against or other events (whether or not specified in the contract).</p> <p>This category does not include <i>contracts of insurance</i> that fall within <i>category numbers</i> 261 (Commercial property) or 343 (Energy).</p>	16
...		
274	<p>Mixed commercial package <i>Contracts of insurance</i> (other than treaty reinsurance contracts) against more than one of:</p> <ul style="list-style-type: none"> (a) loss of or damage to property; (b) risks to the persons insured incurring liabilities to third parties; (c) risks of loss to the persons insured arising from the failure of debtors of theirs to pay their debts when due; (d) risks of loss to the persons insured attributable to interruptions of business carried on by them; (e) risks of loss to the persons insured attributable to their incurring unforeseen expenses; or (f) any other risk of loss to a commercial operation; <p>where the risks and losses covered in the contract are rated on a single package basis and no separately identifiable premium is charged or recorded for internal management purposes for any one group of risks or losses specified in the contract.</p> <p>This category excludes <i>contracts of insurance</i> that fall within <i>category numbers</i> 261 (Commercial property) or 343 (Energy).</p>	8,9,13,14,16, 17
...		

343	<p>Energy (on and off-shore) <i>Contracts of insurance</i> (other than treaty reinsurance contracts) against loss of or damage to property, or against the risks of the persons insured incurring liabilities to third parties, <u>or against risks of loss to the persons insured attributable to interruptions of business carried on by them</u>, arising from the undertaking of energy operations on both land and sea.</p> <p><i>Contracts of insurance</i> other than treaty reinsurance that fall within the definition of <i>category number 114(p)</i> which the insurer elects to allocate to this category.</p>	6,8,9,12,13
344	<p>Protection and indemnity <i>Contracts of insurance</i> (other than treaty reinsurance contracts) against the risks of the persons insured incurring liabilities to third parties for damage to property, injury, illness or death on board vessels on the sea or inland water or at locations associated with the operation of such vessels such as docks, arising from the negligence of the owner of or individuals responsible for the vessels.</p> <p><i>Contracts of insurance</i> other than treaty reinsurance that fall within the definition of <i>category number 114(p)</i> which the insurer elects to allocate to this category.</p>	13 <u>12</u>
...		

Chapter 12

TRANSITIONAL ARRANGEMENTS

...

Insert after guidance paragraph 12.7 the following transitional rules 12.8, 12.9 and 12.10:

Off-market derivatives in linked funds

- 12.8
- (1) This transitional *rule* has effect from 31 December 2006 to 30 December 2007.
 - (2) For the purpose of the definition of *permitted derivative contract* in *IPRU (INS)* 11.1:
 - (a) *INSPRU* 3.2.5R(3)(b) has effect as if the words "and is capable of valuation" and "to *INSPRU* 3.2.35R" were omitted;
 - (b) *INSPRU* 3.2.34R has effect as if it read "For the purpose of *INSPRU* 3.2.5R(3)(b), a transaction is on approved terms only if the *firm* reasonably believes that it may be readily closed out"; and
 - (c) *INSPRU* 3.2.35R does not apply.

Admissible assets

- 12.9
- (1) This transitional *rule* has effect from 31 December 2006 to 30 December 2007.
 - (2) In determining whether its assets are *admissible assets* for the purpose of any *rule* in *IPRU(INS)*, instead of applying *GENPRU* 2 Ann 7R, an *insurer* may elect to treat as an *admissible asset* an asset that would have been an *admissible asset* for the purposes of the Integrated Prudential Sourcebook (PRU) as it was in force on 30 December 2006.
 - (3) (2) does not apply when determining whether a *derivative* or *quasi-derivative* is an *approved derivative* or *approved quasi-derivative*.
 - (4) If an *insurer* applies (2) to any of its assets, it must do so for all of its assets except *derivatives* and *quasi-derivatives*.

Definitions of *FSA general insurance business reporting categories* 343 (Energy) and 262 (Consequential loss) in *IPRU(INS)* Annex 11.3 Part I

- 12.10
- (1) This transitional *rule* has effect from 31 December 2006 to 30 December 2007.

- (2) Subject to (3), an *insurer* may use a definition of 343 (Energy) that is as stated in *IPRU (INS)* Annex 11.3 Part I but with the words "or against risks of loss to the persons insured attributable to interruptions of business carried on by them" omitted.
- (3) If an *insurer* uses a modified definition of 343 (Energy) under (2), it must use a definition of 262 (Consequential loss) that is as stated in *IPRU (INS)* Annex 11.3 Part I but with the words "or 343 (energy)" omitted.

...

INTERIM PRUDENTIAL SOURCEBOOK FOR INSURERS

CONTENTS

VOLUME TWO

Appendices to the Rules

...

Appendix 9.1 Balance sheet and profit and loss account (Forms ~~9-17~~ 1 to 3 and 10 to 19) (rules 9.12 and 9.13)

...

APPENDIX 3.2 (rule 3.7)

PERMITTED LINKS

PART I

DESCRIPTIONS OF PROPERTY BY WHICH BENEFITS MAY BE DETERMINED

...

5. Units or other beneficial interests in -
- (a) a scheme falling within the *UCITS Directive* or an authorised fund which is a non-UCITS retail scheme; and
 - (b) a *collective investment fund* which satisfies the following conditions -
 - (i) the property of the fund comprises property of any of the descriptions in 1 to 10,
 - (ii) the units are *readily realisable* at a price which represents the net value per unit of the assets and liabilities of the fund, and
 - (iii) the price at which the units may be bought and sold is published regularly.

....

APPENDIX 9.1 (rules 9.12 and 9.13)

**BALANCE SHEET AND PROFIT AND LOSS ACCOUNT
(FORMS 1 TO 3 AND 10 TO 19)**

...

- 7 Firms should not normally restate comparatives unless restatement is necessary in order to allow the appropriate comparison to be made. Where in any Form an amount which is a comparative (i.e. shown in a "previous year" column) ~~shown as brought forward from previous year~~ differs from the corresponding amount shown in a "this financial year" column ~~as carried forward from that year in a return for a previous year~~ and the difference is not due solely to the use of a different rate to express other currencies in sterling, an explanation of the reason for the difference must be given by way of a supplementary note to that form. (For **Forms 1, 2, 3, 10, 11, 12, 13, 14, 15, 16, 17, 18,** and **19** the code for the supplementary note is 0111, 0211, 0311, 1011, 1111, 1211, 1311, 1411, 1511, 16121, 1711, 1811, and 1911 respectively.)

....

Premiums

10. (1) Notwithstanding the requirements of the *insurance accounts rules*, amounts included in **Forms 11** and **12** in respect of -
- (a) *gross written premiums receivable;*
 - (b) *gross earned premiums;*
 - (~~b~~c) *claims paid;*
 - (ed) *claims outstanding; and*
 - (~~d~~e) *reinsurance recoveries,*
- must be determined in accordance with *PRU 7.2.66R* and *PRU 7.2.71R*.

- (2) ...

Counterparty exposure

11. (1) There must be given by way of a supplementary note to **Form 13** (code 1305 for other than *long-term insurance business* and code ~~1314~~ 1319 for *long-term insurance business*) –

...

...

Instructions for completion of Form 1

1. ...
7. The excess (deficiency) of available *capital resources* to cover the *guarantee fund* requirement at line 22 is equal to line 81 on Form 3 less line 21, except for a branch. For a *branch* this is equal to line 13 less line 21 less an adjustment because assets held to cover the *guarantee fund* must be held in the *United Kingdom* (or for *UK-deposit insurers*, in the *EEA States* where the *firm* carries on *insurance business*); the adjustment is the difference between form 13 line 89 for categories -4- 1 and 3 (or 5), except for *branches* carrying on both *long-term insurance business* and *general insurance business* (composite *branches*); composite *branches* will need to state how the difference is allocated between *general insurance business* and *long-term insurance business* in a note to the Form (Note 0102).
8. ...

Instructions for completion of Form 2

1. ...
2. The entry at line 13 must be equal to the *total capital resources* after deductions at line 79, column 2 on Form 3. The entry at line 11 represents items relating to the *long-term insurance fund*, and that at line 12 represents amounts arising outside the *long-term insurance fund*. For a *branch*, line 11 is equal to the sum of any *implicit items* plus form 10 line 11 less the sum of lines 11, 12 and 49 in Form 14: when there are implicit items ~~it would be appropriate for note 0202 (see instruction 26) to include an analysis of line 11~~ must be given in a supplementary note (code 0202); if the *insurer* is not carrying on *general insurance business* through the *branch*, line 12 will be equal to Form 10 line 29.
3. ...

Instructions for completion of Form 10

1. ...
3. ~~Line 63 must be equal to lines 13.92.2 to 13.95.2 less lines 13.92.1 to lines 13.95.1 of the Form for the total other than *long-term insurance business assets* category. [deleted]~~
4. ...
- ...

Instructions for completion of Forms 11 and 12

...

1. For a *composite firm*, Forms 11 and 12 must be completed separately for the total *general insurance business* and for the total *long-term insurance business* which is *class IV₂* supplementary accident and sickness insurance business or *life protection reinsurance business written by a pure reinsurer or a mixed insurer*. For other *firms*, the forms must be completed for the total *general insurance business* or for the total *long-term insurance business* which is *class IV₂* ~~or~~ supplementary accident and sickness insurance business or *life protection reinsurance business written by a pure reinsurer or a mixed insurer*, as appropriate.
2. Notwithstanding instruction 1, if the gross annual office premiums for *class IV* business, *life protection reinsurance business written by a pure reinsurer or a mixed insurer* and supplementary accident and sickness insurance in force on the 'valuation date' do not exceed 1% of the gross annual office *premiums* in force on that date for all *long-term insurance business*, Forms 11 and 12 need not be completed for *long-term insurance business* as long as it can be stated that the entry in line 21 of Form 60 exceeds the amount that would be obtained if Forms 11 and 12 were to be completed for *long-term insurance business*. In this circumstance, the method of estimating the entry in line 21 of Form 60, together with a statement of the gross annual office *premiums* in force at the 'valuation date' in respect of *Class IV* business, *life protection reinsurance business written by a pure reinsurer or a mixed insurer* and supplementary accident and sickness insurance, must be given in a supplementary note (code 6001).

...

Instructions for completion of Form 14

1. The Form must be completed for the total *long-term insurance business liabilities* and margins of the *insurer* or *branch* and for each fund or group of funds for which separate assets are appropriated and each *with-profits fund*. ~~The words "total long-term insurance business assets" or the name of the fund must be shown against the heading "Category of assets". The corresponding code box must be completed with the same entries as were used on the corresponding Form 40.~~

2. ...

...

Liabilities (other than long term insurance business)

...

Creditors	Taxation	47		
	Recommended Declared dividend	48		
	Other	49		
...				

...

Instructions for completion of Form 15

1. ...

...

8. Lines 81-8485 must be completed in accordance with the *insurance accounts rules* or *international accounting standards* as applicable to the *insurer* for the purpose of its external financial reporting if the *insurer* is required to produce such accounts. Otherwise these lines must be left blank. Details of amounts in line 83 must be disclosed in a supplementary note (code 1507). The previous year figures must be left blank for financial years ending on or before 30 December 2006.
9. The amount at line 48 column 1 is dividends which had been declared but not paid prior to the end of the financial year. Where the previous financial year ends before 31 December 2006 the amount shown in column 2 must be the amount shown in the previous annual return (where a different definition for this item may have been used).

Profit and loss account (non-technical account)

...

Dividends (paid and proposed or declared)	51		
...			

...

Instructions for completion of Form 16

1. ...

4. The amount at line 51 column 1 excludes dividends which had not been declared prior to the end of the financial year. Where the previous financial year ends before 31 December 2006 the amount shown in column 2 must be the amount shown in the previous annual return (where a different definition for this item may have been used).

...

With-profits insurance capital component for the fund

Name of insurer
 With-profits fund
 Financial year ended
 Units

	As at end of this financial year 1	As at end of the previous year 2
--	---------------------------------------------	-------------------------------------------

Regulatory excess capital

Regulatory value of assets	Long-term admissible assets of the fund	11		
	Implicit items allocated to the fund	12		
	Mathematical reserves in respect of the <u>fund's</u> non-profit insurance contracts <u>written in the fund</u>	13		
	Long-term admissible assets of the fund covering the <u>LTICR</u> long-term insurance capital requirement allocated in respect of the <u>fund's</u> non-profit insurance contracts <u>written in the fund</u>	14		
	Long-term admissible assets of the fund covering the <u>RCR</u> resilience capital requirement allocated in respect of the <u>fund's</u> non-profit insurance contracts <u>written in fund</u>	15		
	Total (11+12-(13+14+15))	19		
Regulatory value of liabilities	Mathematical reserves (after distribution of surplus) in respect of the fund's with-profit insurance contracts	21		
	Regulatory current liabilities of the fund	22		
	Total (21+22)	29		
	Long-term insurance capital requirement in respect of the fund's with-profits insurance contracts	31		
	Resilience capital requirement in respect of the fund's with-profits insurance contracts	32		
	Sum of regulatory value of liabilities, <u>LTICR</u> and <u>RCR</u> long-term insurance capital requirement and resilience capital requirement (29+31+32)	39		
	Regulatory excess capital (19-39)	49		

Realistic excess capital

Realistic excess capital	51		
--------------------------	----	--	--

Excess assets allocated to with-profits insurance business

Excess (deficiency) of assets allocated to with-profits insurance business in fund (49-51)	61		
Face amount of capital instruments attributed to the fund and included in capital resources (unstressed)	62		
Realistic amount of capital instruments attributed to the fund and included in capital resources (stressed)	63		
<u>Present value of future shareholder transfers arising from distribution of surplus</u>	<u>64</u>		
<u>Present value of other future internal transfers not</u>	<u>65</u>		

<u>already taken into account</u>			
With-profits insurance capital component for fund (if 62 exceeds 63, greater of 61+62-63- 64-65 and zero; else greater of 61- 64-65 and zero)	6-4- 6		

Instructions for completion of Form 18

1. The entries at lines 11, 12, 13, and 14 ~~and 15~~ must equal the values determined in accordance with *PRU 7.4.24R*. The entry at line 15 must be left blank for financial years ending on or after 31 December 2006.

...

4. The entries at lines 29, and 31 ~~and 32~~ must equal the values determined in accordance with *PRU 7.4.23R(2)(a)*, and (b) ~~and (c)~~ respectively. The entry at line 32 must be left blank for financial years ending on or after 31 December 2006.

...

10. The entry at line 64 must equal the value determined in accordance with *INSPRU 1.3.7R(2)(b)(ii)*. The previous year figure must be left blank for financial years ending on or before 30 December 2007.

11. The entry at line 65 must equal the amount determined in accordance with *INSPRU 1.3.7R(2)(b)(iii)*. The previous year figure must be left blank for financial years ending on or before 30 December 2007.

102. The entry at line ~~6-4-6~~ must equal the contribution in respect of the fund to the aggregate value determined in accordance with *PRU 7.4.7R(1)*.

...

APPENDIX 9.2 (rules 9.14 to 9.22)

**GENERAL INSURANCE BUSINESS:
REVENUE ACCOUNT AND ADDITIONAL INFORMATION
(FORMS 20A and 20 TO 39)**

...

- 2B (1) In the Table in (2) a Form, specified in the first column, is required for a category of business, specified in the second column, if the criteria, specified in the third column, are met for that category of business.
- (2) Table: Criteria (if any) for whether a Form is required for a category of general insurance business. Paragraph 2C belongs to this Table.

Form	Category of business.	Reporting criteria (if any)
F20 to F25 Technical provisions and profit & loss account	<i>Category number 001</i>	Forms always required
	<i>Category numbers 002,003</i>	Either - (a) the <i>insurer's</i> 'gross undiscounted provisions' in the category of business at the end of the <i>financial year</i> exceed zero; or (b) the <i>insurer's gross written premiums</i> in the category of business in the <i>financial year</i> exceed zero.
	<i>Category numbers 110, 120, 160, 180, 220, 260, 270, 280, 330, 340, 350, 400, 500, 600, 700</i>	Either - (a) the <i>insurer's</i> 'gross undiscounted provisions' in the category of business at the end of the <i>financial year</i> exceed: (i) £100m; or (ii) the higher of 5% of the <i>insurer's</i> total 'gross undiscounted provisions' and £1 million or (b) the <i>insurer's gross written premiums</i> in the category of business in the <i>financial year</i> exceed: (i) £100m; or (ii) the higher of 5% of the <i>insurer's</i> total <i>gross written premiums</i> and £1 million.
	<i>Category number 409</i>	Some business in <i>category number 002</i> is not reported on Forms 20 to 25 for <i>category numbers 110 to 400</i> .
	<i>Category number 709</i>	Some business in <i>category number 003</i> is not reported on Forms 20 to 25 for <i>category numbers 500, 600 and 700</i> .

<p>F26 to F29 Results by year of origin for treaties accepted</p>	<p><i>Category numbers 510 to 590 and 610 to 690</i> denominated in any one currency. <i>Category number 700</i></p>	<p>Either -</p> <p>(a) the <i>insurer's</i> 'gross undiscounted provisions' in the category of business at the end of the <i>financial year</i> exceed:</p> <p>(i) £100m; or (ii) the higher of 5% of the <i>insurer's</i> total 'gross undiscounted provisions' and £1 million or</p> <p>(b) the <i>insurer's gross written premiums</i> in the category of business in the <i>financial year</i> exceed:</p> <p>(i) £100m; or (ii) the higher of 5% of the <i>insurer's</i> total <i>gross written premiums</i> and £1 million.</p>
<p>F31, F32, F34 Gross results by year of origin for direct and facultative business</p>	<p><i>Category numbers 330 to 350 <u>331 to 341</u> to <u>350</u></i> denominated in any one currency. <i>Category numbers 110 to 140 <u>111 to 114</u>, <u>121 to 160</u>, <u>181 to 187</u>, <u>221 to 223</u>, <u>261 to 263</u>, <u>271 to 274</u> and <u>281 to 284</u></i> denominated in any one currency carried on in any 'reporting territory' <i>Category number 400</i></p>	<p>Either -</p> <p>(a) the <i>insurer's</i> 'gross undiscounted provisions' in the category of business at the end of the <i>financial year</i> exceed:</p> <p>(i) £100m; or (ii) the higher of 5% of the <i>insurer's</i> total 'gross undiscounted provisions' and £1 million or</p> <p>(b) the <i>insurer's gross written premiums</i> in the category of business in the <i>financial year</i> exceed:</p> <p>(i) £100m; or (ii) the higher of 5% of the <i>insurer's</i> total <i>gross written premiums</i> and £1 million.</p>

2C

For the purpose of column 2 of the Table in Paragraphs 2B and Paragraphs 3(1) and 3(3) -

- (a) a currency in which a *contract of insurance* is denominated is -
 - (i) the currency in which the contract requires settlement of claims or the successor to that currency if it has been superseded, ~~or~~
 - (ii) the currency in which the *insurer* records claim payments under the contract, if the contract permits settlement of claims in more than one currency or if it is the *insurer's* internal practice to convert claim payments to that currency, or;
 - (iii) the currency in which the *insurer* maintains records of the development of *premiums* or *claims* under the contract in order to determine *technical provisions*;
- (b) business denominated in British pound, converted to British pound, or British pound and converted to British pound combined ~~converted sterling~~ is are to be treated as though they ~~it~~ were denominated in a different currencies ~~currency~~ from each other ~~business denominated in sterling~~; and

...

...
3

- (3) Notwithstanding the provisions of 2, all amounts included in -
 - (a) columns 1, 2, 3 and 11 of **Form 23**;
 - (b) columns 1, 2, 3 and 11 of any **Form 26** or **27** for *category number 700*;
 - (c) columns 3 and 10 of any **Form 31** for *category number 400*; and
 - (d) columns 1 and 8 of any **Form 34** for *category number 400*,must be expressed in sterling, and these amounts that are in respect of business denominated in a non-sterling currency must be expressed in sterling as if conversion of every currency had taken place at the closing middle rate on the last day for which the appropriate rate is available in the *financial year in question*.
- (4) ~~{deleted}~~ For the purpose of (3), the currencies 'Converted to British pound' and 'British pound and converted to British pound combined' are not non-sterling currencies.

...

...

7

- (1) The following information must be stated by way of supplementary notes (codes 20Aa to 20Af) to **Form 20A** -
 - (a) (code 20Aa) in respect of each *risk category* (other than *risk categories with category numbers 274, 590 or 690*) to which an *insurer* has allocated *general insurance business* under rule 9.14B -
 - ...
 - (d) (code 20Ad) in respect of each *risk category* (other than *risk categories 510 to 590, 610 to 690 and 700*) for which amounts reported in **Form 20A** contain both *claims-made policies* and policies which are not *claims-made*:
 - ...

...

...

...

8A Where in any Form an amount which is a comparative (i.e. shown in a "previous year" column) or shown brought forward from a previous year differs from the corresponding amount shown in a "this financial year" column or as carried forward from that year, as the case may be, and the difference is not solely to the use of a different rate to express other currencies in sterling, an explanation of the reason for the difference must be given by way of a supplementary note to that Form ~~in accordance with Appendix 9.1 paragraph 7.~~ For **Forms 20, 21, 22, 23, 24, 26, 27, 28, 31, 32, 33, or 34 or 35,** the code for the supplementary note is 2001, 2101, 2201, 2301, 2401, 2601, 2701, 2801, 3101, 3201, ~~3301, or 3401 or 3501~~ respectively.

...

- 16 (1) ...
- (a) ...
 - (b) If the risk category is not 510 to 590, 610 to 690 or 700, and any of the business reported in **Form 20A** under the *risk category* is attributable to overseas business, the countries in which the business in the *risk category* is carried on; and
 - (c) ...
- (2) ...
- (3) In a **Form 31, 32 or 34,** an *insurer* must enter in the space alongside 'reporting territory' -
- (a) 'World wide' if the business on the Form is a subset of *category numbers* 330 or 340 or *category number* 350 or 400; or
 - (b) ...

...

Instructions for completion of Form 20A

...

2. The amount to be shown under provision for gross unearned premium for an *FSA general insurance business reporting category* must equate to F21.19.2 + F25.22.12, as if **Forms 21 or 25** were required for that *FSA general insurance business reporting category*, plus the reinsurers' share of provision for gross unearned premiums for business in the *FSA general insurance business reporting category* accounted for on an underwriting year basis.

...

7. If the entry at Where line 1 column 1 does not equal the amount shown at ~~is different~~ to line 11 column 1 of Form 11, or the entry at line 1 column 4 does not equal the amount shown at line 11 column 1 of Form 15, the ~~insurer~~ *insurer* must provide an explanation for the difference ~~reason~~ in a supplementary note (code 20A1).

...

Instructions for completion of Form 26

...

9. The amounts shown in line 21 must be analysed on continuation sheets by accident year subject to instructions 10, 10A and 10B below.

10. On the continuation sheet, for *category numbers* 590 and 690, the amounts in columns ~~2 and~~ 4 to 10 for accident years ending prior to 31 December 1996 may be shown in the aggregate and columns 1, to 3 and 11 to 13 need not be completed for accident underwriting years ending prior to 31 December 1996.
- 10A. On the continuation sheet, for *category numbers* 610, 620, 650, 660 and 680 the amounts in columns 4 to 10 for accident years ending prior to 23 December 1993 may be shown in the aggregate and columns 1 to 3 and 11 to 13 need not be completed for accident years ending prior to 23 December 1993.
- 10B. On the continuation sheet, for *category numbers* other than those listed in 10 and 10A above, the amounts in columns 4 to 10 for accident years ending prior to 31 December 1983 may be shown in the aggregate and columns 1 to 3 and 11 to 13 need not be completed for accident years ending prior to 31 December 1983.

...
...

Instructions for completion of Form 27

9. The amounts shown in line 21 must be analysed on continuation sheets by accident year subject to instructions 10, 10A and 10B below.
10. On the continuation sheet, for *category numbers* 590 and 690, the amounts in columns ~~2 and~~ 4 to 10 for accident years ending prior to 31 December 1996 may be shown in the aggregate and columns 1, to 3 and 11 to 13 need not be completed for accident underwriting years ending prior to 31 December 1996.
- 10A. On the continuation sheet, for *category numbers* 610, 620, 650, 660 and 680 the amounts in columns 4 to 10 for accident years ending prior to 23 December 1993 may be shown in the aggregate and columns 1 to 3 and 11 to 13 need not be completed for accident years ending prior to 23 December 1993.
- 10B. On the continuation sheet, for *category numbers* other than those listed in 10 and 10A above, the amounts in columns 4 to 10 for accident years ending prior to 31 December 1983 may be shown in the aggregate and columns 1 to 3 and 11 to 13 need not be completed for accident years ending prior to 31 December 1983.

...
...

Instructions for completion of Form 31

7. For *risk categories* 271 to 274 the amounts shown in line 21 must be analysed by accident year on continuation sheets subject to instructions 8 to 9A ~~and 9~~ below.
- 9A. On the continuation sheet, for *category numbers* 271 to 273, the amounts in columns 2 and 4 to 8 for accident years ending prior to 31 December 1976 may be shown in the aggregate and columns 1 and 3 need not be completed for accident years ending prior to 31 December 1976.

...
...

Instructions for completion of Form 34

7. For *risk categories* 271 to 274 the amounts shown in line 21 must be analysed by underwriting year on continuation sheets subject to instructions 8 to 9A ~~and 9~~ below.

8. On the continuation sheet columns 8 and 9 need not be completed in respect of *financial years* underwriting years ended before 23 December 1994.

...

9A. On the continuation sheet, for category numbers 271 to 273, the amounts in columns 2 to 6 for underwriting years ending prior to 31 December 1976 may be shown in the aggregate and column 1 need not be completed for underwriting years ending prior to 31 December 1976.

...

...

Instructions for completion of Form 38

...

8. The entry at line 23 must be the part of the amount that would appear on Form 22 for *combined categories* 180 and 280, at lines 14 and 18 column 4 (whether or not a Form 22 ~~23~~ for *combined categories* 180 or 280 is required) that relates only to *credit insurance business*.

9. The entry at line 24 must be the part of the amount that would appear on Form 22 for *combined categories* 180 and 280, at lines 19 and 29 column 4 (whether or not a Form 22 ~~23~~ for *combined categories* 180 or 280 is required) that relates only to *credit insurance business*.

...

...

APPENDIX 9.3 (rules 9.14 and 9.23)

**LONG-TERM INSURANCE BUSINESS
REVENUE ACCOUNT AND ADDITIONAL INFORMATION
(FORMS 40 TO 60)**

...

3. For the purposes of this Appendix:
- (a) "overseas business" means *long-term insurance business* which is Overseas Life Assurance Business or Overseas PHI and Sickness Business as defined by the Income and Corporation Taxes Act 1988 or business written overseas by an insurer which does not report its Overseas Life Assurance Business separately for taxation purposes;

...

...

Instructions for completion of Form 40

...

4. Any item of income which cannot properly be allocated to lines 11, 12, 13 or 14 must be entered at line 15, and similarly, any item of expenditure which cannot properly be allocated to lines 21, 22, 23 or 24 must be entered at line 25. Particulars of such items must be specified in a supplementary note [Code 4002]. Lines 15 and 25 must be used for transfers of unit management charges into or out of the fund or subfund. Where there are subfunds, inter-subfund other income and other expenditure must be excluded from the total Form 40.

...

12. Transfers of contracts from or to other funds or from another insurer must be included at line 31 or 32, with details specified in a supplementary note [Code 4004]. Where there are subfunds, inter-subfund transfers must be excluded from the total Form 40.

...

...

Long-term insurance business: Analysis of expenses

Form 43

...

Reinsurance - intra-group						
Commission - acquisition	31					
Commission - other	32					
Management - acquisition	32 3					
Management - maintenance	34					

...

...

Instructions for completion of Form 46

...

3. 'New' regular premiums and 'new' single premiums are premiums from new *policy holders* and scheme members, and ~~may~~ must also include new increments on existing *policies* accepted by the *insurer*, in the *financial year in question*.

...

Instructions for completion of Form 47

1. Information must be shown separately for each type of *insurance business* in the sequence specified below:

- (a) UK life ('UKL');
- (b) UK pension ('UKP'); and
- (c) overseas ('OS').

Overseas business may, at the discretion of the insurer, be subdivided by state or territory.

2. The information must be shown separately within each type of *insurance business* in the sequence specified below:

- (a) *direct insurance business* ('DB');
- (b) *reinsurance* accepted which is external to the *insurance group* ('RE'); and
- (c) *reinsurance* accepted which is from within the *insurance group* ('RG').

3. ...

571	Trustee investment plan UWP
574	<u>UWP investment only reinsurance</u>
575	Miscellaneous UWP

...

790	Miscellaneous protection rider
794	<u>Property linked investment only reinsurance</u>
795	Miscellaneous property linked
...	

...

For the purposes of allocation to product codes (e.g. code 175), group business is where there is another party in the arrangement, normally an employer. An *insurer* may use an internal definition to allocate between individual and group business for schemes with less than ten members.

Group money purchase pensions product codes (535, 540, 735, 740) cover policies where the insurer holds details at member level. Trustee investment plan product codes (571, 755) cover policies which are not in the name of or earmarked for an individual member. Group managed fund product code (765) covers unit-linked investments for final salary pension schemes.

4. ...
5. ... Details of approximations made in determining columns 3 and 5 must be given in a note (code 4703). For reinsurance accepted columns 3 and 5 are nil.

...

...

Instructions for completion of Form 48

1. ...

Line 19.1 must equal line 19.2.

Line 29.1 must equal line 29.2.

Line 19.1 + 29.1 must equal Form 13.89.1 – 13.58.1 – 13.59.1.

2. *Collective investment schemes* (in line 13.43) and collective investment pools (in line 13.49) must be allocated in column 1 to line 18 or 28. In column 2 they must be allocated according to the underlying assets, but holdings of a type of asset within a collective investment scheme or pool of less than 5% of the assets for that collective investment scheme or pool may be grouped with the main type of underlying asset for that collective investment scheme or pool. An amount of collective investment scheme and collective investment pool assets not exceeding 1% of the total non-linked assets may be reallocated from column 1 to column 2 based on the stated investment objective instead of the actual underlying assets at the valuation date.
3. *Equity Shares* (lines 21, 23, 25 and 27 of Form 13) must be allocated in column 2 to lines 11, 15, 16, 21, 25 or 26 as appropriate if the undertaking is principally a holding company for ~~equity~~ *equity shares* or property. An amount of unlisted equity shares not exceeding 1% of the total non-linked assets may be reallocated from column 1 to column 2 based on the stated investment objective instead of the actual underlying assets at the valuation date.

...

10. ... Where *securities* may be redeemed over a period at the option of the guarantor or the issuer, ~~they must be classified~~ the yield must be determined on the assumption that they will be redeemed at the latest possible date implied by the market valuation. ~~or, if it is assumed that they will be redeemed at any earlier date, a~~ If these securities represent more than 1% of fixed and variable interest assets (Form 49 line 61) a supplementary note (code 4803) must be provided explaining how the assumed redemption date was determined and stating the value of these assets ~~what assumption has been made.~~ ...

...

...

Instructions for completion of Form 49

...

7. Other fixed interest securities held in *collective investment schemes* may be allocated to line 38 provided their value does not exceed 1% of the amount in line 39.

...

Instructions for completion of Form 50

...

5. Separate Forms must be completed for the total business and each subfund.

...

Instructions for completion of Forms 51, 52, 53 and 54

1. ...
2. Information must be shown separately for each type of *insurance business* for each of the following:
 - (a) UK life (~~'UKL'~~);
 - (b) UK pension (~~'UKP'~~); and
 - (c) overseas (~~'OS'~~).

Overseas business may, at the discretion of the insurer, be subdivided by state or territory.

3. The information must be shown separately for each source of business for each type of *insurance business* in the sequence specified below:
 - (a) *gross insurance business* (~~'GR'~~);
 - (b) *reinsurance ceded* which is external to the *insurance group* (~~'RE'~~); and
 - (c) *reinsurance ceded* which is ~~from~~ to another member of within the *insurance group* (~~'RG'~~).

...

6. ... For business without such records, the number of group schemes, divided analysed by the *product code*, must be set out in a supplementary note (codes 5101-5401). ...
7. To avoid double counting, if all the premiums in the plan are invested in the *with-profits fund*, a member of a plan offering a choice of funds may be treated as contributing to column 3 for unitised with-profits business. For *policies* with protection rider benefits, the entry in column 3 must be for the main benefit in the plan. A plan must only contribute once to column 3 in Forms 51-54. The total of *premiums* for the plan shown in Forms 51-54 must equal the total *premiums* for the plan. For plans where the *policyholder* has the option for *premiums* to be invested in both with-profits and internal linked funds, the preferred presentation is as follows. If all the *premiums* are invested in with-profits units and the plan is written in the *with-profits fund* the contribution to column 3 should be shown in Form 52, otherwise the contribution to column 3 should be shown in Form 53. The entry in column 3 is for the investment element of the plan, and the entry in column 3 for protection rider benefits is nil. The annual *premium* in column 5 should be allocated between Form 52 and Form 53 based on the current *premium* allocation percentages. If all the *premiums* are invested in with-profits units and the plan is written in the *with-profits fund* the protection rider benefits should be shown in Form 52, otherwise the protection rider benefits should be shown in Form 53. Where the protection rider benefits are paid for by cancelling units the entry in column 5 for the riders should be shown as nil, and all the *premiums* for the plan should be reported in column 5 under the *product code(s)* for the investment element.
8. ...
9. For *non-linked contracts* the amount of benefit in column 4 is the current death benefit (excluding any interim and terminal bonus) for assurances, the amount payable on claim for stand-alone critical illness, the annual amount of annuity for deferred annuities and annuities in payment and the annual amount of benefit for income protection and waiver of premium. For *linked long-term contracts* including life assurance, column 4 must be the current amount payable on death.
10. For *property linked long-term contracts*, unitised *with-profits policies* and deposit administration contracts, column 6 must be the current value of the units or fund as presented to the *policy holder*. For *index linked contracts* column 6 must be the index linked liability with no allowance for discounting. The amount in column 7 is the amount in column 6 allowing for any discounting in the valuation. The amount in column 9 is the sum of columns 7 and 8.
- ...
14. Reserves for non-attributable expenses must be included with the appropriate additional reserves product code, i.e. they are not allocated back to and included with reserves at product code level.
- ...

Instructions for completion of Form 55

1. Where the net assets held by the *insurer* for all the *internal linked funds* sharing the same underlying assets for pricing purposes exceed the lesser of £100m and 10% of

the total *internal linked funds* (line 59 of Form 45), with the exception of share index tracker funds, any such *internal linked fund* which is in one of the categories listed in 2 must be reported in Form 55. Where a life fund and a pension fund share the same underlying assets, the fund must be reported for the main life series and the main pension series.

...

5. Column 5 is the annual unit management charge shown to 2 decimal places for the largest series, e.g. 0.75 for an annual charge of 0.75%.
6. Columns 6 and 7 are the prices used to value the unit liabilities. Where there has been a transfer of business during the financial year, the price shown in column 6 is from the previous insurer.
7. Column 8 is $100 \times (\text{column 7} - \text{column 6}) / \text{column 6}$ shown to 2 decimal places, e.g. 20.00 for a 20% increase in unit price during the year.

...

Instructions for completion of Form 56

1. ...
3. For each index link, the sub-total of values in column 2 (excluding those held in respect of any *deposit back arrangement*) must match the sum of the appropriate entries in column 7 of Form 54 net of *reinsurance ceded*. These sub-totals are not shown on Form 56.

4. ...

...

Instructions for completion of Form 57

...

5. The product group in column 1 must be a narrative description of the products included in the line sufficient to give a ~~n~~easy-cross reference to Forms 51-54, e.g. 'UK L&GA WP Form 51 assurances'.

...

9. The insurer must include a supplementary note (code 5701) where negative mathematical reserves on one group of products have been used to offset positive mathematical reserves on another group of products, giving details of the amounts and products involved.

...

...			
Surplus including contingency and other reserves held towards the <u>solvency margin capital requirements</u> (deficiency) (15-21)	29		
...			

...

Instructions for completion of Forms 59A and 59B

...

3. The date of the maturity value, open market option or surrender value is ~~the 1st of the month preceding the date that the submission of the return is due~~ two months and one day after the valuation date, for example 1st March for a 31st December valuation.

...

...

ABSTRACT OF VALUATION REPORT

...

Product range

2. Any significant changes in products during the *financial year* (new products, new bonus series, products withdrawn, changes to options or guarantees under existing products), including product brand names and charging methods, but not the amounts of the charges where these form part of the product terms. A statement for each with-profits subfund categorising that subfund into one of the categories (a), (b), (c) or (d) below:
- (a) open to new with-profits business;
 - (b) open only to new non-profit business;
 - (c) open but was not actively marketing in the previous *financial year*; or
 - (d) closed to new business except by increment.

Discretionary charges and benefits

3. (1) For each accumulating with-profits product where the *insurer* has the option to apply a market value reduction (or equivalent), a statement of the period when this has been applied during the year and a summary of the policy years of entry to which it applied.
- (2) Any changes to premiums on reviewable non-linked protection policies, including for each product affected, the range of the changes (x% to y%), the amount of business affected by a change, and the amount of business where a change was permitted but did not occur at this review date. For yearly renewable term assurance a change means a change in the underlying premium rates.
- (3) ...

...

Valuation basis (other than for special reserves)

...

4.

...

- (6) A table of expense bases used, showing the product group, the basis for the *financial year in question*, and the basis for the previous *financial year*. The table must show zillmer adjustments, expense assumptions for prospective methods where no further premiums are payable, expense assumptions for gross premium valuations of with-profits and non-profit premium paying business and expense assumptions for non-unit liability calculations for linked business, identifying monetary amounts and the percentages of premiums.

Per policy amounts are only required for the following classes:

CWP savings endowment (product code 120)

CWP target cash endowment (125)

CWP pensions (155 / 165)

Term assurance (325 / 330)

Critical illness (340/ 345 / 350/ 355)

Income protection (360 / 365)

Income protection claims in payment (385)

Annuity (400)

UWP bond (500)

UWP savings endowment (510)

UWP target cash endowment (515)

UWP regular premium pension (525 / 545)

UWP single premium pension (525 / 545)

UWP group regular premium pension (535)

UWP group single premium pension (535)

UL bond (700)

UL savings endowment (715)

UL target cash endowment (720)

UL regular premium pension (725)

UL single premium pension (725)

UL group regular premium pension (735)

UL group single premium pension (735).

Where different expense bases apply to variants within the classes shown above in the same subfund, the basis shown must be that applicable to the largest category by number of policies. Where the expense basis varies by subfund, the table is required at subfund level. Expense bases are not required for other products. Where the *insurer* has treated some expenses as non-attributable, the amount to be shown in the table is the attributable expenses.

Expenses must be shown before adjustment for tax relief and the assumed rate of tax relief must be stated.

- (7) A ~~The table must showing~~ the unit growth rates for gross and net linked business before management charges and the inflation rates assumed for future expenses and future increases in *policy* charges. ~~For non-unit liability calculations, the expense bases must be shown only for the main products (e.g. life regular premium, life single premium, pensions regular premium, and pensions single premium).~~

(78) ...

(89) ~~Any other material basis assumptions not stated elsewhere (e.g. persistency).~~ A summary of the lapse, surrender and paid-up assumptions using the format of the table below.

<u>Product</u>		<u>Average lapse / surrender / paid-up rate for the policy years</u>			
		<u>1-5</u>	<u>6-10</u>	<u>11-15</u>	<u>16-20</u>
<u>Level term</u>	<u>lapse</u>				
<u>Decreasing term</u>	<u>lapse</u>				
<u>Accelerated critical illness</u>	<u>lapse</u>				
<u>Income protection</u>	<u>lapse</u>				
<u>CWP savings endowment</u>	<u>surrender</u>				
<u>CWP target cash endowment</u>	<u>surrender</u>				
<u>UWP savings endowment</u>	<u>surrender</u>				
<u>UWP target cash endowment</u>	<u>surrender</u>				
<u>UL savings endowment</u>	<u>surrender</u>				
<u>UL target cash endowment</u>	<u>surrender</u>				
<u>UWP bond</u>	<u>surrender</u>				
<u>UWP bond</u>	<u>automatic withdrawals</u>				
<u>UL bond</u>	<u>surrender</u>				
<u>UL bond</u>	<u>automatic withdrawals</u>				
<u>CWP pension regular premium</u>	<u>PUP</u>				
<u>CWP pension regular premium</u>	<u>surrender</u>				
<u>CWP pension single premium</u>	<u>surrender</u>				
<u>UWP indiv pension regular premium</u>	<u>PUP</u>				
<u>UWP indiv pension regular premium</u>	<u>surrender</u>				
<u>UWP indiv pension single premium</u>	<u>surrender</u>				
<u>UL indiv pension regular premium</u>	<u>PUP</u>				
<u>UL indiv pension regular premium</u>	<u>surrender</u>				
<u>UL group pension regular premium</u>	<u>PUP</u>				
<u>UL group pension regular premium</u>	<u>surrender</u>				
<u>UL indiv pension single premium</u>	<u>surrender</u>				

The insurer's lapse, surrender and paid-up rates must be converted into average annual rates over the 5 year period. A simple arithmetic average of the individual annual rates is acceptable. For example, the figure for the period 6-10 means the average of the lapse rates in policy years 6, 7, 8, 9 and 10. For pension business assume age 40 at entry and retirement at age 65, e.g. 16-20 represents surrenders from age 55 to 60. Surrender rates

exclude additional surrenders at the end of the period where surrender penalties no longer apply. These additional surrenders must be disclosed in a separate note. For automatic bond withdrawals enter 'x% of current' where the current amount of withdrawal is used at policy level.

The distinction between individual and group pension business is the same as in Form 47 instruction 3 to allocate between product codes.

Where the *insurer* uses alternative bases for the same product (e.g. a basis which differentiates by source of business or subdivisions of that product), the lapse rates in an individual cell may be calculated from a basis which is used by at least 50% of the business for that product. In other circumstances an estimated weighted average must be calculated. The basis is not required for cells where the assumption will not apply to any business other than increments, or where the business is reported under a miscellaneous product code.

Where the *insurer* uses lapse rates which vary with calendar year, the rates in the table must be the average of the rates which apply to a policy of exact duration 0, 5, 10 or 15 in the five years following the valuation. A note must be provided explaining how lapse rates vary with calendar year.

Where the *insurer* uses lapse rates which vary according to whether the *mathematical reserves* are positive or negative, the table must show both sets of rates. A note must be provided explaining how the *insurer* determines which set of rates is applied.

The lapse basis is not required for products not shown in the table above. Where no allowance is made for lapses in the valuation, this must be stated.

(10) Any other material basis assumptions not stated elsewhere.

(911) How the valuation of liabilities ...

(12) An estimate in £m of the effect on *mathematical reserves* of specified changes in valuation methodology as at the valuation date arising from changes in *INSPRU* valuation rules effective from 31 December 2006. The effect of the changes must be analysed into the categories below.

Allowance for lapses on valuation of protection business

Allowance for negative reserves on valuation of protection business

Allowance for lapses on valuation of unit-linked business

Allowance for attributable expenses on valuation of unit-linked business

For protection business, the changes are assumed to be applied in the order shown, e.g. the effect of negative reserves is after the effect of lapses.

Options and guarantees

Where the basic reserve exceeds the lesser of £10m ~~or~~ and 1% of the total gross *mathematical reserves*, ...

5. (1) ...
- (2) Guaranteed surrender values and guaranteed unit-linked maturity values, including:
- ...

...

Expense reserves

6. (1) The aggregate amount of expense loadings, grossed up for taxation where appropriate, expected to arise during the 12 months from the ‘valuation date’ from implicit and explicit reserves made at the ‘valuation date’ to meet expenses in fulfilling contracts in force at the ‘valuation date’. Where all expenses for the insurer are attributable, the amounts arising from each of the implicit allowances, explicit allowances for investment expenses and explicit allowances for other maintenance expenses. ~~explicit and implicit allowances, the amount of investment expenses and the amount of any other maintenance expenses.~~ Where the insurer has treated some expenses as non-attributable (INSPRU 1.2.54AG), the insurer must complete the table below. The name of each risk group must be sufficient to identify the products in the group. The penultimate line is for products where all expenses are attributable.

<u>Homogeneous risk group</u>	<u>Implicit allowances</u>	<u>Explicit allowances (investment)</u>	<u>Explicit allowances (other)</u>	<u>Non – attributable expenses</u>	<u>Total</u>
<group 1>					
...					
<u>All expenses attributable</u>				n/a	
<u>Total</u>					

- (2) ...
- (3) ...
- (4) ...
- (5) ...

(6) Where the *insurer* has treated some expenses as non-attributable, details of the method used to calculate the reserve for these expenses and a table showing the reserve for each homogeneous risk group.

...

Reinsurance

9. (1) ...

(2) Where:

(a) the treaty is a 'financing arrangement'; or

...

...

ABSTRACT OF VALUATION REPORT FOR REALISTIC VALUATION

...

With-profits benefits reserve – Retrospective method

4. (1) ...
- (2) ...
- (3) ...
- (4) ...
- (5) ...
- (6) For each *with-profits fund*, a statement ~~of the average~~ (expressed as a percentage) of the ratio of A to B for each of the three *preceding financial years* where:
- A. is the total *claims* paid during the financial year on *with-profits insurance contracts* written in that fund; and
- B. is the sum of:
- (i) *with-profits benefits reserve* for those *claims*; plus
- (ii) any past miscellaneous surplus attributed to the *with-profits benefits reserve* in respect of those *claims*; less
- (iii) any past miscellaneous deficit attributed to the *with-profits benefits reserve* in respect of those *claims*;

Where there has been a change in procedures such that the ratio of A to B would not be directly comparable from year to year ~~with that ratio disclosed at the end of the preceding financial year~~, details should be disclosed as to the change in procedures.

...

Costs of guarantees, options and smoothing

6. (1) ...

- (2) ...
- (3) ...
- (4) ...
- (5) ...
- (6) ~~For material types of product or classes (as identified in 3 above) a statement of the persistency assumptions~~ A summary of the surrender and paid-up assumptions used to determine the costs in (4) (a), (b) and (c) using the format of the table below, and where appropriate a statement of the assumed take-up rates of guaranteed annuity options and the rates of annuitant mortality assumed.

<u>Product</u>		<u>Average surrender / paid-up rate for the policy years</u>			
		<u>1-5</u>	<u>6-10</u>	<u>11-15</u>	<u>16-20</u>
<u>CWP savings endowment</u>	<u>surrender</u>				
<u>CWP target cash endowment</u>	<u>surrender</u>				
<u>UWP savings endowment</u>	<u>surrender</u>				
<u>UWP target cash endowment</u>	<u>surrender</u>				
<u>UWP bond</u>	<u>surrender</u>				
<u>UWP bond</u>	<u>automatic withdrawals</u>				
<u>CWP pension regular premium</u>	<u>PUP</u>				
<u>CWP pension regular premium</u>	<u>surrender</u>				
<u>CWP pension single premium</u>	<u>surrender</u>				
<u>UWP indiv pension regular premium</u>	<u>PUP</u>				
<u>UWP indiv pension regular premium</u>	<u>surrender</u>				
<u>UWP indiv pension single premium</u>	<u>surrender</u>				

The instructions for completing the table are as for Appendix 9.4 paragraph 4(9).

- (7) ...

...

Analysis of change in working capital

13. For each *with-profits fund*, a reconciliation of the significant movements in the working capital of the *with-profits fund* from that shown at line 68 of **Form 19** at the end of the *preceding financial year* and that same entry shown for the

financial year in question. Such movements must at least include investment return, tax, significant costs (of expenses, guarantees or smoothing) and enhancements or charges to retrospective reserve(s) may be grouped by the underlying cause of the movements such as investment market changes and insurance variation. However, the analysis should at least include, where material:

- (a) the investment return on the opening working capital;
- (b) mismatch profits or losses on assets backing the *future policy related liabilities* (may include associated assumption changes);
- (c) assumption changes split by economic, non-economic and *policyholder actions assumptions*;
- (d) other variances split at least as to economic and non-economic variances;
- (e) the impact of new business;
- (f) changes in the other liabilities of lines 47 and 51 of **Form 19**;
- (g) modelling changes and opening adjustments.

Where a closed fund zeroises its working capital (e.g. by assigning any balance to planned enhancements or financial reinsurance), it should analyse the change in working capital prior to such zeroisation showing the opening and closing zeroisation impacts.

...

APPENDIX 9.5 (rule 9.32)

**GENERAL INSURANCE BUSINESS
ADDITIONAL INFORMATION ON BUSINESS CEDED**

For the purposes of rule 9.32, an *insurer* which carries on *general insurance business* must, in respect of the *financial year in question*, prepare a statement of the following information.

...

5. For each *combined category* (other than *category numbers* 500 and 600) and *risk category* with *category numbers* 160, 350, 400, 510 to 590, and 610 to 690 and 700, and separately for contracts of facultative and non-facultative *reinsurance ceded* in respect of the *financial year in question* the amount of the *reinsurers' share of gross premiums* must be stated.

...

...

APPENDIX 9.10 (rule 9.44 to guidance 9.45)

ENHANCED CAPITAL REQUIREMENT

(FORM ECR1)

ECR Calculation - Summary

Name of insurer

Financial year ended

		£000	Source:
Capital Resources	<u>1</u>		Form:1 Line:13 Col:1
Individual Minimum Capital Requirement (MCR)	<u>2</u>		Form:1 Line:34 Col:1

ECR Calculation

Asset Charge	<u>3</u>		Sheet 2: Asset-related Capital Requirement
Premium Charge - Accident Year Business	<u>4</u>		Sheet 3: Insurance-related Capital Requirement Accident Year <u>Business Charge</u>
Technical Provision Charge - Accident Year Business	<u>5</u>		Sheet 3: Insurance-related Capital Requirement Accident Year <u>Business Charge</u>
Premium Charge - Underwriting Year Business	<u>6</u>		Sheet 4: Insurance-related Capital Requirement Underwriting Year <u>Business Charge</u>
Technical Provision Charge - Underwriting Year Business	<u>7</u>		Sheet 4: Insurance-related Capital Requirement Underwriting Year <u>Business Charge</u>
Less Claims Equalisation Provisions Reserve	<u>8</u>		Form:15 Line:14+15 Col:1

ECR (3+4+5+6+7-8)	<u>9</u>	
ECR gross of Equalisation Provisions (3+4+5+6+7)	<u>10</u>	
ICG (if given)	<u>11</u>	
Capital Resources / ECR (1 / 9)	<u>12</u>	
Capital Resources plus Equalisation Provisions / ICG ([1+8] / 11, if ICG given)	<u>13</u>	
ICG / ECR gross of Equalisation Provisions (11 / 10, if ICG given)	<u>14</u>	

Asset-Related Capital Requirement (Category of assets 1 only)

Name of insurer
Financial Year ended

Asset item	FSA return source (Form13 Column 1)	Assets (£ 000)	Derivative adjustment (£ 000)	Asset-related capital charge factor	Asset-related capital charge (£ 000)
		(1)	(2)	(3)	Max [0, (1)+(2)] * (3) (4)
Land & buildings	L11			7.5%	
Shares in group undertakings excluding participating interests - insurance dependants	L21+23			0.0%	
Shares in group undertakings excluding participating interests - other	L25+27			7.5%	
Debt securities issued by & loans to group undertakings	L22+L24+L26+L28			3.5%	
Participating interests	L29			7.5%	
Debt securities issued by & loans to undertakings in which the insurer has a participating interest	L30			3.5%	
Shares, other variable-yield securities, units in unit trusts and Participation in investment pools	L41+L42+L43+L49			16.0%	
Money market funds				0.0%	
Debt securities and other fixed income securities: approved securities	L45+L47			3.5%	
Debt securities and other fixed income securities: other	L46+L48			3.5%	
Loans secured by mortgages	L50			2.5%	
Other loans	L51+L52+L53			2.5%	
Deposits with approved credit institutions and approved financial institutions	L54+L55			0.0%	
Other financial investments: other	L56+L58+L59			7.5%	
Deposits with ceding undertakings	L57			3.5%	
Reinsurers' share of technical provisions: Provision for unearned premiums	L60			2.5%	
Reinsurers' share of technical provisions: Claims outstanding	L61			2.5%	
Reinsurers' share of technical provisions: Other	L62+63			2.5%	
Debtors arising out of direct insurance operations: policyholders	L71			4.5%	
Debtors arising out of direct insurance operations: intermediaries	L72			3.5%	
Debtors arising out of reinsurance operations	L74+L75			2.5%	
Other debtors	L73+L76+L77+L78+L79			1.5%	
Tangible assets	L80			7.5%	
Cash at bank and in hand	L81+L82			0.0%	
Other Assets	L83			0.0%	
Accrued interest and rent	L84			0.0%	
Deferred acquisition costs	L85			0.0%	
Other prepayments and accrued income	L86			0.0%	
TOTAL	L89+L87-L44				

Insurance-Related Capital Requirement Charge - Accident Year Business

Name of insurer

Financial year ended

FSA Combined Category or Risk Category	Net Written Premium (£ 000)		Net claims outstanding carried forward (£ 000)		Net unearned premium and unexpired risks less deferred acquisition costs (£ 000)		Net Written Premium capital charge factor	Net technical provision capital charge factor	Net Written Premium capital charge	Net Technical provision capital charge	
	FSA return source	1	FSA return source	2	FSA return source	3	4	5	Max[0,(1)] *(4)	Max[0,(2)+(3)] *(5)	
Direct and facultative business											
110: Total primary (direct) and facultative accident and health	1						5.0%	7.5%			
120: Total primary (direct) and facultative personal lines motor business	2						10.0%	9.0%			
160: Primary (direct) and facultative household and domestic all risks	3						10.0%	10.0%			
180: Total primary (direct) and facultative personal lines financial loss business	4	Form21 . Lines(11+12+ 13+14+ 15). Column s(5+6)					25.0%	14.0%			
220: Total primary (direct) and facultative commercial motor business	5						10.0%	9.0%			
260: Total primary (direct) and facultative commercial lines property business	6						10.0%	10.0%			
270: Total primary (direct) and facultative commercial lines liability business	7						14.0%	14.0%			
280: Total primary (direct) and facultative commercial lines financial loss business	8						25.0%	14.0%			
330: Total primary (direct) and facultative aviation business	9						32.0%	14.0%			
340: Total primary (direct) and facultative marine business	10						22.0%	17.0%			
350: Primary (direct) and facultative goods in transit	11						12.0%	14.0%			
400: Miscellaneous primary (direct) and facultative business	12						25.0%	14.0%			
002: Total primary (direct) and facultative business (sum of lines 1 to 12)	13										
Treaty reinsurance business											
510: Non-proportional accident and health	14		N/A					35.0%	16.0%		
520: Non-proportional motor	15							10.0%	14.0%		
530: Non-proportional aviation	16						61.0%	16.0%			
540: Non-proportional marine	17						38.0%	17.0%			
550: Non-proportional transport	18						16.0%	15.0%			
560: Non-proportional property	19						53.0%	12.0%			
570: Non-proportional liability (non-motor)	20						14.0%	14.0%			
580: Non-proportional financial lines	21						39.0%	14.0%			
590: Non-proportional aggregate cover	22						53.0%	12.0%			
500: Total Non-Proportional Treaty Reinsurance Treaty Business accepted (sum of lines 14 to 22)	23	F21L(1 1+ 12+13+ 14+15) C(5+6)			F22L(13 +14+17+ 18)C3		F21L19C 6+F22L(19-29)C3				
610: Proportional accident and health	24	N/A					12.0%	16.0%			
620: Proportional motor	25						10.0%	12.0%			
630: Proportional aviation	26						33.0%	16.0%			
640: Proportional marine	27						22.0%	17.0%			
650: Proportional transport	28						12.0%	15.0%			
660: Proportional property	29						23.0%	12.0%			
670: Proportional liability (non-motor)	30						14.0%	14.0%			
680: Proportional financial lines	31						25.0%	14.0%			
690: Proportional aggregate cover	32						23.0%	12.0%			
600: Total Proportional Treaty Reinsurance Treaty Business accepted (sum of lines 24 to 32)	33		F21L(1 1+ 12+13+ 14+15) C(5+6)		F22L(13 +14+17+ 18)C3		F21L19C 6+F22L(19-29)C3				
700: Miscellaneous treaty reinsurance business accepted	34	N/A		N/A		N/A	39.0%	14.0%			

003: Total treaty reinsurance business (sum of lines 14 to 22, 24 to 32 and 34)	35	F21L(1 1+ 12+13+ 14+15) C(5+6)		F22L(13 +14+17+ 18)C3		F21L19C 6+F22L(19-29)C3					
001: Total Business (sum of lines 1 to 12, 14 to 22, 24 to 32 and 34)	36	F21L(1 1+ 12+13+ 14+15) C(5+6)		F22L(13 +14+17+ 18)C3		F21L19C 6+F22L(19-29)C3					

Insurance-Related Capital Requirement Charge - Underwriting Year Business

Name of insurer
Financial year ended

FSA Combined Category or Risk Category		Net Written Premium (£ 000)		Net claims outstanding carried forward (£ 000)		Net unearned premium and unexpired risks (£ 000)		Net Written Premium capital charge factor	Net technical provision capital charge factor	Net Written Premium capital charge Max[0,(1)] *(4)	Net Technical provision capital charge Max[0,(2)+(3)] *(5)		
		FSA return source	1	FSA return source	2	FSA return source	3					4	5	6	7
Direct and facultative business													
110: Total primary (direct) and facultative accident and health	1	Form 24. Line 19. Column 99		Form 25. Lines(11-12+13-14+15). Column 99		Form 25. Lines (22+23-24). Column 99		5.0%	7.5%				
120: Total primary (direct) and facultative personal lines motor business	2									10.0%	9.0%		
160: Primary (direct) and facultative household and domestic all risks	3									10.0%	10.0%		
180: Total primary (direct) and facultative personal lines financial loss business	4									25.0%	14.0%		
220: Total primary (direct) and facultative commercial motor business	5									10.0%	9.0%		
260: Total primary (direct) and facultative commercial lines property business	6									10.0%	10.0%		
270: Total primary (direct) and facultative commercial lines liability business	7									14.0%	14.0%		
280: Total primary (direct) and facultative commercial lines financial loss business	8									25.0%	14.0%		
330: total primary (direct) and facultative aviation business	9									32.0%	14.0%		
340: Total primary (direct) and facultative marine business	10									22.0%	17.0%		
350: Primary (direct) and facultative goods in transit	11									12.0%	14.0%		
400: Miscellaneous primary (direct) and facultative business	12									25.0%	14.0%		
002: Total Primary (Direct) and Facultative Business (sum of lines 1 to 12)	13												
Treaty reinsurance business													
510: Non-proportional accident and health	14	Form 28. Line 19. Column 99		Form 29. Lines (11-12+13-14+15). Column 99		Form 29. Lines (22+23-24). Column 99		35.0%	16.0%				
520: Non-proportional motor	15									10.0%	14.0%		
530: Non-proportional aviation	16									61.0%	16.0%		
540: Non-proportional marine	17									38.0%	17.0%		
550: Non-proportional transport	18									16.0%	15.0%		
560: Non-proportional property	19									53.0%	12.0%		
570: Non-proportional liability (non-motor)	20									14.0%	14.0%		
580: Non-proportional financial lines	21									39.0%	14.0%		
590: Non-proportional aggregate cover	22									53.0%	12.0%		
500: Total Non-Proportional Treaty Reinsurance Treaty Business accepted (sum of lines 14 to 22)	23	F24L19C99		F25L(11-12+13-14+15)C99		F25L(22+23-24)C99							
610: Proportional accident and health	24	Form 28. Line 19. Column 99		Form 29. Lines (11-12+13-14+15). Column 99		Form 29. Lines (22+23-24). Column 99		12.0%	16.0%				
620: Proportional motor	25									10.0%	12.0%		
630: Proportional aviation	26									33.0%	16.0%		
640: Proportional marine	27									22.0%	17.0%		
650: Proportional transport	28									12.0%	15.0%		
660: Proportional property	29									23.0%	12.0%		
670: Proportional liability (non-motor)	30									14.0%	14.0%		
680: Proportional financial lines	31									25.0%	14.0%		
690: Proportional aggregate cover	32									23.0%	12.0%		
600: Total Proportional Treaty Reinsurance Treaty Business accepted (sum of lines 24 to 32)	33	F24L19C99		F25L(11-12+13-14+15)C99		F25L(22+23-24)C99							
700: Miscellaneous treaty reinsurance business accepted	34	F28L19C99		F29L(11-12+13-14+15)C99		F29L(22+23-24)		39.0%	14.0%				
003: Total Treaty Reinsurance Business (sum of lines 14 to 22, 24 to 32 and 34)	35	F24L19C99		F25L(11-12+13-14+15)C99		F25L(22+23-24)C99							
001: Total Business (sum of lines 1 to 12, 14 to 22, 24 to 32 and 34)	36	F24L19C99		F25L(11-12+13-14+15)C99		F25L(22+23-24)C99							

Instructions for completion of Form ECR1

...

ECR Calculation – Summary (Sheet 1)

2. The amount shown on the ICG line must be the most recent Individual Capital Guidance (ICG) amount given by the FSA. The ICG will usually be based on a percentage of the ECR gross of Equalisation Provisions. In this case the percentage should be applied to the current ECR gross of Equalisation Provisions to obtain the ICG amount. If no ICG has been given, enter "N/A".
- 2A. If ICG is based on a percentage of the ECR gross of Equalisation Provisions and that percentage is different to the ratio that appears on line 14, an explanation for the difference must be provided in a supplementary note.

Asset-related Capital Requirement Sheet (Sheet 2)

...

7. ...
- 7A. To give effect to *INSPRU 2.2.11R (2)*, the asset related capital charge shown in column 4 is the asset related capital charge factor in column 3 multiplied by the higher of:
 - (a) the sum of columns 1 and 2; and
 - (b) zero.

Insurance-related Capital Requirement - Accident and Underwriting Year Accounted Business (Sheets 3-4)

...

10. ...
- 10A. To give effect to *INSPRU 1.1.77R (2)*, the amount derived in the "Net Written Premium capital charge" column is the net-written premium capital charge factor in column 4 multiplied by the higher of:
 - (a) the net written premium in column 1; and
 - (b) zero.
11. To give effect to *INSPRU 1.1.77 R (2)*, the amount derived in the "Net technical provision capital charge" column is the net technical provision capital charge factor in column 5 multiplied by the higher of:
 - (a) the sum of the net claims outstanding carried forward and the net unearned premium less deferred acquisition costs; and
 - (b) zero.

...

HANDBOOK ADMINISTRATION (NO 4) INSTRUMENT 2006**Powers exercised**

- A. The Financial Services Authority makes this instrument in the exercise of the powers and related provisions listed in Schedule 4 to the General Provisions (Powers exercised) of the Handbook.
- B. The rule-making powers referred to above are specified for the purpose of section 153(2) (Rule-making instruments) of the Financial Services and Markets Act 2000.

Commencement

- C. This instrument comes into force as follows:
- (1) the amendments in Annex I come into force on 22 December 2006;
 - (2) Annex B, Parts 1 and 3, come into force on 31 December 2006 and Part 2 comes into force on 1 January 2007;
 - (3) the amendments in Annex D come into force on 31 December 2006;
 - (4) Annex J Part 2A comes into force on 31 December 2006. Parts 1B and 2B and Annex L come into force on 1 January 2007;
 - (5) the amendments in Annexes A, C, E, G, and H come into force on 1 January 2007;
 - (6) the amendments in Annex F come into force on 6 January 2007; and
 - (7) the amendments in Annexes K and L come into force on 6 April 2007.

Amendments to the Handbook

- D. The modules of the FSA Handbook of rules and guidance listed in column (1) below are amended in accordance with the Annexes to this instrument listed in column (2).

(1)	(2)
Glossary of definitions	Annex A
General Prudential sourcebook (GENPRU)	Annex B
Prudential sourcebook for Banks, Building Societies and Investment Firms (BIPRU)	Annex C
Prudential sourcebook for Insurers (INSPRU)	Annex D
Prudential sourcebook for UCITS Firms (UPRU)	Annex E
Interim Prudential sourcebook for Investment Businesses (IPRU(INV))	Annex F
Collective Investment Schemes sourcebook (CIS)	Annex G
New Collective Investment Schemes sourcebook (COLL)	Annex H

Amendments to FSA Instruments

- E. The General Prudential sourcebook Instrument 2006 (FSA 2006/40) is amended in accordance with Annex I to this instrument.

- F. The CRD (Consequential Amendments) Instrument 2006 (FSA 2006/53) is amended as follows:
- (1) Annex A, Amendments to the Glossary; and
 - (2) Annex L, Amendments to the Supervision manual are amended in accordance with Annex J to this instrument.
- G. Annex G of the Home Reversion and Home Purchase Activities (Consequential Amendments to the Handbook) Instrument 2006 (FSA 2006/37) is amended in accordance with Annex K to this instrument.
- H. Annex A of the Mortgages: Conduct of Business Sourcebook (Home Reversion and Home Purchase Activities) Instrument 2006 (FSA 2006/45) is amended in accordance with Annex L to this instrument.

Citation

- I. This instrument may be cited as the Handbook Administration (No 4) Instrument 2006.

By order of the Board
21 December 2006

Annex A

Amendments to the Glossary of definitions

Insert the following new definitions in the appropriate alphabetical position in the Glossary.

CAD

Capital Adequacy Directive

*Capital Requirements
Regulations 2006*

the Capital Requirements Regulations 2006 (SI 2006/3221).

Annex B

Amendments to the General Prudential sourcebook (GENPRU)

In this Annex, underlining indicates new text and striking through indicates deleted text. The changes detailed in Part 1 and Part 3 to this Annex take effect on 31 December 2006 and those detailed in Part 2 take effect on 1 January 2007.

Part 1

Amend GENPRU TP 8 (Miscellaneous capital resources definitions for BIPRU firms) as follows:

...

Specific issues of TONS and other securities

8.4 R ...

8.5 R The issues of *securities* referred to in *GENPRU* TP 8.4R are as follows:

(1) ...

...

(5) Lloyds TSB ~~\$850m~~ \$1000m 6.90% perpetual capital securities; and

(6) ...

Amend GENPRU 1.2 as follows:

...

1.2.30 R A *firm* must have in place sound, effective and complete processes, strategies and systems:

(1) ...

that enable it to identify and manage the major sources of risks referred to in (1), including the major sources of risk in each of the

(2) following categories ~~where they are relevant to the *firm* given the nature and scale of its business~~ where they are relevant to the *firm* given the nature and scale of its business:

(a) ...

...

1.2.81 G ...

~~1.8.82~~ G ...

1.2.82

1.2.83 G ...

Amend GENPRU 1.3 as follows:

- 1.3.6 G In particular, unless an exception applies, *GENPRU* 1.3.4R should be applied for the purposes of *GENPRU*, *BIPRU* and *INSPRU* to determine how to account for:
- ...
- (4) assets transferred or received under a ~~sale and repurchase~~ sale and repurchase or *stock lending* transaction; and
- (5) ...
- ...
- 1.3.43 R *GENPRU* 1.3.13R and *GENPRU* 1.3.41R do not apply to *shares* in, and ~~debts~~ debts due from a *related undertaking* that is: ...
- ...
- 1.3.44 G The effect of *GENPRU* 1.3.43R is that *shares* in, and ~~debts~~ debts due from, *related undertakings* of the types referred to are not valued on a mark to market basis by *insurers*. As a result, ~~debts~~ debts due from these *undertakings*, and ...
- 1.3.45 R Except where the contrary is expressly stated in *GENPRU*, whenever a ~~rule~~ rule in *GENPRU* or *INSPRU* refers to *shares* held in, and ~~debts~~ debts due from, an *undertaking* referred to in *GENPRU* 1.3.43R(1) or *GENPRU* 1.3.43R(3), a *firm* must value the *shares* held in accordance with *GENPRU* 1.3.47R.
- 1.3.46 R In relation to *shares* in, and ~~debts~~ debts due from, an *undertaking* referred to in *GENPRU* 1.3.43R(1), ...

Part 2

Amend GENPRU 2.2 as follows:

Limits on the use of different kinds of capital: Combined tier two and tier three limits (BIPRU firm only)

- 2.2.49 R For the purpose of meeting the requirements in *GENPRU* 2.2.47R(1) to (3) and subject to *GENPRU* 2.2.50R, a *BIPRU firm* must not include any item in either:
- (1) its *tier two capital resources* falling within *GENPRU* 2.2.47R(6) (excess *tier two capital*) ; or
- (2) its *upper tier three capital resources*;
- to the extent that the sum of (1) and (2) would exceed 250% of the amount resulting from the following calculation:
- (3) calculate the amount at stage F of the calculation in the *capital resources table* (Total tier one capital after deductions); and
- (4) deduct from (3) those parts of the *firm's tier one capital* used to meet the requirements in *GENPRU* 2.2.44R(1) and (2) as established by *GENPRU* 2.2.48R.

...

Example of how the capital resources calculation for BIPRU firms works

- 2.2.51 G *GENPRU 2.2.52G to GENPRU 2.2.59G illustrate how to calculate a BIPRU firm's capital resources and how the capital resources gearing rules work. In this example the BIPRU firm has a combined credit, operational and counterparty risk requirement of £100 (of which £10 is due to counterparty risk) and a market risk requirement of £90, making a total capital requirement of £190. Its capital resources are as set out in the table in GENPRU 2.2.52G.*
- 2.2.55 G *The combined credit, operational and counterparty risk capital requirement is deducted after stage N of the capital resources table and the market risk requirement following stage T of the capital resources table. These calculations are shown in the table in GENPRU 2.2.56G.*
- 2.2.56 G *Table: Example of how capital resources of a BIPRU firm are measured against its capital resources requirement*

This table belongs to *GENPRU 2.2.55G*

Description of the stage of the capital resources calculation	Stage in the <i>capital resources table</i>	Amount (£)
Total <i>tier one capital and tier two capital</i> after deductions	Stage N	140
Credit, <u>operational and counterparty</u> risk requirement		(100)
<i>Tier one capital and tier two capital</i> available to meet market risk requirement		40
<i>Tier three capital</i>	Stage Q	50
Total capital available to meet market risk requirement		90
Market risk requirement		(90)
Market risk requirement met subject to meeting gearing limit set out in <i>GENPRU 2.2.49R</i> – see <i>GENPRU 2.2.57G</i>		

- 2.2.57 G The gearing limit in *GENPRU 2.2.49* (Combined tier two and tier three limits) requires that the *upper tier three capital* used to meet the market risk requirement does not exceed 250% of the relevant tier one capital ~~used to meet market risk~~.
- 2.2.58 G In this example it is assumed that the maximum possible amount of *tier one capital* is carried forward to meet the market risk requirement. There are other options as to the allocation of *tier one capital* and *tier two capital* to the credit, operational and counterparty risk requirement.

In order to calculate the relevant tier one capital for the upper tier three gearing limit in accordance with GENPRU 2.2.49R it is first necessary to allocate tier one capital and tier two capital to the individual credit, operational and counterparty risk requirements. This allocation process underlies the calculation of the overall amount referred to in GENPRU 2.2.48R. The calculation in GENPRU 2.2.49R (3) and (4) then focuses on the tier one element of this earlier calculation.

In this worked example, if it is assumed that the counterparty risk requirement has been met by tier one capital, the relevant tier one capital for gearing is £50. This is because the deductions of £20 and the credit and operational risk requirements of £90 have been met by tier two capital in the first instance. However, the total sum of deductions and credit and operational risk requirements exceed the tier two capital amount of £80 by £30. Hence the £80 of tier one capital has been reduced by £30 to leave £50.

In practical terms, the same result is achieved for the relevant tier one capital for gearing by taking the amount carried forward to meet market risk of £40 and adding back the £10 in respect of the counterparty risk requirement. Again, there are other options as to the allocation to credit, operational and counterparty risk of the constituent elements of Stage N of the capital resources table. Therefore in this example the various tiers of capital resources are applied to meet the market risk requirement

The outcome of these calculations can be summarised as follows:

- (1) The relevant tier one capital ~~used to meet market risk~~ for the gearing calculation is £50~~40~~;
- (2) 250% of the relevant tier one capital ~~used to meet market risk~~ is £12500;
and
- (3) the *upper tier three capital* used to meet market risk is £50.

- 2.2.59 G The 250% gearing limit is met as the limit of £12500 is greater than the *upper tier three capital* of £50 used in this example.

...

Part 3

Amend GENPRU 2.2 as follows:

2.2.64 R The conditions that an item of capital of a *firm* must comply with under *GENPRU* 2.2.62R(3) (2) are as follows: ...

...

Step-ups and redeemable tier one instruments

2.2.76 R In relation to an *innovative tier one instrument* or a *PIBS* which is redeemable and which satisfies ~~any of~~ the following conditions:

(1) it is or may become subject to a *step-up*; ~~or~~ and

(2) a reasonable *person* would think that:

(a) the *firm* is likely to redeem it before the tenth anniversary of its date of issue; or

(b) the *firm* is likely to have an economic incentive to redeem it before the tenth anniversary of its date of issue;

the redemption date in *GENPRU* 2.2.70R(2)(a) is amended by replacing "fifth anniversary" with "tenth anniversary".

...

2.2.229 R A loan is also *connected lending of a capital nature* if:

(1) it funds directly or indirectly a loan to a connected party of the *bank* falling into ~~*GENPRU* 2.2.229R~~ *GENPRU* 2.2.228R or an investment in the capital of a connected party of the *bank*; and

(2) ...

Amend *GENPRU* 2 Annex 7R as follows:

2 Annex 7R Admissible assets in insurance

...

1 Investments that are, or amounts arising from the disposal of:

...

(f) an *approved derivative* or *quasi-derivative* transaction that satisfies the conditions in *INSPRU* 3.2.5R or an *approved stock lending transaction* ~~transaction~~ transaction that satisfies the conditions in *INSPRU* 3.2.36R.

2 Debts and claims:

...

(c) debts owed by *policyholders* and ~~*intermediaries*~~ intermediaries arising out of direct and *reinsurance* operations (except where overdue for more than 3 months and other than *commission* prepaid to agents or ~~*intermediaries*~~ intermediaries);

Annex C

Amendments to the Prudential sourcebook for Banks, Building Societies and Investment Firms (BIPRU)

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

Amend BIPRU TP 10 (Pre CRD capital requirements applying on a consolidated basis during 2007) as follows:

...

- 10.14 R (1) ...
- (2) The list in *BIPRU* 8 Ann 6R (List of equivalent third country regulators) does not apply and instead:
- (a) if the *UK consolidation group* or *non-EEA sub-group* is a banking group or building society group as defined in *BIPRU* TP 1.7R (Classification of groups for certain consolidation rules), the lists in ~~Appendix~~ Appendices C and D of chapter CS of *IPRU(BANK)* ~~applies~~ apply; and
- (b) if the *UK consolidation group* or *non-EEA sub-group* is an investment firm group as defined in *BIPRU* TP 1.7R, the list in ~~Appendix 57~~ 59 of chapter 10 of *IPRU(INV)* applies.
- (3) ...
- ...

Amend BIPRU 1.2 (Definition of the trading book) as follows:

...

- 1.2.22 R ...
- ~~1.1.23~~ R ...
- 1.2.23
- 1.2.24 R

Amend BIPRU 1.3 (Applications for advanced approaches) as follows:

...

- 1.3.2 G (2) A *firm* should apply for a *waiver* if it wants to:
- ...
- (e) apply the treatment in *BIPRU* 10.89 (~~Exemption from limits in *BIPRU* 10.5 for concentration risk counterparty~~ Wider integrated groups waiver).

...

- 1.3.13 D Subject to *BIPRU* 1.3.14D to ~~*BIPRU* 1.3.21D~~ 1.3.20D, if a *firm*...

...

BIPRU Annex 1D

Application form to apply the advanced management approach

~~[link to be added]~~ http://www.fsa.gov.uk/pubs/international/app_pack_ama.pdf

BIPRU Annex 2D

Application form to apply the IRB approach

~~[link to be added]~~ http://www.fsa.gov.uk/pubs/international/app_pack_irb.pdf

BIPRU Annex 3D

Application form to apply the CCR internal model method approach

~~[link to be added]~~ http://www.fsa.gov.uk/pubs/international/app_pack_imm.pdf

Amend BIPRU 2.2.47G as follows:

- 2.2.47 G In considering if there are any systems and control weaknesses and their effect on the adequacy of the *CRR*, a *firm* should be able to demonstrate to the *FSA* that all the issues identified in *SYSC 3.2* (~~Areas covered by systems and controls~~) have been considered and that appropriate plans and procedures exist to deal adequately with adverse scenarios.

Amend BIPRU 2.3.4G as follows:

- 2.3.4 G *BIPRU 2.3* sets out more detail on how the systems and controls requirements in *SYSC 3* (~~Systems and controls~~) and *GENPRU 1.2.30R* (Processes, strategies and systems for risks) and the requirements about stress and scenario testing in *GENPRU 1.2.36R* apply to interest rate risk in the *non-trading book*.

Amend BIPRU 2.3.8G as follows:

- 2.3.8 G A *firm* should, under *BIPRU 2.3.8R(2)* ~~2.3.8R(2)~~ *2.3.7R(2)*, apply a 200 basis point shock ...

Amend BIPRU 3.2.9R as follows:

- 3.2.9 R A *firm* must assign each *exposure* to one of the following *exposure* classes:
...
(7) claims or contingent claims on ~~corporates~~ corporates;
...
(14) short-term claims on *institutions* and ~~corporates~~ corporates;
...

Amend BIPRU 3.4 as follows:

- ...
3.4.82 G (1) ...
(2) ...

~~(2)~~
(3) ...

...
3.4.100 G The application of *BIPRU* 3.4.96R and *BIPRU* 3.4.99R may be illustrated on the basis of a £110,000 loan on a property valued at £100,000, where £80,000 of the loan is secured and £30,000 of the exposure is unsecured and provisions of £20,000 are taken:
(1) Option 1 ...:
...
(c) the *risk weight* to be applied to the unsecured *exposure* of £30,000 is ~~50%~~150%;

Amend *BIPRU* 3.6.1R as follows:

3.6.1 R The use of *ECAI* credit assessments for the calculation of a *firm's risk weighted exposure amounts* must be consistent and in accordance with *BIPRU* 3.56. Credit assessments must not be used selectively.

Amend *BIPRU* 4.2.7 as follows:

4.2.7	G	(1)	This paragraph provides <i>guidance</i> on <i>BIPRU</i> 4.2.2R and in particular <i>BIPRU</i> 4.2.2R(2).
		(2)	The <i>IRB approach</i> as applicable to a <i>firm</i> should be an integral part of its business and risk management processes and procedures to the extent that credit risk is relevant to them. It should also have a substantial influence on its decision-making and actions. In particular, the FSA would expect a firm to have regard to the following areas
		(a)	particular regard should be had to the use of the <i>IRB approach</i> in: (i) credit approval; (ii) individual and portfolio limit setting; (iii) reporting of credit risk information; and (iv) provisioning; and (v) the setting and use of the significant criteria by reference to which other decisions to incur or maintain credit risk are taken or by reference to which credit risk is otherwise assessed;
		(b)	other relevant aspects include assessment of : (v i) assessment of economic capital; (v ii) internal capital allocation so far as related to credit risk; (v iii) risk appetite; (i xv) strategy and acquisitions; (x v) profitability and performance; and (x vi) performance-related remuneration;
			...

Remove underlining and amend *BIPRU* 4.3.97G as follows:

- 4.3.97 G If a firm excludes *defaulted exposures* that have been cured (as referred to in *BIPRU 4.3.71R*) or restructured (as referred to in *BIPRU 4.3.63R(5)*) from estimates of *LGD* in accordance with *BIPRU 4.3.100G*, it may also exclude cures from estimates of *PD* for these ~~exposures~~ exposures.

Amend *BIPRU 4.4.67R(6)* as follows:

- Calculations: maturity
- 4.4.67 R ...
- (6) Notwithstanding (7), a firm that uses a *CCR internal model method* model to calculate a ~~one-sided credit valuation adjustment~~ one-sided credit valuation adjustment (*CVA*) may use the effective credit duration estimated by the model as *M* if permitted to do so by its *CCR internal model method permission*.
- ...

Amend *BIPRU 4.4.85R(1)(b)* as follows:

- 4.4.85 R To be eligible for the treatment set out in *BIPRU 4.4.79R*, credit protection deriving from a guarantee or credit derivative must meet the following conditions:
- (1) the underlying obligation must be to:
- (a) ...
- (b) an *exposure* to a regional government, local authority or *public sector entity* which is not treated as an *exposure* to a central government or a ~~central bank~~ central bank according to *BIPRU 4.4.2R*; or
- ...

Amend *BIPRU 4.10.36R(3)* as follows:

- 4.10.36 R (3) $LG D^* = LG D \times (E^*/E)$ where:
- (a) ...
- (b) *E* is the *exposure* value as calculated under ~~*BIPRU 4.5.X*~~ ~~*[provision implementing paragraph 34 of Part 3 of Annex VIII of the Banking Consolidation Directive]*~~; and
- (c) *E** is as calculated under ~~*BIPRU 5.X-5.4.28R(3)*~~ ~~*[provision implementing paragraph 34 of Part 3 of Annex VIII of the Banking Consolidation Directive]*~~ (Calculation of adjusted values under the financial collateral comprehensive method).

Amend *BIPRU 4.10.41R* as follows:

- 4.10.41 R The requirements in *BIPRU 4.10.40R(2)* and ~~*BIPRU 4.10.42R*~~ ~~*-BIPRU 4.10.48R*~~ do not apply for guarantees provided by *institutions* and central governments and ~~central banks~~ central banks if the firm has received approval under *BIPRU 4.2* to apply the *standardised approach* for *exposures* to such entities. In this case the requirements of *BIPRU 5* (credit risk mitigation) apply.

Amend BIPRU 5.4 as follows:

- ...
- 5.4.39 R (1) ...
(2) ...
(3) For other *capital market-driven transactions*, the liquidation period is 10 business days.
- ...
- 5.4.51 R ... and 10 *business days* for other *capital market-driven transactions*.
- ...
- 5.4.66 R ...

Amend BIPRU 5.6.2R as follows:

- 5.6.2 R For master netting agreements covering *repurchase transactions* and/or *securities or commodities lending or borrowing transactions* and/or other *capital market-driven transactions* to be recognised for the purposes of *BIPRU 5*, they must: ...

Amend BIPRU 5.6 (Master netting agreements) as follows:

- 5.6.16 R ... The internal model used for the *master netting agreement internal models approach* must provide estimates of the potential change in value of the unsecured *exposure* amount ...
- 5.6.17 R A *firm* may also use the internal model used for the *master netting agreement internal models approach* for *margin lending transactions* ...
- ...
- 5.6.19 R ...
(11) The internal model used for the *master netting agreement internal models approach* must meet the requirements set out in *BIPRU 13.6.65R* to *BIPRU 13.6.67R*.
- ...
- 5.6.26 G No changes should be made to the internal model used for the *master netting agreement internal models approach* unless ...

Amend BIPRU 6.2.8G as follows:

- 6.2.8 G A *firm* may apply to the *FSA* for a *waiver* from *BIPRU 6.2.7R* where it can demonstrate good cause for changing to the standardised approach ...

Amend BIPRU 6.3 as follows:

- ...
- 6.3.2 R (1) ...
...
(3) If, for any given observation, the sum of a *firm's* net interest income

and net non-interest income; is negative ...

6.3.3 G If a *firm* has: ...

Amend BIPRU 6.5 as follows:

...
6.5.11 G (1) ...
...
(6) is clearly documented; ...

...
6.5.27 R (1) ...
(2) The insurance policy must have an initial term of no less than one year. ...

Amend BIPRU 8.3 (Scope and basic consolidation requirements for non-EEA sub-groups) as follows:

8.3.7 G A *firm* will not be a member of a *non-EEA sub-group* unless it is also a member of a *UK consolidation group*...

...
8.3.9 G If more than one *BIPRU firm* is a direct or indirect *parent undertaking* in accordance with *BIPRU 8.3.7G(2)(a)* then the *sub-groups* of each of them are all potential *non-EEA sub-groups*...

...
8.3.15 G If more than one *financial holding company* is a direct or indirect *parent undertaking* in accordance with *BIPRU 8.3.12G(2)(a)* then the *sub-groups* of each of them are all potential *non-EEA sub-groups*.

...
8.3.18 G ...
(1) one potential *non-EEA sub-group* is contained within a wider potential *non-EEA sub-group*; and
(2) ...

Amend BIPRU 8.6.10R(3) as follows:

Treatment of minority interests
8.6.10 R (1) ...
...
(3) A *firm* must include the minority interest in the tier of capital in which that *undertaking* would have to include the capital referred to in (2) if it were a *firm* calculating its *capital resources* on a solo basis under whichever method applies to the group under *BIPRU 8.6.6R* to *BIPRU 8.6.98R*.
(4) ...

Amend BIPRU 8.8.7G as follows:

8.8.7 G *BIPRU 8.7.226R* deals with the combination of the *advanced measurement*

approach with other approaches to *operational risk* on a group level.

Amend BIPRU 8 Annex 6R as follows:

Non-EEA regulators' requirements deemed CRD-equivalent for individual risks
Part 1 (Non-EEA banking regulators' requirements deemed CRD-equivalent for individual risks)

Regime regulators	Market risk	Credit risk	Operational risk
...			
<u>Korea</u> ...			
...			
<u>Jersey</u>	<u>Y</u>	<u>Y</u>	<u>Y</u>
<u>Guernsey</u>	<u>N</u>	<u>Y</u>	<u>Y</u>
<u>Isle of Man</u>	<u>N</u>	<u>Y</u>	<u>Y</u>
Note 1: ...			

Part 2 (Non-EEA investment firm regulators' requirements deemed CRD-equivalent for individual risks)

Regime regulators	Market risk	Credit risk	Operational risk
...			
<u>USA</u>			
Securities and Exchange Commission (SEC): Net Capital rule only	Y Note 3	* <u>Y</u>	N
Commodities and Futures Trading Commission	Y	N	N
Note 1: ...			

Amend BIPRU 9.4.1R as follows:

9.4.1 R The *originator* of a *traditional securitisation* may exclude ~~securitised exposures~~ *exposures* from the calculation of *risk weighted exposure amounts* and *expected loss* amounts if significant credit risk associated with the *securitised exposures* has been transferred to third parties and the transfer complies with the conditions in *BIPRU 9.4.2R-BIPRU 9.4.10R*.

Amend BIPRU 9.7.3G as follows:

9.7.3 G The *guidance* in *BIPRU 3.3* (Recognition of ratings agencies) applies for the purposes of *BIPRU 9* as it does to *exposure risk weighting* in *BIPRU 3*, save that the reference in *BIPRU 3.3* to the ~~Regulation 3~~ regulation 22 of the ~~EC/ES/ Capital Requirements Regulations 2006~~ should be read as a reference to ~~Regulation 4~~ regulation 23 of the ~~EC/ES/ Capital Requirements Regulations 2006~~ for the purposes of *BIPRU 9*.

Amend BIPRU 9.9.1R as follows:

9.9.1 R ...

[Note: BCD Article 96(1) (part) and Annex ~~XI~~ IX, Part 4 point 1]

Amend BIPRU 9.12.20R(9) as follows:

The ABCP internal assessment approach

9.12.20 R ...

(9) In developing its internal assessment methodology the *firm* must take into consideration relevant published ratings methodologies of the *eligible ECAIs* that rate the commercial paper of the ~~ABCP programme~~ ABCP programme. This consideration must be documented by the *firm* and updated regularly, as outlined in (15).

...

Amend BIPRU 13.4.2R as follows:

13.4.2 R A *firm* must obtain the current replacement cost of all contracts with positive values by attaching ~~current market values~~ current market values to contracts (marking to market).

Amend BIPRU 13.5 (CCR standardised method) as follows:

...

13.5.12 R For interest rate *risk positions* from money deposits received from the counterparty as collateral, from *payment legs* and from underlying debt instruments, to which according to the table in ~~BIPRU 7.2.XR~~ 7.2.44R a capital charge of 1.60% or less applies, ...

...

13.5.18 R (1) For interest rate *risk positions* from money deposits that are posted with a counterparty as collateral when that counterparty does not have debt obligations of low *specific risk* outstanding and from underlying debt instruments, to which according to the table in ~~BIPRU 7.2.XR~~ 7.2.44R a capital charge of more than 1.60% applies, there is one *hedging set* for each issuer.

(2) ...

...

13.5.22 R This table belongs to BIPRU 13.5.21R

<i>Hedging set</i> categories	CCR Multiplier (CCRM)
(1)
(2)

(3)	Interest Rates for <i>risk positions</i> from a debt instrument or reference debt instrument to which a capital charge of more than 1.60% applies under <i>BIPRU 7.2.XR 7.2.44R</i>.	...
(4)	...	...

...
13.5.27 R A *firm* may only recognise collateral for this method if it is collateral that is eligible under *BIPRU 5.X.XR [Annex VIII, Part 1, point 11] 5.4.8R* and *BIPRU 14.2.12R* to *BIPRU 14.2.13R*.

Amend BIPRU 13.6 (CCR internal model method) as follows:

...
13.6.29 R A *firm* must calculate *EE* or *peak exposure* measures based on a ~~distribution of exposures~~ distribution of exposures that accounts for the possible non-normality of the ~~distribution of exposures~~ distribution of exposures.

...
13.6.38 R ...
(2) ...
(~~4~~3) ...

...
13.6.51 R The ~~distribution of exposures~~ distribution of exposures generated by the model used to calculate *effective EPE* must be closely integrated into the day-to-day *CCR* management process of the *firm*. The model's output must accordingly play an essential role in the credit approval, *CCR* management, internal capital allocation, and corporate governance of the *firm*.

13.6.52 R A *firm* must have a track record in the use of models that generate a ~~distribution of exposures~~ distribution of exposures to *CCR*. Thus, the *firm* must be able to demonstrate that it has been using a model to calculate the ~~distribution of exposures~~ distribution of exposures upon which the *EPE* calculation is based that meets, broadly, the minimum requirements set out in *BIPRU 13.6* for at least one year prior to the date of its *CCR internal model method permission*.

13.6.53 R (1) A *firm* must ensure that the model used to generate a ~~distribution of exposures~~ distribution of exposures to *CCR* is part of a *CCR* management framework that includes the identification, measurement, management, approval and internal reporting of *CCR*. This framework must include the measurement of usage of credit lines (aggregating *CCR exposures* with other credit *exposures*) and internal capital allocation.
(2) ...
...
(4) The use test is satisfied if a *firm* uses other *CCR* measures, such as *peak exposure* or *PFE* (see *BIPRU 13.6.47R*), based on the ~~distribution of exposures~~ distribution of exposures generated by the same model to compute *EPE*.

Amend BIPRU 13.8.7R as follows:

- 13.8.7 R Notwithstanding *BIPRU* 13.8.2R, a *firm* must determine the *exposure* value of a credit risk *exposure* outstanding with a *central counterparty* in accordance with ~~*BIPRU* 13.8.10R~~ 13.8.8R, provided that the *central counterparty's counterparty credit risk exposures* with all participants in its arrangements are fully collateralised on a daily basis.

Amend BIPRU 14.1 as follows:

- 14.1.2 G ...
Purpose
~~14.1.2~~ G *BIPRU* 14 implements: ...
14.1.3

Delete BIPRU 14.2.19R as follows:

- 14.2.19 R ~~For the purposes of *BIPRU* 14.2.18R(1), for such a *firm*, the value adjustments referred to in *BIPRU* 14.2.18R(1) must not be included in *capital resources* other than in accordance with *BIPRU* 14.2.18R(1).~~
[deleted]

Amend BIPRU 14.3.4 as follows:

- 14.3.4 R A *firm* must multiply the price difference calculated under *BIPRU* 14.3.23R by the appropriate factor in column A of the Table in *BIPRU* 14.3.4R in order to calculate its capital requirement for the purposes of *BIPRU* 14.3.

Annex D

Amendments to the Prudential sourcebook for Insurers (INSPRU)

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

In the provisions of INSPRU specified in column (1) of the following Table, replace the reference to the provision in column (2) of the Table with a reference to the corresponding provision in column (3):

(1) Provision	(2) SYSC reference	(3) New reference
INSPRU 5.1.6G	SYSC 3A	SYSC 13
INSPRU 5.1.10G(1)	SYSC 3A.5.1G(3)	SYSC 13.5.1G(3)
INSPRU 5.1.16G	SYSC 3A.5.1G(2)	SYSC 13.5.1G(2)
INSPRU 5.1.22G(1)	SYSC 3A.6	SYSC 13.6
INSPRU 5.1.22G(2)	SYSC 3A.7	SYSC 13.7
INSPRU 5.1.22G(3)	SYSC 3A.9 SYSC 3A.10	SYSC 13.9 SYSC 13.10
INSPRU 7.1.30G	SYSC 3A	SYSC 13

Amend INSPRU 1.3.39BG as follows:

- 1.3.39B G In determining current market yields for the purpose of ~~INSPRU 1.3.3R(4)~~ 1.3.37R(4), a *firm* is required to have regard to IFRS 4 as if it were being applied to determine the value under that standard for the first time, that is, without reference to existing practices. Paragraph 27 of the standard is likely to be of particular relevance. A *firm* should not include an allowance for future investment margins until they are earned. In particular, a *firm* should not include an allowance for capital growth in determining current market yields for equities and real estate investments.

Amend INSPRU 2.1.22R as follows:

- 2.1.22 R ...
(3) ...
(c) for a *counterparty* exposure to a *person*, or the aggregate exposure arising from the *counterparty* exposures to each member of a group of closely related *persons*, who do not fall into the categories of *counterparty* to whom (a) and (b) apply:
(i) ...
(ii) 1% for that part of the exposure arising from *shares* and other variable yield participations, bonds, ~~debt securities~~ securities and other *money market instruments* and capital market instruments from the same *counterparty* that are not dealt in on a *regulated market*, or any beneficial interest in a *collective investment scheme* which is not a *UCITS scheme*, a *non-UCITS retail scheme* or a recognised

scheme; the limit for that part of the exposure arising from *debt securities* (other than hybrid securities) issued by the same *regulated institution* is increased to 5%;

(iii) ...

Annex E

Amendments to the Prudential sourcebook for UCITS Firms (UPRU)

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

Transitional provision for UPRU

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
1.	This sourcebook	R	An <i>operator</i> of a <i>UCITS scheme</i> ... its activities to those specified under <i>CIS</i> 16.5.1R (1) <u>to (3)</u> or <i>COLL</i> 6.9.9R (1) to (3), as appropriate.	From 01/01/07 to 12/02/07	01/01/07

Annex F

**Amendments to the Interim Prudential sourcebook for Investment Businesses
(IPRU(INV))**

In this Annex, underlining indicates new text.

...

Annex D

...

3.2 FORM OF DEED OF TERMINATION

THIS DEED OF TERMINATION is made on the day of 20.....

BETWEEN -

- (1) * [insert full name of Lender] [(registered in [England] number *) whose registered office is at][if an individual or partnership of] * (“the **Lender**”).
- (2) * [insert full name of Borrower] [(registered in [England] number *) whose registered office is at][if an individual or partnership of] * (“the **Borrower**”).
- (3) **The Financial Services Authority Limited** (registered in England number 1920623) whose registered office is at 25 The North Colonnade, Canary Wharf, London, E14 5HS (“**the FSA**”).

...

IN WITNESS WHEREOF this Deed has been executed by the parties and is intended to be and is hereby delivered on the date first above written.

Executed as a deed by [full name of Lender]

.....

Signed
Director

Signed
Director/Secretary

or

Signed as a deed by
[full names of individual partners of Lender]

(as such partners and as individuals)

Signed
Partner

Signed.....
Partner/Witness

or

Signed as a deed by [full name of Lender]
(if an individual)

Signed.....

in the presence of

Signed.....
Witness

Executed as a deed by [full name of Borrower]

.....

Signed.....
Director

Signed.....
Director/Secretary

or

Signed as a deed by [full names of individual
partners of Borrower]
(as such partners and as individuals)

Signed.....
Partner

Signed.....
Partner/Witness

or

Signed as a deed by [full name of Borrower]
(if an individual)

Signed.....

in the presence of

Signed.....
Witness

The Common Seal of THE FINANCIAL SERVICES AUTHORITY LIMITED was hereunto affixed in the presence of

Signed
Authorised Signatory

Signed.....
Authorised Signatory

3.3 FORM OF DEED OF VARIATION

THIS DEED OF VARIATION is made on the day of 20.....

BETWEEN -

- (1) * [insert full name of Lender] [(registered in [England] number *) whose registered office is at][*if an individual or partnership of*] * (“the **Lender**”).
- (2) * [insert full name of Borrower] [(registered in [England] number *) whose registered office is at][*if an individual or partnership of*] * (“the **Borrower**”).
- (3) **The Financial Services Authority Limited** (registered in England number 1920623) whose registered office is at 25 The North Colonnade, Canary Wharf, London, E14 5HS (“the **FSA**”).

...

IN WITNESS WHEREOF this Deed has been executed by the parties and is intended to be and is hereby delivered on the date first above written.

Executed as a deed by [full name of Lender]

.....

Signed.....
Director

Signed.....
Director/Secretary

or

Signed as a deed by
[full names of individual partners of Lender]

(as such partners and as individuals)

Signed.....
Partner

Signed.....
Partner/Witness

or

Signed as a deed by [full name of Lender]
(if an individual)

Signed.....

in the presence of

Signed.....
Witness

Executed as a deed by [full name of Borrower]

.....

Signed.....
Director

Signed.....
Director/Secretary

or

Signed as a deed by [full names of individual
partners of Borrower]
(as such partners and as individuals)

Signed.....
Partner

Signed.....
Partner/Witness

or

Signed as a deed by [full name of Borrower]
(if an individual)

Signed.....

in the presence of

Signed.....
Witness

The Common Seal of THE FINANCIAL SERVICES AUTHORITY LIMITED was hereunto affixed in the presence of

Signed
Authorised Signatory

Signed.....
Authorised Signatory

...

10.3 FORM OF DEED OF TERMINATION

THIS DEED OF TERMINATION is made on the day of 20....

BETWEEN -

- (1) * [insert full name of Lender] [(registered in [England] number *) whose registered office is at][if an individual or partnership of] * (“the **Lender**”).
- (2) * [insert full name of Borrower] [(registered in [England] number *) whose registered office is at][if an individual or partnership of] * (“the **Borrower**”).
- (3) **The Financial Services Authority Limited** (registered in England number 1920623) whose registered office is at 25 The North Colonnade, Canary Wharf, London, E14 5HS (“**the FSA**”).

...

IN WITNESS WHEREOF this Deed has been executed by the parties and is intended to be and is hereby delivered on the date first above written.

Executed as a deed by [full name of Lender]

.....

Signed.....
Director

Signed.....
Director/Secretary

or

Signed as a deed by
[full names of individual partners of Lender]

(as such partners and as individuals)

Signed.....
Partner

Signed.....
Partner/Witness

or

Signed as a deed by [full name of Lender]
(if an individual)

Signed.....

in the presence of

Signed.....
Witness

Executed as a deed by [full name of Borrower]

.....

Signed.....
Director

Signed.....
Director/Secretary

or

Signed as a deed by [full names of individual partners of Borrower]
(as such partners and as individuals)

Signed.....
Partner

Signed.....
Partner/Witness

or

Signed as a deed by [full name of Borrower]
(if an individual)

Signed.....

in the presence of

Signed.....
Witness

The Common Seal of THE FINANCIAL SERVICES AUTHORITY LIMITED was hereunto affixed in the presence of

Signed
Authorised Signatory

Signed.....
Authorised Signatory

10.4 FORM OF DEED OF VARIATION

THIS DEED OF VARIATION is made on the day of 2.....

BETWEEN -

- (1) * [insert full name of Lender] [(registered in [England] number *) whose registered office is at][if an individual or partnership of] * (“the **Lender**”).
- (2) * [insert full name of Borrower] [(registered in [England] number *) whose registered office is at][if an individual or partnership of] * (“the **Borrower**”).
- (3) **The Financial Services Authority Limited** (registered in England number 1920623) whose registered office is at 25 The North Colonnade, Canary Wharf, London, E14 5HS (“the **FSA**”).

[...]

IN WITNESS WHEREOF this Deed has been executed by the parties and is intended to be and is hereby delivered on the date first above written.

Executed as a deed by [full name of Lender]

.....

Signed.....
Director

Signed.....
Director/Secretary

or

Signed as a deed by
[full names of individual partners of Lender]

(as such partners and as individuals)

Signed.....
Partner

Signed.....
Partner/Witness

or

Signed as a deed by [full name of Lender]
(if an individual)

Signed.....

in the presence of

Signed.....
Witness

Executed as a deed by [full name of Borrower]

.....

Signed.....
Director

Signed.....
Director/Secretary

or

Signed as a deed by [full names of individual
partners of Borrower]
(as such partners and as individuals)

Signed.....
Partner

Signed.....
Partner/Witness

or

Signed as a deed by [full name of Borrower]
(if an individual)

Signed.....

in the presence of

Signed.....
Witness

The Common Seal of THE FINANCIAL
SERVICES AUTHORITY LIMITED
was hereunto affixed in the
presence of

Signed
Authorised Signatory

Signed.....
Authorised Signatory

Annex G

Amendments to the Collective Investment Schemes sourcebook (CIS)

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

CIS TP 1 Transitional Provisions

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional provision	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
...					
21	<i>CIS 16.5.1 R (4) to CIS 16.5.1 R (6)</i>	G	A UK <u>UCITS</u> <i>investment firm</i> will not be able to act as such and exercise an <i>EEA right</i> under the <i>UCITS</i> <i>Directive</i> unless it complies with the Prudential sourcebook for UCITS Firms <u><i>BIPRU</i></u> .		
...					

Annex H

Amendments to the New Collective Investment Schemes sourcebook (COLL)

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

COLL TP 1 Transitional Provisions

(1)	(2) Material to which the transitional provision applies	(3)	(4) Transitional provisions	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
...					
5	<i>COLL 6.9.9R</i> (2) <u>(4)</u> to (6) (Restrictions of business for UCITS management companies)	R	A <i>UCITS management company</i> must not carry on any of the activities specified in <i>COLL 6.9.9 (2)</i> <i>COLL 6.9.9 (3)</i> <i>COLL 6.9.9 (4)</i> <i>COLL 6.9.9 (5)</i> <i>COLL 6.9.9 (6)</i> <i>COLL 6.9.9R</i> (2) <u>(4)</u> to (6) (inclusive) unless ...	From 1 April 2004 to 12 February 2007	1 April 2004
6	<i>COLL 6.9.9 (2)</i> <i>COLL 6.9.9 (3)</i> <i>COLL 6.9.9 (4)</i> <i>COLL 6.9.9 (5)</i> <i>COLL 6.9.9 (6)</i> <i>COLL 6.9.9R</i> (2) <u>(4)</u> to (6) (Restrictions of business for UCITS management companies)	G	A <i>UK UCITS investment firm</i> will not be able to act as such and exercise an <i>EEA right</i> under the <i>UCITS Directive</i> unless it complies with <i>UPRU</i> <u><i>BIPRU</i></u> .		
...					

Annex I

Amendments to Annex A to the General Prudential Sourcebook Instrument 2006 (FSA 2006/40)

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

Amend the table in Annex A to the General Prudential Sourcebook Instrument as follows:

PRU provision: current location	Destination
...	...
8 Annex 1 R	GENPRU & <u>3</u> Annex 1 R
8 Annex 2 R	GENPRU & <u>3</u> Annex 2 R
8 Annex 3 G	GENPRU & <u>3</u> Annex 3 G
8 Annex 4 R	GENPRU & <u>3</u> Annex 4 R

Annex J

Amendments to the CRD (Consequential Amendments) Instrument 2006 (FSA 2006/53)

Annex A Amendments to the Glossary

Part 1B (New definitions taking effect on 1 January 2007)

<i>non-EA<u>EA</u> sub-group</i>	a group of <i>undertakings</i> identified as a <i>non-EEA sub-group</i> in <i>BIPRU 8.3.1R</i> (Main consolidation rule for non-EEA sub-groups); however where the provision in question refers to a <i>non-EA<u>EA</u> sub-group</i> in another <i>EEA State</i> it means a group of <i>undertakings</i> identified in Article 73(2) of the <i>Banking Consolidation Directive</i> (Non-EA <u>EA</u> sub-groups) required to be supervised on a consolidated basis under Article 73(2) of the <i>Banking Consolidation Directive</i> by a <i>competent authority</i> in that <i>EEA State</i> .
----------------------------------	--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------

Part 2A (Revised definitions taking effect on 31 December 2006)

- guaranteed fund* (1)
- (a) ...
 - (b) where the *firm* is required to calculate a *UK MCR* or an *EEA MCR* under ~~PRU 7.6~~ INSPRU 1.1, for the purposes of that section...
- insurance health risk and life protection reinsurance capital component* one of the components of the *long-term insurance capital requirement* as set out in ~~PRU 7.2.85R~~ INSPRU 1.1.85R to ~~PRU 7.2.86R~~ INSPRU 1.1.86R.

Part 2B (Revised definitions taking effect on 1 January 2007)

- commodity*
- (1) (except for the purpose of calculating *position risk requirements*) a physical asset (other than a financial instrument or cash) which is capable of delivery.
 - (2) (for the purpose of calculating *position risk requirements*) any of the following (but excluding gold):
 - (a) a commodity within the meaning of paragraph (1); and
 - (b) any:
 - (i) physical or energy product; or
 - (ii) of the items referred to in paragraph 10 of Section C of Annex I of the *MIFID* as an underlying with respect to the *derivatives* mentioned in that paragraph;
which is, or can be, traded on a secondary market.
- competent authority*
- (1) ...
 - ...
 - (3) (in relation to a group, and for the purposes of ~~PRU 8.1 SYSC 12~~ (Group risk systems and controls requirement), ~~GENPRU 8.4~~ (Cross sector groups), ~~PRU 8.5~~ (Third country groups), ~~PRU 8 Ann 1R~~ (Capital adequacy calculations for financial conglomerates) and ~~PRU 8 Ann 2R~~ (Prudential rules for third country groups), *BIPRU* and *INSPRU*, any national authority
...
- EEA firm*
- ...
 - (b) a *credit institution* (as defined in article ~~14~~(1) of the *Banking Consolidation Directive*)
 - (c) a financial institution (as defined in article ~~14~~(5) of the *Banking Consolidation Directive*) which is a subsidiary of the kind mentioned in article ~~19~~ 24 and which fulfils the conditions in articles ~~18~~ 23 and ~~19~~24;
- financial instrument*
- (1) (other than for the purposes of *BIPRU* and *GENPRU*) as defined in Article 5 of the *Prescribed Markets and Qualifying Investments Order* and Article 1(3) of the *Market Abuse Directive*, and which consequently carries the same meaning in the *Buy-back and Stabilisation Regulation*):
 - (a) ...

...

- (2) (for the purposes of *BIPRU* and *GENPRU*) an instrument listed in Section B of the Annex to the *ISD*.

Annex L

Amendments to the Supervision manual

Part 4: Consequential amendments taking effect on 1 January 2007

Amend SUP 10.12 as follows:

- 10.12.3 G In accordance with section 60 of the *Act* (Applications for approval), applications must be submitted by, or on behalf of, the *firm* itself, not by the *candidate*. Usually this will be the *firm* that is employing the *candidate* to perform the *controlled function*. Where a *firm* has outsourced the performance of a *controlled function*, the details of the outsourcing determine where responsibility lies and whom the *FSA* anticipates will submit *approved persons* forms. SUP 10.12.4 G describes some common situations. The *firm* which is outsourcing is referred to as "A" and the *person* to whom the performance of the function has been outsourced, or which makes the *arrangement* for the function to be performed, is referred to as "B". In each situation, A must take reasonable care to ensure that, in accordance with section 59(2) of the *Act*, no *person* performs a *controlled function* under an *arrangement* entered into by its contractor in relation to the carrying on by A of a *regulated activity*, without approval from the *FSA*. See also SYSC 3.2.4G and SYSC 8.1.1R and if applicable ~~IPRU (BANK) OS, IPRU (BSOC) OS,~~ and for *insurers* SYSC 13.9.

Amend SUP 15.3 as follows:

...

- 15.3.8 G (1) Compliance with *Principle 11* includes, but is not limited to, giving the *FSA* notice of:
- (a) ...
 - ...
 - (e) entering into, or significantly changing, a *material outsourcing* arrangement (a *bank* ~~should also see IPRU(BANK) OS 4.2, and~~ a *building society* should also see ~~IPRU(BSOC) 11 OS 4.2~~ SYSC 3.2.4G and SYSC 8, and an *insurer* should also see SYSC ~~3A.9~~13.9 for further details); or

...

Annex K

Amendments to Annex G of the Home Reversion and Home Purchase Activities (Consequential Amendments to the Handbook) Instrument 2006 (FSA 2006/37)

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

COB 4 Annex 5R: Combined initial disclosure document (“CIDD”)

..

2. Whose products do we offer? [Note 6] [Note 7]

...

[2] [**Islamic Home Purchase Plans**] [Note 13A] [Note 14]

...

We [can] [Note 8] only offer [a limited range of the] [an] Islamic home purchase plan[s] from [a single provider]. [Note 10(1) **an (3)**] [Note 13]

...

...

3. Which service will we provide you with? [Note 6]

...

[Home Finance Products] [Note 14]

[1] [Mortgages] [Equity Release Products] [Note 14]

We will advise and make a recommendation for you [on [lifetime mortgages] [home reversions] [equity release products]] after we have assessed your needs.

You will not receive advice or a recommendation from us. We may ask some questions to narrow down the selection of [products][lifetime mortgages] [home reversions] [equity release products] that we will provide details on. You will then need to make your own choice about how to proceed.

...

4 What will you have to pay us for our services?

...

[Home Finance Products] [Note 14]

[1] [Mortgages] [Equity Release Products] [Note 14]

...

Refund of fees [Note 19] [Note 14]

If we charge you a fee, and your [lifetime] [mortgage] [home reversion plan] [equity release product] does not go ahead, you will receive: [Note 20]

...

Note 7A – the 'Compliance with Islamic law' subsection is optional unless the *firm* holds itself, its *regulated mortgage contract* or *home purchase plan* products or services out as compliant with Islamic law in the CIDD. ~~If a *firm* includes Section 1A then it must describe the section on the CIDD as section 2 and renumber subsequent sections accordingly.~~ If the statement does not apply to all of the *firm*'s home finance services then it must amend the statement to make clear to which services it applies.

...

Note 14 – in describing the services and products provided, *firms* must omit the text in brackets that do not apply and ensure that they describe accurately their activities with respect of the services and products that they offer, as follows:

...

(2) Describing the products in Section 2: In the text associated with boxes that are not ticked, a *firm* must delete references to 'home reversions' and 'lifetime mortgages' but leave references to 'equity release products'.

(23) Describing the products in Section 3:

a. If a *firm* advises or gives personalised information on *lifetime mortgages*, it must change "mortgage" to "lifetime mortgage" and use the text in brackets related to *lifetime mortgages*.

...

(34) Describing the provider: If a *firm* advises or gives personalised information on *home purchase plans* or *home reversion plans*, it must change "mortgage" to "product" and "lender" to "company" or "provider", as appropriate.

Note 41 - A *firm* must only include this paragraph if the services to which the CIDD relates include *home purchase activities* and do not include *regulated mortgage activities*. If the *firm* does not carry on *regulated mortgage activities*, it must include the second sentence and delete the third. If the *firm* carries on *regulated mortgage activities* (but the CIDD does not relate to these services) as well as *home purchase activities* it must omit the second sentence and include the third.

Annex L

Amendments to Annex A of the Mortgages: Conduct of Business Sourcebook (Home Reversion and Home Purchase Activities) Instrument 2006 (FSA 2006/45)

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

MCOB 8 Annex 1 Initial disclosure document (“IDD”)

...

2. Whose products do we offer? [Note 3] [Note 7] [Note 8]

...

We [can] [Note 9] only offer [a limited range of] [lifetime mortgages] [home reversion plans] [equity release products] from [a single lender/company] [name of single company]. [Note 11] [Note 11A]

[or]

We only offer our own [lifetime mortgages] [home reversion plans] [equity release products]. [Note 12]

...

...

3. Which service will we provide you with? [Note 3] [Note 7]

We will advise and make a recommendation for you on [lifetime mortgages] [home reversion plans] [equity release products] ~~for you~~ after we have assessed your needs.

...

Note 7 – *firms* must describe their scope of service by selecting and ticking, the box or boxes that describe the products and services that the firm expects to provide to the *customer*. ~~This means a firm will select either one or both boxes within this section.~~ *Firms* must not delete the boxes not selected (but see Note 8A). In the text associated with boxes that are not ticked;

- a. in Section 2 a firm must delete references to 'home reversions' and 'lifetime mortgages' but leave references to 'equity release products', omitting the square brackets. This is so that a *customer* can see other possible options, even if not available from the *firm* issuing the IDD; and
- b. in Section 3, a firm must use the words in square brackets that reflect the products it is offering in Section 2. If the firm advises or gives personalised information on products from both equity release market sectors, it must use the term 'equity release products'.

MCOB 9 Annex 2R

...

<h4>3. What is a home reversion plan?</h4>

...

When does a home reversion plan end?

- This depends on the terms of the plan but will usually include death or where you (or, in the case of a joint plan, the ~~surviving spouse~~ survivor) move out permanently, for example into long-term residential care. The property will be put up for sale by the provider and the value of any part you do not sell to the provider will be paid to you or your estate. See also "Cancelling a home reversion", below.

Moving home

- Not all home reversion plans can be transferred to a new property, if you should want to move home in the future. Section 5 will tell you if this plan cannot be transferred. ...

...

**INTERIM PRUDENTIAL SOURCEBOOK FOR FRIENDLY SOCIETIES
(AMENDMENT NO 2) INSTRUMENT 2006**

Powers exercised

- A. The Financial Services Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):
- (1) section 138 (General rule-making power);
 - (2) section 141 (Insurance business rules);
 - (3) section 150(2) (Actions for damages);
 - (4) section 156 (General supplementary powers); and
 - (5) section 340 (Appointment).
- B. The rule-making powers listed above are specified for the purpose of section 153(2) (Rule-making instruments) of the Act.

Commencement

- C. This instrument comes into force on 31 December 2006.

Amendments to the Handbook

- D. The Interim Prudential sourcebook for Friendly Societies (IPRU(FSOC)) is amended in accordance with the Annex to this instrument.

Citation

- E. This instrument may be cited as the Interim Prudential Sourcebook for Friendly Societies (Amendment No 2) Instrument 2006.

By order of the Board
21 December 2006

Annex

Amendments to the Interim Prudential sourcebook for Friendly Societies (IPRU(FSOC))

In this Annex underlining indicates new text and striking through indicates deleted text. Where a new section of text is inserted, this is indicated and the new text is not underlined.

...

5.1

...

(2) ...

and one of those copies must be signed as required by rule 5.12.⁷ The copies must be sent to Insurance Returns, The Financial Services Authority, PO Box 35747, London E14 5WP (and must not be addressed to the *friendly society's* normal supervisory contact).

...

5.2

...

(2) ...

and one of those copies must be signed as required by rule 5.20.⁸ The copies must be sent to Insurance Returns, The Financial Services Authority, PO Box 35747, London E14 5WP (and must not be addressed to the *friendly society's* normal supervisory contact).

...

5.11

...

(2) ~~In giving this opinion the auditor must state whether he has relied on—~~

- (a) ~~the certificate given in accordance with rule 5.10 with respect to the *mathematical reserves* and the *required minimum margin* of the *friendly society*; and~~
- (b) ~~the identity and value of any *implicit items* valued in accordance with a waiver under section 148 of the Act. [deleted]~~

...

Chapter 8

TRANSITIONAL PROVISIONS

...

Insert after Table 2 the following transitional rule 8.6:

Off-market derivatives in linked funds

- 8.6
- (1) This transitional *rule* has effect from 31 December 2006 to 30 December 2007.
 - (2) For the purpose of the definition of *permitted derivative contract* in *IPRU (FSOC) 7.1* as it applies for a *directive friendly society*:
 - (a) *INSPRU 3.2.5R(3)(b)* has effect as if the words "and is capable of valuation" and "to *INSPRU 3.2.35R*" were omitted;
 - (b) *INSPRU 3.2.34R* has effect as if it read "For the purpose of *INSPRU 3.2.5R(3)(b)*, a transaction is on approved terms only if the *firm* reasonably believes that it may be readily closed out"; and
 - (c) *INSPRU 3.2.35R* does not apply.

DELETION OF AUTHORISATION MANUAL INSTRUMENT 2006

Powers exercised

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

Commencement

- B. This instrument comes into force on 31 December 2006.

Amendments to the Handbook

- C. The modules of the FSA’s Handbook of rules and guidance listed in column (1) below are amended in accordance with the Annexes to this Instrument listed in column (2).

(1)	(2)
Glossary of definitions	Annex A
Authorisation Manual (AUTH)	Annex B

Citation

- D. This instrument may be cited as the Deletion of the Authorisation Manual Instrument 2006.

By order of the Board
21 December 2006

Annex A

Amendments to the Glossary of definitions

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

~~AUTH~~ ————— ~~the Authorisation Manual~~

Annex B

Amendments to the Authorisation Manual (AUTH)

Where entire sections are deleted, these are not shown struck through.

AUTH Chapter 1, 3 and 6 are deleted in their entirety.

AUTH 1 [deleted]

AUTH 3 [deleted]

AUTH 6 [deleted]

AUTH Transitional Provisions is deleted in its entirety.

AUTH TP 1 [deleted]

AUTH Schedules 1 – 6 are deleted in their entirety.

AUTH Schedule 1 [deleted]

AUTH Schedule 2 [deleted]

AUTH Schedule 3 [deleted]

AUTH Schedule 4 [deleted]

AUTH Schedule 5 [deleted]

AUTH Schedule 6 [deleted]

**INTEGRATED REGULATORY REPORTING (CREDIT INSTITUTIONS AND
INVESTMENT FIRMS) (NO 2) INSTRUMENT 2006**

Powers exercised

- A. The Financial Services Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):
- (1) section 138 (General rule-making power);
 - (2) section 156 (General supplementary powers); and
 - (3) section 157(1) (Guidance).
- B. The rule-making powers listed above are specified for the purpose of section 153(2) (Rule-making instruments) of the Act.

Commencement

- C. This instrument comes into force as follows:
- (1) the amendments in Annexes A, B, and C (Part 2 and Parts 5, 6, 7) come into force on 1 January 2007;
 - (2) the amendments in Annexes C (Part 1 and Parts 3, 4) and D come into force on 1 January 2008.
 - (3) the amendments in Annexes E and F come into force on 30 September 2008.
 - (4) the amendments in Annex G come into force on 1 January 2009.

Amendments to the Handbook

- D. The modules of the FSA’s Handbook of rules and guidance listed in column (1) below are amended in accordance with the Annexes to this instrument listed in column (2).

(1)	(2)
Glossary of definitions	Annex A
Interim Prudential sourcebook for Banks (IPRU(BANK))	Annex B
Supervision manual (SUP)	Annex C
Credit Union sourcebook (CRED)	Annex D
Further amendments to Glossary of definitions	Annex E

Further amendments to Supervision manual (SUP)	Annex F
Electronic Money sourcebook (ELM)	Annex G

Citation

- E. This instrument may be cited as the Integrated Regulatory Reporting (Credit Institutions and Investment Firms) (No 2) Instrument 2006.

By order of the Board
21 December 2006

Annex A

Amendments to the Glossary of definitions

In this Annex, underlining indicates new text.

...

RAG regulated activity group

...

regulated activity group A set of one or more regulated activities (with associated investment types and customer types) referred to in SUP 16 to determine a firm's or other regulated person's data item submission requirements.

...

Annex B

Amendments to the Interim Prudential sourcebook for Banks (IPRU(BANK))

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

LM: Section 1

MISMATCH LIQUIDITY INTRODUCTION

1

...

1.2 Application

4

...

1. (a) For UK-incorporated banks, the ~~present~~ reporting form LR (or data item FSA010 after 1 January 2008) is completed on a solo basis. Where a bank already reports for capital and large exposures purposes on a solo-consolidated basis with the agreement of the supervisor, the Form LR or FSA010 as appropriate should be submitted on a solo-consolidated basis rather than a solo basis.
2. (i) ...
3. (b) ... The FSA monitors the liquidity of such branches by requiring them to submit Form LR, or FSA012 (which consists of a simplified cash flow maturity ladder) after 1 January 2008. Such branches may apply for a 'global concession' in accordance with section 4.2.

...

LM: Section 2

2 RATIONALE

...

2.2 How the FSA monitors liquidity

...

7

...

- (a) This is checked during the course of normal supervision through prudential discussions and the Form LR, FSA010 or FSA012 as applicable. These mechanisms are supplemented by review team visits, treasury visits and reports by accountants or other persons with relevant professional skills commissioned under the Act.

8 ...

See ch
LS

- (a) ...
- (b) The FSA does not apply the full maturity mismatch approach to branches of EEA banks that do not have a deposit-taking permission in the UK, but instead monitors their liquidity via the Form LR or FSA012 as appropriate.

LM: Section 3

3 MAIN FEATURES OF THE LIQUIDITY POLICY

...

3.2 A bank's reporting obligations

See s9.2
See
Supervis
ion
Manual,
Chapter
16

5 A bank that has a deposit-taking permission in the UK must report its liquidity position quarterly on the Form LR (FSA010 after 1 January 2008) or more frequently as required by the FSA.

See
Supervis
ion
Manual,
Chapter
16

6 An EEA bank with a branch in the UK that does not have a UK deposit-taking permission must report its liquidity position quarterly on the Form LR (or six-monthly on FSA012 after 1 January 2008), or more frequently as required by the FSA.

LM: Section 4

4 THE FRAMEWORK FOR MEASURING LIQUIDITY

4.2 'Global concession' policy

9 Where a global policy is agreed the FSA does not normally require a bank to complete the Form LR, FSA010 or FSA012 as applicable. However, the FSA will request information on a branch's liquidity position in an appropriate format should the need arise.

LM: Section 5

5 INCLUDING ASSETS AND LIABILITIES IN THE TIME BANDS

...

5.1 Components of the cashflow and maturity analysis ladder

5.1.1 General

1 In the period up to 31 December 2007, the timebands in the maturity ladder are divided into two sections. The time periods out to 6 months are to be reported on the Form LR on a cashflow basis and those over 6 months to 5 years should be reported on the basis of residual maturities of assets and liabilities. From 1 January 2008, only the cashflow basis will be used on FSA010.

...

LM: Section 6

6 STOCK OF MARKETABLE ASSETS

...

6.3 Inclusion of marketable assets in the maturity ladder

...

6.3.3 Procedures for discounting assets

10 In deciding whether a bank should enter assets on Part 1 of the Form LR (or FSA010 after 1 January 2008) the FSA takes account of the following factors;

...

LM: Section 9

9 MONITORING LIQUIDITY

...

9.2 Monitoring performance against guidelines

...

4 A bank is required to report its cashflow and assets and liability maturity profile on a quarterly basis using the LR return (or FSA010 after 1 January 2008).

...

9.3 Breaches of guidelines

6 ... A bank should also report any breaches of its guidelines on the Form LR (or FSA010 after 1 January 2008) retrospectively at the end of the quarter.

...

LM: Section 10

LS: Section 3

3 MAIN FEATURES OF THE POLICY

...

3.2 Reporting by a sterling stock liquidity bank

7 A sterling stock liquidity bank should report its sterling stock liquidity position to the FSA monthly up to end December 2007, and quarterly after 1 January 2008.

(a) Its liquidity position should be reported on the Sterling Liquidity Return ('form SLR1') up to 31 December 2007, and on data item FSA013 after 1 January 2008. Unless otherwise agreed with the FSA in writing, the form SLR1 (or FSA013) should be completed on a consolidated basis.

...

(b) Unless otherwise agreed in writing with the FSA, the form SLR1 should be completed as at the second Wednesday of each month, and FSA013 quarterly at dates based on a firm's accounting reference date.

...

5 **MONITORING LIQUIDITY**

...

5.2 **Monitoring and reporting performance of sterling stock liquidity**

2 A sterling stock liquidity bank should monitor its liquidity position on an inter-day basis. Any breaches of the wholesale sterling net outflow limit, the sterling stock 'floor' or the sterling stock liquidity ratio should be reported immediately to the FSA and a completed, contemporaneous form SLR1 (or a paper version of FSA013 after 1 January 2008) sent to the firm's usual supervisory contact at the FSA detailing the liquidity breach. ...

...

3 A sterling stock liquidity bank should report its liquidity position to the FSA monthly on the form SLR1 up to end December 2007 and, after 1 January 2008, quarterly on FSA013. Unless otherwise agreed in writing with the FSA, the form SLR1 (FSA013 after 1 January 2008) should be completed on a consolidated basis.

(a) Unless otherwise agreed in writing with the FSA, the form SLR1 should be completed as at the second Wednesday of each month, and FSA013 quarterly at dates based on a firm's accounting reference date.

4 The FSA monitors a sterling stock liquidity bank's liquidity profile up to end December 2007 on a monthly basis in line with the submission of the form SLR1; after 1 January 2008, it will monitor the liquidity profile quarterly in line with the submission of FSA013. ...

...

Annex C

Amendments to the Supervision Manual (SUP)

In this Annex, underlining indicates new text and striking through indicates deleted text. Except Part 4 where a whole section is new text and is not underlined.

Part 1

SUP Transitional provisions TP1

...
SUP TP 1.2

(1)		(2) Material to which the transitional provision applies	(3)	(4) Transitional Provisions	(5) Transitional provision: dates in force	(6) Handbook provision: coming into force
...						
12K	...					
<u>12L</u>	(1)	<u>SUP 16.7.7.</u> <u>SUP 16.7.8.</u> <u>SUP 16.7.16.</u> <u>SUP 16.7.17.</u> <u>SUP 16.7.24.</u> <u>SUP 16.7.25.</u> <u>SUP 16.7.26.</u> <u>SUP 16.7.27.</u> <u>SUP 16.7.30.</u> <u>SUP 16.7.35.</u> <u>SUP 16.7.36.</u> <u>SUP 16.7.67.</u> <u>SUP 16.7.68.</u> <u>SUP 16.7.76.</u> <u>SUP 16.7.77.</u>	<u>R</u>	<u>Except to the extent required by a transitional provision in TP12M, a <i>BIPRU firm</i> will not be required to report under these rules in respect of reporting dates after 31 December 2007, but will instead report under SUP 16.12.</u>	<u>1 January 2008 to 30 September 2008</u>	<u>1 January 2008</u>
	(2)	<u>SUP 16.7.9.</u> <u>SUP 16.7.10</u>	<u>R</u>	<u>Except to the extent required by a transitional provision in TP12M, an <i>EEA Bank</i>, other than one with <i>permission</i> for <i>cross border services</i> only, will not be required to report under these rules in respect of reporting dates after 31 December 2007 but will instead report under SUP 16.12.5R.</u>	<u>1 January 2008 to 30 September 2008</u>	<u>1 January 2008</u>
	(3)	<u>SUP 16.7.11.</u> <u>SUP 16.7.12</u>	<u>R</u>	<u>Except to the extent required by a transitional provision in TP12M, a <i>bank</i> established outside the <i>EEA</i> will not be</u>	<u>1 January 2008 to 30 September 2008</u>	<u>1 January 2008</u>

				<u>required to report under these rules in respect of reporting dates after 31 December 2007 but will instead report under SUP 16.12.5R.</u>		
	(4)	<u>SUP 16.7.62, SUP 16.7.63</u>	R	<u>A credit union will not be required to report under these rules in respect of reporting dates after 31 December 2007 but will instead report under SUP 16.12.5R.</u>	<u>1 January 2008 to 30 September 2008</u>	<u>1 January 2008</u>
	(5)	<u>SUP 16.7.66</u>	R	<u>An ELM that is required to report a consolidated reporting statement on capital adequacy in the case of ELM 7.3.2R in respect of reporting dates after 31 December 2007 will use FSA003 in place of FSA009. FSA003 should be submitted in accordance with SUP 16.12.3R (3).</u>	<u>1 January 2008</u>	<u>1 January 2008</u>
	(6)	<u>SUP 16.7.82, SUP 16.7.83</u>	R	<u>(1) A firm that is a member of a financial conglomerate:</u> <u>(a) that is at the head of an FSA regulated EEA financial conglomerate; or</u> <u>(b) whose Part IV permission contains a relevant requirement;</u> <u>will not be required to report under these rules in respect of reporting dates after 31 December 2007 but will instead report under SUP 16.12.32R and SUP 16.12.33R.</u> <u>(2) In (1)(b), a relevant requirement is one as set out in SUP 16.7.82R (2).</u>	<u>1 January 2008 to 30 September 2008</u>	<u>1 January 2008</u>

<u>12 M</u>	(1)	<u>SUP 16.12.5</u>	R	<u>Firms in Regulated Activity Group 1 are not required to submit the following data items for reporting dates falling prior to 1 January 2009:</u> <u>FSA005</u> <u>FSA006</u> <u>FSA007</u> <u>FSA014</u> <u>FSA020</u>	<u>1 January 2008 to 31 December 2008</u>	<u>1 January 2008</u>
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				<u>FSA021</u> <u>FSA022</u> <u>FSA023</u> <u>FSA024</u> <u>FSA025</u> <u>FSA026</u>		
	<u>(2)</u>	<u>SUP 16.12.5</u>	<u>R</u>	<u>UK banks in Regulated Activity Group 1 should not submit FSA017 for reporting dates prior to 1 January 2009.</u>	<u>1 January 2008 to 31 December 2008</u>	<u>1 January 2008</u>
	<u>(3)</u>	<u>SUP 16.12.5</u>	<u>R</u>	<u>A building society in Regulated Activity Group 1:</u> <u>(i) should not submit FSA017 for reporting dates prior to 1 January 2009;</u> <u>(ii) should instead submit an ‘Analysis of interest rate gap’ quarterly, within 15 business days of the quarter end, except in the case of a building society on the “Administered” approach (see IPRU(BSOC) 4 Ann 4A 4A.2) which is not required to submit the ‘Analysis of interest rate gap’.</u> <u>In the case of (ii), reports should be prepared as at the end of March, June, September and December of each year. The ‘Analysis of interest rate gap’ must be submitted in accordance with TP 12L (4).</u>	<u>1 January 2008 to 31 December 2008</u>	<u>1 January 2008</u>
	<u>(4)</u>	<u>SUP 16.12.5</u>	<u>R</u>	<u>In respect of the transitional reporting requirements in this transitional provision TP12L (3), the report should be submitted in accordance with SUP 16.3.6 R to SUP 16.3.10R.</u>	<u>1 January 2008 to 31 December 2008</u>	<u>1 January 2008</u>
	<u>(5)</u>	<u>SUP 16.12.11</u>	<u>R</u>	<u>Firms in Regulated Activity Group 3 are not required to submit the following data items for reporting dates falling prior to 1 January 2009:</u> <u>FSA005</u> <u>FSA006</u> <u>FSA007</u>	<u>1 January 2008 to 31 December 2008</u>	<u>1 January 2008</u>
	<u>(6)</u>	<u>SUP</u>	<u>R</u>	<u>Firms in Regulated Activity</u>	<u>1 January</u>	<u>1 January</u>

		<u>16.12.15</u>		<u>Group 4 are not required to submit the following data items for reporting dates falling prior to 1 January 2009:</u> <u>FSA005</u> <u>FSA006</u> <u>FSA007</u>	<u>2008 to 31 December 2008</u>	<u>2008</u>
	(7)	<u>SUP</u> <u>16.12.22</u>	<u>R</u>	<u>Firms in Regulated Activity Group 7 are not required to submit the following data items for reporting dates falling prior to 1 January 2009:</u> <u>FSA005</u> <u>FSA006</u> <u>FSA007</u>	<u>1 January 2008 to 31 December 2008</u>	<u>1 January 2008</u>
	(8)	<u>SUP</u> <u>16.12.25</u>	<u>R</u>	<u>Firms in Regulated Activity Group 8 are not required to submit the following data items for reporting dates falling prior to 1 January 2009:</u> <u>FSA005</u> <u>FSA006</u> <u>FSA007</u>	<u>1 January 2008 to 31 December 2008</u>	<u>1 January 2008</u>

Part 2

SUP 3.1 Application

...

3.1.2 R Table Applicable sections (see SUP 3.1.1R)

(1) Category of firm		(2) Sections applicable to the firm	(3) Sections applicable to its auditor
...			
(7C)	<i>BIPRU investment firm</i>	<i>SUP 3.1 – 3.7</i>	<i>SUP 3.1, SUP 3.2, SUP 3.8 – SUP 3.10</i> <i>SUP 3.8, SUP 3.10</i>
...			

...

SUP 16.7 Financial reports

Application

16.7.1 G The effect of SUP 16.1.1R is that this section applies to every *firm* within a category listed in the left hand column of SUP 16.7.5G. Firms should also have regard to reporting requirements that arise from SUP 16.12, including Transitional Provisions, for reporting dates after 1 January 2008.

...

16.7.66 R Reports from an ELMI (see SUP 16.7.65 R)

Content of Report	Form (Note 1)	Frequency	Due Date
...			
Consolidated reporting statement on capital adequacy in the case of <i>ELM 7.3.2R</i>	BSD3 <u>FSA009</u> (note 3)	Half yearly	20 business days after period end (22 business days if submitted electronically)
...			
Note 1 = When giving the report required, an <i>ELMI</i> must use the form or			

return indicated (if any). A copy of ~~Forms BSD3 and ELM CA/LE~~ are is set out in SUP 16 Annex 1R and FSA009 in SUP 16 Annex 24R.

...

Note 3 = FSA009 should be submitted by electronic submission via the Early Reporting System available from or through the FSA's website.

...

...

16.7.83 R Financial reports from a member of a financial conglomerate (see SUP 16.7.82R)

Content of Report	Form (Note 1)	Frequency	Due Date
...			
Note 2 = ...			
If Part 4 of PRU 8 Annex 1R applies (method 4):			
(1)	a banking conglomerate must use form SUP 16 Annex 1 (BSD3) <u>a banking / investment conglomerate must use FSA009 (located in SUP 16 Annex 24R); and</u>		
(2)	a building society conglomerate must use form SUP 16 Annex 3 (MFS1 Tables D&F);		
(3)	an investment services conglomerate must use form SUP 16 Ann 20;		
(4)(2)	an insurance conglomerate must use...		

Part 3

SUP 16.1-16.3

SUP 16 Reporting requirements

16.1 Application

...

16.1.2 G The only categories of *firm* to which no section of this chapter applies are:

- (1) an *ICVC*;
- (2) an *incoming EEA firm* or *incoming Treaty firm*, unless it is:
 - (a) a *firm* of a type listed in SUP 16.1.3 R as a type of *firm* to which SUP 16.6, SUP 16.7, ~~SUP 16.9~~ or SUP 16.12 applies; or
 - (b) an *insurer* with *permission* to effect or carry out life policies;
 - (c) a *firm* with *permission* to establish, operate or wind up a *stakeholder pension scheme*;
- (3) a *UCITS qualifier*.

16.1.3 R Application of different sections of SUP 16

(1) Section(s)	(2) Categories of firm to which section applies	(3) Applicable rules and guidance
...		
SUP 16.11	...	
<u>SUP 16.12</u>	<u>A firm undertaking the regulated activities as listed in SUP 16.12.4R, unless exempted in SUP 16.12.1R</u>	<u>Sections as relevant to regulated activities as listed in SUP 16.12.4R</u>

...

...

16.1.4 G ...

- (3) Requirements for individual *firms* reflect:
 - (a) the category of *firm*;
 - (b) the nature of business carried on;
 - (c) whether a *firm* has its registered office (or if it does not have a

registered office, its head office) in the *United Kingdom*; ~~and~~

(d) whether a *firm* is an *incoming EEA firm* or *incoming Treaty firm*; ~~and~~

(e) the regulated activities the *firm* undertakes.

...

SUP 16.3 General provisions on reporting

...

16.3.1 G (2) ...

(a) a *firm* of a type listed in SUP 16.1.3R as a *firm* to which section SUP 16.6, ~~or SUP 16.7~~ or SUP 16.12 applies

...

16.3.2 G This chapter has been split into ~~eight~~ the following sections, covering:

...

(7) verification of *standing data* (SUP 16.10); ~~and~~

(8) product sales data reporting (SUP 16.11); ~~and~~

(9) integrated regulatory reporting (SUP 16.12).

...

16.3.4 G The compliance ~~and financial reports~~ sections ~~are~~ is both set out by category of *firm*, with detailed requirements set out in tables giving:

...

...

16.3.25 G ...

Nevertheless, the requirement to provide a report or *data item*, and the responsibility for the report or *data item*, remains with each *firm* in the *group*. However, reporting requirements that apply to a *firm*, by reason of the *firm* being a member of a *financial conglomerate*, are imposed only on one member of the *financial conglomerate* (see, for example, ~~SUP 16.7.82R~~ SUP 16.12.32 R).

...

Part 4

SUP 16.12

After *SUP* 16.11 insert the following new chapter *SUP* 16.12. The inserted text is not underlined.

16.12 Integrated Regulatory Reporting

Application

16.12.1 G The effect of *SUP* 16.1.1R is that this section applies to every *firm* carrying on business set out in column (1) of *SUP* 16.12.4R except:

- (1) a *bank* with *permission* for *cross border services* only;
- (2) an *oil market participant*;
- (3) an *authorised professional firm*, which must comply with *SUP* 16.12.31R; and
- (4) a *financial conglomerate*, which must comply with *SUP* 16.12.32R: *firms* that are members of a *financial conglomerate* will have their own reporting requirements under *SUP* 16.12.32R.

Purpose

- 16.12.2 G
- (1) *Principle 4* requires *firms* to maintain adequate financial resources. The Interim Prudential sourcebooks, *PRU*, *BIPRU* and *GENPRU* set out the *FSA*'s detailed capital adequacy requirements. By submitting regular data, *firms* enable the *FSA* to monitor their compliance with *Principle 4* and their prudential requirements in the *FSA Handbook*.
 - (2) The *data items* submitted help the *FSA* analyse *firms*' financial and other conditions and performance and to understand their business. By means of further collation and review of the data which the *data items* provide, the *FSA* also uses the *data items* to identify developments across the financial services industry and its constituent sectors.
 - (3) The requirements in this section differ according to a *firm*'s *regulated activity group (RAG)*, as different information is required to reflect different types of business. Standard formats are used for reporting, to assist compatibility between *firms* which carry on similar types of business. Timely submission is important to ensure the *FSA* has up-to-date information.

Reporting requirement

16.12.3 R (1) Any *firm* carrying on any of the activities within each of the *RAGs*

set out in column (1) of the table in SUP 16.12.4 R must:

- (a) (i) unless (ii) applies, submit to the *FSA* the duly completed *data items* or other items applicable to the *firm* as set out in the provision referred to in column (2) of that table;
- (ii) to the extent that a *firm* is required to submit completed *data items* in respect of more than one *RAG*, the *firm* must only submit the *data item* of the same name and purpose in respect of the lowest numbered *RAG* applicable to it;
- (iii) (ii) does not apply to any *data items* relating to the *FSA* fees or *FOS* or *FSCS* levy which must be submitted in respect of each *RAG*;
- in the format specified as applicable to the *firm* in the provision referred to in column (2);
- (b) at the frequency and in respect of the periods set out in the provision referred to in column (3); and
- (c) by the due date referred to in the provision referred to in column (4).
- (2) Unless (3) applies, any *data item* in (1) must be submitted by electronic means made available by the *FSA*;
- (3) (2) does not apply to:
- (a) *credit unions* solely in relation to the reporting requirement for *RAG 1* activities, where SUP 16.3.6R to SUP 16.3.10G will apply; and
- (b) *firms* in *RAG 2* in relation to the reporting requirements for *RAG 2* activities.
- (4) A *firm* that is a member of a *financial conglomerate* must also submit financial reports as required by SUP 16.12.32 R

16.12.4 R Table of applicable rules containing *data items*, frequency and submission periods

(1)		(2)	(3)	(4)
<i>RAG</i> number	<i>Regulated Activities</i>	Provisions containing:		
		applicable <i>data items</i>	reporting frequency/ period	Due date
<i>RAG 1</i>	<ul style="list-style-type: none"> • accepting deposits • issuing electronic money 	<i>SUP</i> 16.12.5R	<i>SUP</i> 16.12.6R	<i>SUP</i> 16.12.7R
<i>RAG 2.1</i>	<ul style="list-style-type: none"> • effecting contracts of insurance 	[to follow]	[to follow]	[to follow]

	<ul style="list-style-type: none"> • carrying out contracts of insurance • entering as provider into a funeral plan contract 			
RAG 2.2	<ul style="list-style-type: none"> • managing the underwriting capacity of a Lloyds syndicate as a managing agent at Lloyds • advising on syndicate participation at Lloyds • arranging deals in contracts of insurance written at Lloyds 	[to follow]	[to follow]	[to follow]
RAG 3	<ul style="list-style-type: none"> • dealing in investment as principal • dealing in investments as agent • advising on investments (excluding retail investment activities) • arranging (bringing about) deals in investments (excluding retail investment activities) 	<i>SUP</i> 16.12.11R	<i>SUP</i> 16.12.12R	<i>SUP</i> 16.12.13R
RAG 4	<ul style="list-style-type: none"> • managing investments • establishing, operating or winding up a regulated collective investment scheme • establishing, operating or winding up an unregulated collective investment scheme • establishing, operating or winding up a stakeholder pension scheme • acting as depository or sole director of an OEIC 	<i>SUP</i> 16.12.15R	<i>SUP</i> 16.12.16R	<i>SUP</i> 16.12.17R
RAG 5	<ul style="list-style-type: none"> • entering into a regulated mortgage contract • administering a regulated mortgage contract 	[to follow]	[to follow]	[to follow]
RAG 6	<ul style="list-style-type: none"> • acting as trustee of an authorised unit trust • safeguarding and administration of assets (without arranging) • arranging safeguarding and administration of assets 	[to follow]	[to follow]	[to follow]
RAG 7	<ul style="list-style-type: none"> • retail investment activities • advising on pensions transfers & opt-outs • arranging (bringing about deals) in retail investments 	<i>SUP</i> 16.12.22R	<i>SUP</i> 16.12.23R	<i>SUP</i> 16.12.24R
RAG 8	<ul style="list-style-type: none"> • making arrangements with a view to transactions in investments 	<i>SUP</i> 16.12.25R	<i>SUP</i> 16.12.26R	<i>SUP</i> 16.12.27R
RAG 9	<ul style="list-style-type: none"> • mortgage mediation activity • insurance mediation activity (non-investment insurance contracts) 	[to follow]	[to follow]	[to follow]
RAG 10	<ul style="list-style-type: none"> • the activities of an <i>RIE/RCH</i> 	[to follow]	[to follow]	[to follow]

Regulated Activity Group 1

Applicable data items

16.12.5 R The applicable *data items* and forms or reports referred to in *SUP* 16.12.4R are set out according to firm type in the table below:

Description of data item	Prudential category of firm and applicable data items (Note 1)						
	<i>UK bank</i>	<i>Building society</i>	<i>Non-EEA bank</i>	<i>EEA bank that has permission to accept deposits, other than one with permission for cross border services only</i>	<i>EEA bank that does not have permission to accept deposits, other than one with permission for cross border services only</i>	Electronic money institutions	<i>Credit union</i>
Annual accounts	No standard format		No standard format, but in English			No standard format	
Audited accounts of the <i>mixed-activity holding company</i> (note 9)	No standard format						
Solvency statement (note 10)	No standard format						
Balance sheet	FSA001 (note 2)	FSA001 (note 2)				FSA020	CQ; CY
Income statement	FSA002 (note 2)	FSA002 (note 2)	FSA002			FSA021	CQ; CY
Capital adequacy	FSA003 (note 2)	FSA003 (note 2)				FSA022	CQ; CY
Credit risk	FSA004 (note 2)	FSA004 (note 2)					
Market risk	FSA005 (notes 2, 4)	FSA005 (notes 2, 4)				FSA023	
Market risk - supplementary	FSA006 (note 5)						
Operational risk	FSA007 (notes	FSA007 (notes 2,					

	2, 6)	6)					
Large exposures	FSA008 (note 2)	FSA008 (note 2)				FSA024	CQ; CY
UK integrated group large exposures	FSA018 (note 12)	FSA018 (note 12)					
Liquidity (other than stock)	FSA010 (note 3)	FSA011	FSA010	FSA010	FSA012	FSA025	CQ; CY
Liquidity – stock	FSA013 (note 3)						
Forecast data	FSA014 (note 11)	FSA014 (note 11)					
Solo consolidation data	FSA016 (note 7)	FSA016 (note 7)					
Interest rate gap report	FSA017	FSA017					
ELMI questions						FSA026	
Non-EEA sub-group	FSA028 (note 8)					FSA028 (note 8)	
Note 1	When submitting the completed <i>data item</i> required, a <i>firm</i> must use the format of the <i>data item</i> set out in SUP 16 Ann 24R, except for credit union reports that are in SUP 16 Ann 14R. Guidance notes for completion of the data items are contained in SUP 16 Ann 25G (or Ann 15G for credit unions).						
Note 2	Firms that are members of a <i>UK consolidation group</i> subject to the capital resources requirement at stage 1 of BIPRU 8 Annex 5R are also required to submit this <i>data item</i> on a <i>UK consolidation group</i> basis. <i>Firms'</i> attention is drawn to SUP 16.3.25G regarding a single submission for all <i>firms</i> in the <i>group</i> .						
Note 3	A <i>UK bank</i> is not required to submit both FSA010 and FSA013. A <i>UK bank</i> which monitors its liquidity according to the maturity mismatch approach as set out in IPRU(BANK) LM must submit FSA010. A <i>UK bank</i> which monitors its liquidity according to the sterling stock liquidity approach as set out in IPRU(BANK) LS must submit FSA013.						
Note 4	This is only applicable to a <i>firm</i> where, at the annual review of this requirement, following its <i>accounting reference date</i> , (a) for a <i>firm</i> that was reporting this <i>data item</i> or similar in the previous year, one or both of the last two quarterly submissions in the previous year show that the threshold was exceeded; or (b) for a <i>firm</i> that was not reporting this <i>data item</i> or similar in the previous year, both of the last two quarterly submissions in the previous year show that the threshold was exceeded; and in either case the <i>FSA</i> has notified the <i>firm</i> that it is required to submit the data item in accordance with the above. In both cases, the threshold is exceeded if <i>data element</i> 93A in <i>data item</i> FSA003 (or similar) is greater than £50 million, or its currency equivalent at the reporting date.						
Note 5	Only applicable to <i>firms</i> with a CAD2 waiver under GENPRU 2.1.52R.						

Note 6	This is only applicable to a <i>firm</i> that has adopted, in whole or in part, either the Standardised Approach, Alternative Standardised Approach, or Advanced Modelling Approaches under <i>BIPRU 7</i> .
Note 7	Only applicable to a <i>firm</i> that has a waiver under <i>BIPRU 2.1</i> to solo consolidate subsidiaries.
Note 8	This will be applicable to <i>firms</i> that report ‘yes’ in data element 4A in FSA001 on a half-yearly reporting date. <i>Firms’</i> attention is drawn to <i>SUP 16.3.25G</i> regarding a single submission for all <i>firms</i> in the <i>group</i> .
Note 9	Only applicable to a <i>firm</i> whose ultimate <i>parent</i> is a <i>mixed activity holding company</i> .
Note 10	Only applicable to a <i>firm</i> that is a <i>partnership</i> , when the report must be submitted by each <i>partner</i> .
Note 11	Members of a <i>UK consolidation group</i> should only submit this <i>data item</i> at the <i>UK consolidation group</i> level. <i>Firms’</i> attention is drawn to <i>SUP 16.3.25G</i> regarding a single submission for all <i>firms</i> in the <i>group</i> .
Note 12	Members of a <i>UK integrated group</i> should only submit this <i>data item</i> at the <i>UK integrated group</i> level. <i>Firms’</i> attention is drawn to <i>SUP 16.3.25G</i> regarding a single submission for all <i>firms</i> in the <i>group</i> .

16.12.6 R The applicable reporting frequencies for submission of *data items* and periods referred to in *SUP 16.12.5R* are set out in the table below according to firm type. Reporting frequencies are calculated from a *firm's accounting reference date*, unless indicated otherwise.

	Unconsolidated <i>UK banks and building societies</i>	Solo consolidated <i>UK banks and building societies</i>	Report on a <i>UK consolidation group</i> basis by <i>UK banks and building societies</i>	Other members of RAG 1
Annual accounts	Annual			Annual
Annual accounts of the <i>mixed-activity holding company</i>	Annual			
Solvency statement	Annual			
CQ				Quarterly
CY				Annually (note 2)
FSA001	Quarterly		Half yearly	
FSA002	Quarterly		Half yearly	Half yearly
FSA003	Quarterly or monthly (note 1)		Half yearly	
FSA004	Quarterly		Half yearly	
FSA005	Quarterly		Half yearly	
FSA006		Quarterly		
FSA007		Annually		
FSA008		Quarterly		
FSA010	Quarterly			Quarterly

FSA011	Quarterly		
FSA012			Half yearly
FSA013	Quarterly		
FSA014	Half yearly		
FSA016		Half yearly	
FSA017	Quarterly		Half yearly
FSA018	Quarterly		
FSA020			Half yearly
FSA021			Half yearly
FSA022			Half yearly
FSA023			Half yearly
FSA024			Half yearly
FSA025			Half yearly
FSA026			Half yearly
FSA028	Half yearly		
Note 1	Monthly submission only applicable if the <i>firm</i> has been notified in writing that it is required to report (when, on an annual review, it has two consecutive quarterly submissions of FSA003 showing <i>data element</i> 93A being greater than £50 million, or its currency equivalent, and also greater than 50% of <i>data element</i> 70A or, during 2007, it has two consecutive quarterly submissions of FSA009 showing <i>data element</i> 27A and <i>data element</i> 33A combined being greater than £50 million, or its currency equivalent, and also greater than 50% of <i>data element</i> 36A.		
Note 2	The annual report required from a <i>credit union</i> by SUP 16.12.5R must be made up for the same period as the audited accounts published by the <i>credit union</i> in accordance with section 3A of the Friendly and Industrial and Provident Societies Act 1968 (see CRED 14 Ann 1). CRED 14.10.10R (2)(a) states that the audited accounts referred to in SUP 16.12.5R are to be made up for the period beginning with the date of the <i>credit union's</i> registration or with the date to which the <i>credit union's</i> last annual accounts were made up, and ending on the <i>credit union's</i> most recent financial year end.		

16.12.7 R The applicable due dates for submission referred to in SUP 16.12.4R are set out in the table below. The due dates are the last day of the periods given in the table below following the relevant reporting frequency period set out in SUP 16.12.6R.

<i>Data item</i>	Monthly submission	Quarterly submission	Half yearly submission	Annual submission
Annual accounts				3 months (note 1) 7 months (note 2)
Annual accounts of the <i>mixed-activity holding company</i>				7 months
Solvency statement				3 months
CQ		1 month		

CY				7 months
FSA001		20 <i>business days</i>	45 <i>business days</i>	
FSA002		20 <i>business days</i>	45 <i>business days</i>	
FSA003	15 <i>business days</i>	20 <i>business days</i>	45 <i>business days</i>	
FSA004		20 <i>business days</i>	45 <i>business days</i>	
FSA005		20 <i>business days</i>	45 <i>business days</i>	
FSA006		20 <i>business days</i>		
FSA007				2 months
FSA008		20 <i>business days</i> (note 3) 45 <i>business days</i> (note 4)		
FSA010		15 <i>business days</i>		
FSA011		15 <i>business days</i>		
FSA012			30 <i>business days</i>	
FSA013		15 <i>business days</i>		
FSA014			30 <i>business days</i> (note 3); 45 <i>business days</i> (note 4)	
FSA016			30 <i>business days</i>	
FSA017		20 <i>business days</i>		
FSA018		45 <i>business days</i>		
FSA020			30 <i>business days</i>	
FSA021			30 <i>business days</i>	
FSA022			30 <i>business days</i>	
FSA023			30 <i>business days</i>	
FSA024			30 <i>business days</i>	
FSA025			30 <i>business days</i>	
FSA026			30 <i>business days</i>	
FSA028			30 <i>business days</i>	
Note 1	Applicable to <i>UK banks</i> and electronic money institutions.			
Note 2	Applicable to <i>non-EEA banks</i> .			
Note 3	Applicable to unconsolidated and solo consolidated reports			
Note 4	Applicable to <i>UK consolidation group reports</i>			

Regulated Activity Group 2.1

16.12.8 [to follow]

Regulated Activity Group 2.2

16.12.9 [to follow]

Regulated Activity Group 3

16.12.10 [to follow]

16.12.11 R The applicable *data items* referred to in SUP 16.12.4R are set out according to *firm* type in the table below:

Description of data item	<i>Firms</i> prudential category and applicable data items (note 1)							
	<i>BIPRU firms</i>			<i>Firms</i> other than <i>BIPRU firms</i>				
	730K	125K and <i>UCITS investment firms</i>	50K	IPRU INV Chapter 3	IPRU INV Chapter 5	IPRU INV Chapter 9	IPRU INV Chapter 13	UPRU
Annual accounts	No standard format			[to follow]				
Annual accounts of the <i>mixed-activity holding company</i> (note 10)	No standard format							
Solvency statement	No standard format (note 11)							
Balance sheet	FSA001 (note 2)	FSA001 (note 2)	FSA001 (note 2)					
Income statement	FSA002 (note 2)	FSA002 (note 2)	FSA002 (note 2)					
Capital adequacy	FSA003 (note 2)	FSA003 (note 2)	FSA003 (note 2)					
Credit risk	FSA004 (notes 2, 3)	FSA004 (notes 2, 3)	FSA004 (notes 2, 3)					
Market risk	FSA005 (notes 2, 4)	FSA005 (notes 2, 4)	FSA005 (notes 2, 4)					
Market risk - supplementary	FSA006 (note 5)	FSA006 (note 5)	FSA006 (note 5)					
Operational risk	FSA007	FSA007 (notes 7)	FSA007 (notes 7)					

	(notes 2, 6, 7)	2, 6, 7)	2, 6, 7)	
Large exposures	FSA008 (note 2)	FSA008 (note 2)	FSA008 (note 2)	
UK integrated group large exposures	FSA018 (note 12)	FSA018 (note 12)	FSA018 (note 12)	
Solo consolidation data	FSA016	FSA016	FSA016	
Pillar 2 questionnaire	FSA019 (note 8)	FSA019 (note 8)	FSA019 (note 8)	
Non-EEA sub-group	FSA028 (note 9)	FSA028 (note 9)	FSA028 (note 9)	
Note 1	When submitting the completed <i>data item</i> required, a <i>firm</i> must use the format of the <i>data item</i> set out in SUP 16 Ann 24R. Guidance notes for completion of the data items are contained in SUP 16 Ann 25G.			
Note 2	Firms that are members of a <i>UK consolidation group</i> subject to the capital resources requirement at stages 2, 3 or 4 of BIPRU 8 Annex 5R are also required to submit this report on a <i>UK consolidation group</i> basis.			
Note 3	<p>This is only applicable to a <i>firm</i> where, at the annual review of this requirement, following its <i>accounting reference date</i>,</p> <p>(a) for a <i>firm</i> that was reporting this <i>data item</i> or similar in the previous year, one or both of the last two quarterly submissions in the previous year show that the threshold was exceeded; or</p> <p>(b) for a <i>firm</i> that was not reporting this <i>data item</i> or similar in the previous year, both of the last two quarterly submissions in the previous year show that the threshold was exceeded;</p> <p>and in either case the <i>FSA</i> has notified the <i>firm</i> that it is required to submit the data item in accordance with the above.</p> <p>In both cases, the threshold is exceeded if <i>data element 77A</i> in <i>data item</i> FSA003 (or similar) is greater than £10 million, or its currency equivalent at the reporting date.</p>			
Note 4	<p>This is only applicable to a <i>firm</i> where, at the annual review of this requirement, following its <i>accounting reference date</i>,</p> <p>(a) for a <i>firm</i> that was reporting this <i>data item</i> or similar in the previous year, one or both of the last two quarterly submissions in the previous year show that the threshold was exceeded; or</p> <p>(b) for a <i>firm</i> that was not reporting this <i>data item</i> or similar in the previous year, both of the last two quarterly submissions in the previous year show that the threshold was exceeded;</p> <p>and in either case the <i>FSA</i> has notified the <i>firm</i> that it is required to submit the data item in accordance with the above.</p>			

	In both cases, the threshold is exceeded if <i>data element</i> 93A in <i>data item</i> FSA003 (or similar) is greater than £50 million, or its currency equivalent at the reporting date.
Note 5	Only applicable to <i>firms</i> with a CAD2 waiver under <i>GENPRU</i> 2.1.52R.
Note 6	This will not be applicable to <i>BIPRU limited activity firms</i> or <i>BIPRU limited licence firms</i> unless they have a waiver under <i>BIPRU</i> 6.1.2G.
Note 7	This is only applicable to a <i>firm</i> that has adopted, in whole or in part, either the Standardised Approach, Alternative Standardised Approach, or Advanced Modelling Approaches under <i>BIPRU</i> 7.
Note 8	Only applicable to <i>firms</i> that are: (a) subject to consolidated supervision under <i>BIPRU</i> 8, <u>except</u> those that are either included within the consolidated supervision of a group that includes a UK <i>credit institution</i> , or that have been granted an <i>investment firm consolidation waiver</i> ; (b) subject to consolidated supervision under <i>BIPRU</i> 8 that have been granted an <i>investment firm consolidation waiver</i> ; and (c) not subject to consolidated supervision under <i>BIPRU</i> 8. A <i>firm</i> under (a) should complete the report on the basis of its UK <i>consolidation group</i> . A <i>firm</i> under (b) or (c) should complete the report on the basis of its solo position.
Note 9	This will be applicable to firms that report ‘yes’ in data element 4A in FSA001 on the reporting date. Firms’ attention is drawn to <i>SUP</i> 16.3.25G regarding a single submission for all firms in the group.
Note 10	Only applicable to a <i>firm</i> whose ultimate <i>parent</i> is a <i>mixed activity holding company</i> .
Note 11	Only applicable to a firm that is a <i>sole trader</i> or a <i>partnership</i> , when the report must be submitted by each <i>partner</i> .
Note 12	Members of a UK <i>integrated group</i> should only submit this <i>data item</i> at the UK <i>integrated group</i> level. Firms’ attention is drawn to <i>SUP</i> 16.3.25G regarding a single submission for all <i>firms</i> in the group.

16.12.12 R The applicable reporting frequencies for *data items* referred to in *SUP* 16.12.16 R are set out in the table below according to *firm* type. Reporting frequencies are calculated from a *firm's accounting reference date*, unless indicated otherwise.

Data item	<i>BIPRU</i> 730K <i>firm</i>	<i>BIPRU</i> 125K <i>firm</i> and <i>UCITS</i> <i>investment</i> <i>firm</i>	<i>BIPRU</i> 50K <i>firm</i>	Consolidated <i>BIPRU</i> <i>investment</i> <i>firm</i>	<i>Firms</i> other than <i>BIPRU</i> <i>firms</i>
Annual accounts	Annually	Annually	Annually		[to follow]
Annual accounts of the <i>mixed-activity holding company</i>	Annually	Annually	Annually		

Solvency statement	Annually	Annually	Annually		
FSA001	Quarterly	Quarterly	Half yearly	Half yearly	
FSA002	Quarterly	Quarterly	Half yearly	Half yearly	
FSA003	Monthly	Quarterly	Half yearly	Half yearly	
FSA004	Quarterly	Quarterly	Half yearly	Half yearly	
FSA005	Quarterly	Quarterly	Half yearly	Quarterly	
FSA006	Quarterly	Quarterly	Quarterly	Quarterly	
FSA007	Annual	Annual	Annual	Annual	
FSA008	Quarterly	Quarterly	Quarterly	Quarterly	
FSA016	Half yearly	Half yearly	Half yearly		
FSA018	Quarterly	Quarterly	Quarterly		
FSA019	Annually	Annually	Annually	Annually	
FSA028	Half yearly	Half yearly	Half yearly		

16.12.13 R The applicable due dates for submission referred to in *SUP* 16.12.6R are set out in the table below. The due dates are the last day of the periods given in the table below following the relevant reporting frequency period set out in *SUP* 16.12.12R.

<i>Data item</i>	Monthly submission	Quarterly submission	Half yearly submission	Annual submission
Annual accounts				80 <i>business days</i>
Annual accounts of the <i>mixed-activity holding company</i>				7 months
Solvency statement				3 months
FSA001		20 <i>business days</i>	30 <i>business days</i> (note 1) 45 <i>business days</i> (note 2)	
FSA002		20 <i>business days</i>	30 <i>business days</i> (note 1) 45 <i>business days</i> (note 2)	
FSA003	15 <i>business days</i>	20 <i>business days</i>	30 <i>business days</i> (note 1) 45 <i>business days</i> (note 2)	
FSA004		20 <i>business days</i>	30 <i>business days</i> (note 1) 45 <i>business days</i> (note 2)	
FSA005		20 <i>business days</i>	30 <i>business days</i> (note 1) 45 <i>business days</i> (note 2)	
FSA006		20 <i>business days</i>		

FSA007				2 months
FSA008		20 <i>business days</i> (note 1); 45 <i>business days</i> (note 2)		
FSA016			30 <i>business days</i>	
FSA018		45 <i>business days</i>		
FSA019				2 months
FSA028			30 <i>business days</i>	
Note 1	For unconsolidated and solo-consolidated reports.			
Note 2	For <i>UK consolidation group</i> reports.			

Regulated Activity Group 4

16.12.14 [to follow]

16.12.15 R The applicable *data items* referred to in *SUP* 16.12.4R according to type of *firm* are set out in the table below:

Description of data item	<i>Firms prudential category and applicable data items (note 1)</i>							
	<i>BIPRU</i>			<i>Firms other than BIPRU firms</i>				
	730K	125K and <i>UCITS</i> <i>investment</i> <i>firms</i>	50K	IPRU INV Chapter 3	IPRU INV Chapter 5	IPRU INV Chapter 9	IPRU INV Chapter 13	UPRU
Annual accounts	No standard format			[to follow]				
Annual accounts of the <i>mixed-activity holding company</i> (note 10)	No standard format							
Solvency statement (note 11)	No standard format							
Balance sheet	FSA00 1 (note 2)	FSA00 1 (note 2)	FSA00 1 (note 2)					
Income statement	FSA00 2 (note 2)	FSA00 2 (note 2)	FSA00 2 (note 2)					
Capital adequacy	FSA00 3 (note 2)	FSA00 3 (note 2)	FSA00 3 (note 2)					
Credit risk	FSA00	FSA00	FSA00					

	4 (notes 2, 3)	4 (notes 2, 3)	4 (notes 2, 3)
Market risk	FSA00 5 (notes 2, 4)	FSA00 5 (notes 2, 4)	FSA00 5 (notes 2, 4)
Market risk - supplementa ry	FSA00 6 (note 5)	FSA00 6 (note 5)	FSA00 6 (note 5)
Operational risk	FSA00 7 (notes 2, 6, 7)	FSA00 7 (notes 2, 6, 7)	FSA00 7 (notes 2, 6, 7)
Large exposures	FSA00 8 (note 2)	FSA00 8 (note 2)	FSA00 8 (note 2)
UK integrated group large exposures	FSA01 8 (note 12)	FSA01 8 (note 12)	FSA01 8 (note 12)
Solo consolidatio n data	FSA01 6	FSA01 6	FSA01 6
Pillar 2 questionnair e	FSA01 9 (note 8)	FSA01 9 (note 8)	FSA01 9 (note 8)
Non-EEA sub-group	FSA02 8 (note 9)	FSA02 8 (note 9)	FSA02 8 (note 9)
Note 1:	When submitting the completed <i>data item</i> required, a <i>firm</i> must use the format of the <i>data item</i> set out in SUP 16 Ann 24R. Guidance notes for completion of the data items are contained in SUP 16 Ann 25G.		
Note 2	Firms that are members of a <i>UK consolidation group</i> subject to the capital resources requirement at stages 2, 3 or 4 of BIPRU 8 Annex 5R are also required to submit this report on a <i>UK consolidation group</i> basis.		
Note 3	<p>This is only applicable to a <i>firm</i> where, at the annual review of this requirement, following its <i>accounting reference date</i>,</p> <p>(a) for a <i>firm</i> that was reporting this <i>data item</i> or similar in the previous year, one or both of the last two quarterly submissions in the previous year show that the threshold was exceeded; or</p> <p>(b) for a <i>firm</i> that was not reporting this <i>data item</i> or similar in the previous year, both of the last two quarterly submissions in the previous year show that the threshold was exceeded;</p> <p>and in either case the FSA has notified the <i>firm</i> that it is required to submit the data item in accordance with the above.</p> <p>In both cases, the threshold is exceeded if <i>data element 77A in data item FSA003</i> (or similar) is greater than £10 million, or its currency equivalent at the reporting date.</p>		
Note 4	This is only applicable to a <i>firm</i> where, at the annual review of this requirement, following its <i>accounting reference date</i> ,		

	<p>(a) for a <i>firm</i> that was reporting this <i>data item</i> or similar in the previous year, one or both of the last two submissions in the previous year show that the threshold was exceeded; or</p> <p>(b) for a <i>firm</i> that was not reporting this <i>data item</i> or similar in the previous year, both of the last two submissions in the previous year show that the threshold was exceeded;</p> <p>and in either case the FSA has notified the <i>firm</i> that it is required to submit the data item in accordance with the above.</p> <p>In both cases, the threshold is exceeded if <i>data element 93A</i> in <i>data item FSA003</i> (or similar) is greater than £50 million, or its currency equivalent at the reporting date.</p>
Note 5	Only applicable to <i>firms</i> with a CAD2 waiver under <i>GENPRU 2.1.52R</i> .
Note 6	This will not be applicable to <i>BIPRU limited activity firms</i> or <i>BIPRU limited licence firms</i> unless they have a waiver under <i>BIPRU 6.1.2G</i> .
Note 7	This is only applicable to a <i>firm</i> that has adopted, in whole or in part, either the Standardised Approach, Alternative Standardised Approach, or Advanced Modelling Approaches under <i>BIPRU 7</i> .
Note 8	<p>Only applicable to <i>firms</i> that are:</p> <p>(a) subject to consolidated supervision under <i>BIPRU 8</i>, <u>except</u> those that are either included within the consolidated supervision of a group that includes a UK <i>credit institution</i>, or that have been granted an <i>investment firm consolidation waiver</i>;</p> <p>(b) subject to consolidated supervision under <i>BIPRU 8</i> that have been granted an <i>investment firm consolidation waiver</i>; and</p> <p>(c) not subject to consolidated supervision under <i>BIPRU 8</i>.</p> <p>A <i>firm</i> under (a) should complete the report on the basis of its UK <i>consolidation group</i>. A <i>firm</i> under (b) or (c) should complete the report on the basis of its solo position.</p>
Note 9	This will be applicable to firms that report ‘yes’ in data element 4A in FSA001 on the reporting date. Firms’ attention is drawn to <i>SUP 16.3.25G</i> regarding a single submission for all firms in the group.
Note 10	Only applicable to a <i>firm</i> whose ultimate <i>parent</i> is a <i>mixed activity holding company</i> .
Note 11	Only applicable to a firm that is a <i>sole trader</i> or a <i>partnership</i> , when the report must be submitted by each <i>partner</i> .
Note 12	Members of a UK <i>integrated group</i> should only submit this <i>data item</i> at the UK <i>integrated group</i> level. Firms’ attention is drawn to <i>SUP 16.3.25G</i> regarding a single submission for all <i>firms</i> in the <i>group</i> .

16.12.16 R The applicable reporting frequencies for *data items* referred to in *SUP 16.12.15R* are set out in the table below according to *firm* type. Reporting frequencies are calculated from a *firm's accounting reference date*, unless indicated otherwise.

Data item	Firms' prudential category				
	<i>BIPRU 730K firm</i>	<i>BIPRU 125K firm and UCITS investment firm</i>	<i>BIPRU 50K firm</i>	Consolidated <i>BIPRU investment firm</i>	<i>Firms other than BIPRU firms</i>
Annual	Annually	Annually	Annually		[to follow]

accounts					
Annual accounts of the <i>mixed-activity holding company</i>	Annually	Annually	Annually		
Solvency statement	Annually	Annually	Annually		
FSA001	Quarterly	Quarterly	Half yearly	Half yearly	
FSA002	Quarterly	Quarterly	Half yearly	Half yearly	
FSA003	Monthly	Quarterly	Half yearly	Half yearly	
FSA004	Quarterly	Quarterly	Half yearly	Half yearly	
FSA005	Quarterly	Quarterly	Half yearly	Half yearly	
FSA006	Quarterly	Quarterly	Half yearly	Half yearly	
FSA007	Annually	Annually	Annually	Annually	
FSA008	Quarterly	Quarterly	Quarterly	Quarterly	
FSA016	Half yearly	Half yearly	Half yearly		
FSA018	Quarterly	Quarterly	Quarterly		
FSA019	Annually	Annually	Annually	Annually	
FSA028	Half yearly	Half yearly	Half yearly		

16.12.17 R The applicable due dates for submission referred to in *SUP* 16.12.4R are set out in the table below. The due dates are the last day of the periods given in the table below following the relevant reporting frequency period set out in *SUP* 16.12.16R.

<i>Data item</i>	Monthly submission	Quarterly submission	Half yearly submission	Annual submission
Annual accounts				3 months (note 1)
Annual accounts of the <i>mixed-activity holding company</i>				7 months
Solvency statement				3 months
FSA001		20 <i>business days</i>	30 <i>business days</i> (note 2); 45 <i>business days</i> (note 3)	
FSA002		20 <i>business days</i>	30 <i>business days</i> (note 2); 45 <i>business days</i> (note 3)	
FSA003	15 <i>business days</i>	20 <i>business days</i>	30 <i>business days</i> (note 2); 45 <i>business days</i> (note 3)	

FSA004		20 <i>business days</i>	30 <i>business days</i> (note 2); 45 <i>business days</i> (note 3)	
FSA005		20 <i>business days</i>	30 <i>business days</i> (note 2); 45 <i>business days</i> (note 3)	
FSA006		20 <i>business days</i>		
FSA007				2 months
FSA008		20 <i>business days</i> (note 2); 45 <i>business days</i> (note 3)		
FSA016			30 <i>business days</i>	
FSA018		45 <i>business days</i>		
FSA019				2 months
FSA028			30 <i>business days</i>	
Note 1	<i>BIPRU investment firms</i> – 3 months:			
Note 2	For unconsolidated and solo-consolidated reports.			
Note 3	For <i>UK consolidation group</i> reports.			

Regulated Activity Group 5

16.12.18 [to follow]

Regulated Activity Group 6

16.12.19 [To follow]

16.12.20 [To follow]

16.12.21 [To follow]

Regulated Activity Group 7

16.12.22 R The applicable *data items* referred to in *SUP* 16.12.4R are set out in the table below:

Description of <i>Data item</i>	Firm prudential category and applicable <i>data item</i> (note 1)				
	<i>BIPRU 730K firm</i>	<i>BIPRU 125K firm and UCITS investment firm</i>	<i>BIPRU 50K firm</i>	IPRU INV Chapter 13 firms carrying out European – wide activities under MiFID	IPRU INV Chapter 13 firms not carrying out European-wide activities under MiFID
Annual accounts	No standard format			[to follow]	
Annual accounts of the <i>mixed-activity holding company</i> (note 10)	No standard format				
Solvency statement	No standard format (note 11)				
Balance Sheet	FSA001 (note 2)	FSA001 (note 2)	FSA001 (note 2)		
Income Statement	FSA002 (note 2)	FSA002 (note 2)	FSA002 (note 2)		
Capital Adequacy	FSA003 (note 2)	FSA003 (note 2)	FSA003 (note 2)		
Credit risk	FSA004 (notes 2, 3)	FSA004 (notes 2, 3)	FSA004 (notes 2, 3)		
Market risk	FSA005 (notes 2, 4)	FSA005 (notes 2, 4)	FSA005 (notes 2, 4)		
Market risk - supplementary	FSA006 (note 5)	FSA006 (note 5)	FSA006 (note 5)		
Operational risk	FSA007 (notes 2, 6, 7)	FSA007 (notes 2, 6, 7)	FSA007 (notes 2, 6, 7)		
Large exposures	FSA008 (note 2)	FSA008 (note 2)	FSA008 (note 2)		
UK integrated group large exposures	FSA018 (note 12)	FSA018 (note 12)	FSA018 (note 12)		
Solo consolidation data	FSA016	FSA016	FSA016		
Pillar 2 questionnaire	FSA019 (note 8)	FSA019 (note 8)	FSA019 (note 8)		
Non-EEA sub-group	FSA028 (note 9)	FSA028 (note 9)	FSA028 (note 9)		
Professional indemnity insurance	Section E RMAR	Section E RMAR	Section E RMAR		
Threshold	Section F	Section F	Section F		

Conditions	RMAR	RMAR	RMAR
Training and Competence	Section G RMAR	Section G RMAR	Section G RMAR
COB data	Section H RMAR	Section H RMAR	Section H RMAR
Supplementary product sales data	Section I RMAR	Section I RMAR	Section I RMAR
Fees and levies	Section J RMAR	Section J RMAR	Section J RMAR
Note 1	When submitting the completed <i>data item</i> required, a <i>firm</i> must use the format of the <i>data item</i> set out in SUP 16 Ann 24R. Guidance notes for completion of the data items are contained in SUP 16 Ann 25G.		
Note 2	Firms that are members of a <i>UK consolidation group</i> subject to the capital resources requirement at stages 2, 3 or 4 of BIPRU 8 Annex 5R are also required to submit this report on a <i>UK consolidation group</i> basis.		
Note 3	<p>This is only applicable to a <i>firm</i> where, at the annual review of this requirement, following its <i>accounting reference date</i>,</p> <p>(a) for a <i>firm</i> that was reporting this <i>data item</i> or similar in the previous year, one or both of the last two submissions in the previous year show that the threshold was exceeded; or</p> <p>(b) for a <i>firm</i> that was not reporting this <i>data item</i> or similar in the previous year, both of the last two submissions in the previous year show that the threshold was exceeded;</p> <p>and in either case the <i>FSA</i> has notified the <i>firm</i> that it is required to submit the data item in accordance with the above.</p> <p>In both cases, the threshold is exceeded if <i>data element 77A</i> in <i>data item FSA003</i> (or similar) is greater than £10 million, or its currency equivalent at the reporting date.</p>		
Note 4	<p>This is only applicable to a <i>firm</i> where, at the annual review of this requirement, following its <i>accounting reference date</i>,</p> <p>(a) for a <i>firm</i> that was reporting this <i>data item</i> or similar in the previous year, one or both of the last two submissions in the previous year show that the threshold was exceeded; or</p> <p>(b) for a <i>firm</i> that was not reporting this <i>data item</i> or similar in the previous year, both of the last two submissions in the previous year show that the threshold was exceeded;</p> <p>and in either case the <i>FSA</i> has notified the <i>firm</i> that it is required to submit the data item in accordance with the above.</p> <p>In both cases, the threshold is exceeded if <i>data element 93A</i> in <i>data item FSA003</i> (or similar) is greater than £50 million, or its currency equivalent at the reporting date.</p>		
Note 5	Only applicable to <i>firms</i> with a CAD2 waiver under GENPRU 2.1.52R.		
Note 6	This will not be applicable to <i>BIPRU limited activity firms</i> or <i>BIPRU limited licence firms</i> unless they have a waiver under BIPRU 6.1.2G.		
Note 7	This is only applicable to a <i>firm</i> that has adopted, in whole or in part, either the Standardised Approach, Alternative Standardised Approach, or Advanced Modelling Approaches under BIPRU 7.		
Note 8	<p>Only applicable to <i>firms</i> that are:</p> <p>(a) subject to consolidated supervision under BIPRU 8, <u>except</u> those that are either included within the consolidated supervision of a group that includes a <i>UK credit</i></p>		

	<p><i>institution</i>, or that have been granted an <i>investment firm consolidation waiver</i>;</p> <p>(b) subject to consolidated supervision under <i>BIPRU 8</i> that have been granted an <i>investment firm consolidation waiver</i>; and</p> <p>(c) not subject to consolidated supervision under <i>BIPRU 8</i>.</p> <p>A <i>firm</i> under (a) should complete the report on the basis of its <i>UK consolidation group</i>. A <i>firm</i> under (b) or (c) should complete the report on the basis of its solo position.</p>
Note 9	This will be applicable to firms that report ‘yes’ in data element 4A in FSA001 on the reporting date. Firms’ attention is drawn to <i>SUP 16.3.25G</i> regarding a single submission for all firms in the group.
Note 10	Only applicable to a <i>firm</i> whose ultimate <i>parent</i> is a <i>mixed activity holding company</i> .
Note 11	Only applicable to a firm that is a <i>sole trader</i> or a <i>partnership</i> , when the report must be submitted by each <i>partner</i> .
Note 12	Members of a <i>UK integrated group</i> should only submit this <i>data item</i> at the <i>UK integrated group</i> level. <i>Firms</i> ’ attention is drawn to <i>SUP 16.3.25G</i> regarding a single submission for all <i>firms</i> in the <i>group</i> .

16.12.23 R The applicable reporting frequencies for *data items* referred to in *SUP 16.12.22R* are set out in the table below. Reporting frequencies are calculated from a *firm's accounting reference date*, unless indicated otherwise.

<i>Data item</i>	Frequency				
	Unconsolidated <i>BIPRU investment firm</i>	Solo consolidated <i>BIPRU investment firm</i>	Consolidated <i>BIPRU investment firm</i>	Annual regulated business revenue up to and including £5 million	Annual regulated business revenue over £5 million
Annual accounts	No standard format			[to follow]	
Annual accounts of the <i>mixed-activity holding company</i>	No standard format				
Solvency statement	No standard format				
FSA001	Quarterly or half yearly (note 1)	Quarterly or half yearly (note 1)	Half yearly		
FSA002	Quarterly or half yearly (Note 1)	Quarterly or half yearly (note 1)	Half yearly		
FSA003	Monthly, quarterly or	Monthly, quarterly or	Half yearly		

	half yearly (note 2)	half yearly (note 2)	
FSA004	Quarterly or half yearly (note 1)	Quarterly or half yearly (note 1)	Half yearly
FSA005	Quarterly or half yearly (note 1)	Quarterly or half yearly (note 1)	Half yearly
FSA006	Quarterly	Quarterly	Quarterly
FSA007	Annually	Annually	Annually
FSA008	Quarterly	Quarterly	Quarterly
FSA016		Half yearly	
FSA018	Quarterly	Quarterly	Quarterly
FSA019	Annually	Annually	Annually
FSA028	Half yearly	Half yearly	
Section E RMAR	Half yearly	Half yearly	Half yearly
Section F RMAR	Half yearly	Half yearly	Half yearly
Section G RMAR	Half yearly	Half yearly	Half yearly
Section H RMAR	Half yearly	Half yearly	Half yearly
Section I RMAR	Half yearly	Half yearly	Half yearly
Section J RMAR	Annually	Annually	Annually
Note 1:	<i>BIPRU 730K firms</i> and <i>BIPRU 125 K firms</i> – quarterly; <i>BIPRU 50K firms</i> – half yearly.		
Note 2:	<i>BIPRU 730K firms</i> – monthly; <i>BIPRU 125K firms</i> – quarterly; <i>BIPRU 50K firms</i> – half yearly.		

16.12.24 R The applicable due dates for submission referred to in *SUP* 16.12.4R are set out in the table below. The due dates are the last day of the periods given in the table below following the relevant reporting frequency period set out in *SUP* 16.12.23R.

<i>Data item</i>	Monthly submission	Quarterly submission	Half yearly submission	Annual submission
Annual accounts				3 months
Annual accounts of the <i>mixed-activity holding company</i>				7 months
Solvency statement				3 months

FSA001		20 <i>business days</i>	30 <i>business days</i> (note 1); 45 <i>business days</i> (note 2)	
FSA002		20 <i>business days</i>	30 <i>business days</i> (note 1); 45 <i>business days</i> (note 2)	
FSA003	15 <i>business days</i>	20 <i>business days</i>	30 <i>business days</i> (note 1); 45 <i>business days</i> (note 2)	
FSA004		20 <i>business days</i>	30 <i>business days</i> (note 1); 45 <i>business days</i> (note 2)	
FSA005		20 <i>business days</i>	30 <i>business days</i> (note 1); 45 <i>business days</i> (note 2)	
FSA006		20 <i>business days</i>		
FSA007				2 months
FSA008		20 <i>business days</i> (note 1); 45 <i>business days</i> (note 2)		
FSA016			30 <i>business days</i>	
FSA018		45 <i>business days</i>		
FSA019				2 months
FSA028			30 <i>business days</i>	
FSA031		20 <i>business days</i>	20 <i>business days</i>	
Section E RMAR			30 <i>business days</i>	
Section F RMAR			30 <i>business days</i>	
Section G RMAR			30 <i>business days</i>	
Section H RMAR			30 <i>business days</i>	
Section I RMAR			30 <i>business days</i>	
Section J RMAR				30 <i>business days</i>
Note 1	For unconsolidated and solo consolidated reports			
Note 2	For <i>UK consolidation group</i> reports			

Regulated Activity Group 8

16.12.25 R The applicable *data items* referred to in SUP 16.12.4R are set out in the

table below:

Description of data item	<i>Firms prudential category and applicable data item (note 1)</i>							
	<i>BIPRU</i>			<i>Firms other than BIPRU firms</i>				
	730K	125K	50K	IPRU INV Chapter 3	IPRU INV Chapter 5	IPRU INV Chapter 9	IPRU INV Chapter 13	UPRU
Annual accounts	No standard format			[to follow]				
Annual accounts of the <i>mixed-activity holding company</i> (note 10)	No standard format							
Solvency statement (note 11)	No standard format							
Balance sheet	FSA00 1 (note 2)	FSA00 1 (note 2)	FSA00 1 (note 2)					
Income statement	FSA00 2 (note 2)	FSA00 2 (note 2)	FSA00 2 (note 2)					
Capital adequacy	FSA00 3 (note 2)	FSA00 3 (note 2)	FSA00 3 (note 2)					
Credit risk	FSA00 4 (note 2, 3)	FSA00 4 (note 2, 3)	FSA00 4 (note 2, 3)					
Market risk	FSA00 5 (notes 2, 4)	FSA00 5 (notes 2, 4)	FSA00 5 (notes 2, 4)					
Market risk - supplementary	FSA00 6 (note 5)	FSA00 6 (note 5)	FSA00 6 (note 5)					
Operational risk	FSA00 7 (notes 2, 6, 7)	FSA00 7 (notes 2, 6, 7)	FSA00 7 (notes 2, 6, 7)					
Large exposures	FSA00 8 (note 2)	FSA00 8 (note 2)	FSA00 8 (note 2)					
UK Integrated group large exposures	FSA01 8 (note 12)	FSA01 8 (note 12)	FSA01 8 (note 12)					

Solo consolidation data	FSA01 6	FSA01 6	FSA01 6
Pillar 2 questionnaire	FSA01 9 (note 8)	FSA01 9 (note 8)	FSA01 9 (note 8)
Non-EEA sub-group	FSA02 8 (note 9)	FSA02 8 (note 9)	FSA02 8 (note 9)
Note 1:	When submitting the completed <i>data item</i> required, a <i>firm</i> must use the format of the <i>data item</i> set out in SUP 16 Ann 24R. Guidance notes for completion of the data items are contained in SUP 16 Ann 25G.		
Note 2	Firms that are members of a <i>UK consolidation group</i> subject to the capital resources requirement at stages 2, 3 or 4 of BIPRU 8 Annex 5R are also required to submit this report on a <i>UK consolidation group</i> basis.		
Note 3	<p>This is only applicable to a <i>firm</i> where, at the annual review of this requirement, following its <i>accounting reference date</i>,</p> <p>(a) for a <i>firm</i> that was reporting this <i>data item</i> or similar in the previous year, one or both of the last two submissions in the previous year show that the threshold was exceeded; or</p> <p>(b) for a <i>firm</i> that was not reporting this <i>data item</i> or similar in the previous year, both of the last two submissions in the previous year show that the threshold was exceeded;</p> <p>and in either case the <i>FSA</i> has notified the <i>firm</i> that it is required to submit the data item in accordance with the above.</p> <p>In both cases, the threshold is exceeded if <i>data element 77A</i> in <i>data item FSA003</i> (or similar) is greater than £10 million, or its currency equivalent at the reporting date.</p>		
Note 4	<p>This is only applicable to a <i>firm</i> where, at the annual review of this requirement, following its <i>accounting reference date</i>,</p> <p>(a) for a <i>firm</i> that was reporting this <i>data item</i> or similar in the previous year, one or both of the last two submissions in the previous year show that the threshold was exceeded; or</p> <p>(b) for a <i>firm</i> that was not reporting this <i>data item</i> or similar in the previous year, both of the last two submissions in the previous year show that the threshold was exceeded;</p> <p>and in either case the <i>FSA</i> has notified the <i>firm</i> that it is required to submit the data item in accordance with the above.</p> <p>In both cases, the threshold is exceeded if <i>data element 93A</i> in <i>data item FSA003</i> (or similar) is greater than £50 million, or its currency equivalent at the reporting date.</p>		
Note 5	Only applicable to <i>firms</i> with a CAD2 waiver under GENPRU 2.1.52R.		
Note 6	This will not be applicable to <i>BIPRU limited activity firms</i> or <i>BIPRU limited licence firms</i> unless they have a waiver under BIPRU 6.1.2G.		
Note 7	This is only applicable to a <i>firm</i> that has adopted, in whole or in part, either the Standardised Approach, Alternative Standardised Approach, or Advanced Modelling Approaches under BIPRU 7		
Note 8	<p>Only applicable to <i>firms</i> that are:</p> <p>(a) subject to consolidated supervision under BIPRU 8, <u>except</u> those that are either included within the consolidated supervision of a group that includes a <i>UK credit institution</i>, or that have been granted an <i>investment firm</i></p>		

	<i>consolidation waiver</i> ; (b) subject to consolidated supervision under <i>BIPRU 8</i> that have been granted an <i>investment firm consolidation waiver</i> ; and (c) not subject to consolidated supervision under <i>BIPRU 8</i> . A <i>firm</i> under (a) should complete the report on the basis of its <i>UK consolidation group</i> . A <i>firm</i> under (b) or (c) should complete the report on the basis of its solo position.
Note 9	This will be applicable to firms that report ‘yes’ in data element 4A in FSA001 on the reporting date. Firms’ attention is drawn to <i>SUP 16.3.25G</i> regarding a single submission for all firms in the group.
Note 10	Only applicable to a <i>firm</i> whose ultimate <i>parent</i> is a <i>mixed activity holding company</i> .
Note 11	Only applicable to a firm that is a <i>sole trader</i> or a <i>partnership</i> , when the report must be submitted by each <i>partner</i> .
Note 12	Members of a <i>UK integrated group</i> should only submit this <i>data item</i> at the <i>UK integrated group</i> level. Firms’ attention is drawn to <i>SUP 16.3.25G</i> regarding a single submission for all <i>firms</i> in the <i>group</i> .

16.12.26 R The applicable reporting frequencies for *data items* referred to in *SUP 16.12.25R* are set out in the table below. Reporting frequencies are calculated from a *firm's accounting reference date*, unless indicated otherwise.

	<i>BIPRU 730K firm</i>	<i>BIPRU 125K firm</i>	<i>BIPRU 50K firm</i>	<i>Consolidated BIPRU investment firm</i>	<i>Firms other than BIPRU firms</i>
Annual accounts	Annually	Annually	Annually		[to follow]
Annual accounts of the <i>mixed-activity holding company</i>	Annually	Annually	Annually	Annually	
Solvency statement	Annually	Annually	Annually		
FSA001	Quarterly	Quarterly	Half yearly	Half yearly	
FSA002	Quarterly	Quarterly	Half yearly	Half yearly	
FSA003	Monthly	Quarterly	Half yearly	Half yearly	
FSA004	Quarterly	Quarterly	Half yearly	Half yearly	
FSA005	Quarterly	Quarterly	Half yearly	Quarterly	
FSA006	Quarterly	Quarterly	Quarterly		
FSA007	Annually	Annually	Annually	Annually	
FSA008	Quarterly	Quarterly	Quarterly	Quarterly	
FSA016	Half yearly	Half yearly	Half yearly		
FSA018	Quarterly	Quarterly	Quarterly		
FSA019	Annually	Annually	Annually	Annually	
FSA028	Half yearly	Half yearly	Half yearly		

16.12.27 R The applicable due dates for submission referred to in SUP 16.12.4R are set out in the table below. The due dates are the last day of the periods given in the table below following the relevant reporting frequency period set out in SUP 16.12.26R.

<i>Data item</i>	Monthly submission	Quarterly submission	Half yearly submission	Annual submission
Annual accounts				80 <i>business days</i>
Annual accounts of the <i>mixed-activity holding company</i>				As soon as available after the year end
Solvency statement				3 months
FSA001		20 <i>business days</i>	30 <i>business days</i> (note 1); 45 <i>business days</i> (note 2)	
FSA002		20 <i>business days</i>	30 <i>business days</i> (note 1); 45 <i>business days</i> (note 2)	
FSA003	15 <i>business days</i>	20 <i>business days</i>	30 <i>business days</i> (note 1); 45 <i>business days</i> (note 2)	
FSA004		20 <i>business days</i>	30 <i>business days</i> (note 1); 45 <i>business days</i> (note 2)	
FSA005		20 <i>business days</i>	30 <i>business days</i> (note 1); 45 <i>business days</i> (note 2)	
FSA006		20 <i>business days</i>	30 <i>business days</i> (note 1); 45 <i>business days</i> (note 2)	
FSA007				2 months
FSA008		20 <i>business days</i> (note 1); 45 <i>business days</i> (note 2)		
FSA016			30 <i>business days</i>	
FSA018		45 <i>business days</i>		
FSA019				2 months
FSA028			30 <i>business days</i>	
Note 1	For unconsolidated and solo consolidated reports.			
Note 2	For <i>UK consolidation group</i> reports			

Regulated Activity Group 9

16.12.28 [to follow]

Regulated Activity Group 10

16.12.29 [to follow]

16.12.30 [to follow]

Authorised professional firms

16.12.31 [to follow]

Financial conglomerates

- 16.12.32 R (1) A *firm* that is a member of a *financial conglomerate* must submit financial reports to the *FSA* in accordance with the table in *SUP* 16.12.33R if:
- (a) it is at the head of an *FSA regulated EEA financial conglomerate*; or
 - (b) its *Part IV permission* contains a relevant *requirement*.
- (2) In (1)(b), a relevant *requirement* is one which:
- (a) applies *SUP* 16.12.33R to the *firm*; or
 - (b) applies *SUP* 16.12.33R to the *firm* unless the *mixed financial holding company* of the *financial conglomerate* to which the *firm* belongs submits the report required under this *rule* (as if the *rule* applied to it).
- 16.12.33 R Financial reports from a member of a financial conglomerate (see *SUP* 16.12.32R)

Content of Report	Form (Note 1)	Frequency	Due Date
Calculation of supplementary capital adequacy requirements in accordance	Note 2	Note 5	Note 5

with one of the four technical calculation methods			
Identification of significant <i>risk concentration</i> levels	Note 3	Yearly	4 months after year end
Identification of significant <i>intra-group transactions</i>	Note 4	Yearly	4 months after year end
Report on compliance with PRU 8.4.35R <i>GENPRU</i> 3.1.[35]R where it applies	Note 6	Note 5	Note 5
Note 1	When giving the report required, a <i>firm</i> must use the form indicated, if any.		
Note 2	<p>If Part 1 of <i>GENPRU</i> 3 Annex 1R (method 1), Part 2 of <i>GENPRU</i> 3 Annex 1R (method 2), or Part 3 of <i>GENPRU</i> 3 Annex 1R (method 3) applies, there is no specific form. Adequate information must be provided, and each <i>financial conglomerate</i> for which the <i>FSA</i> is the <i>co-ordinator</i> must discuss with the <i>FSA</i> how to do this.</p> <p>If Part 4 of <i>GENPRU</i> 3 Annex 1R applies (method 4):</p> <p>(1) a <i>banking / investment conglomerate</i> must use FSA003; and</p> <p>(2) an <i>insurance conglomerate</i> must use:</p> <p>(a) (where <i>SUP</i> 16.12.32(1)(a) applies), Forms 1, 2 and 3 in Appendix 9.1 of <i>IPRU(INS)</i> prepared in accordance with <i>IPRU (INS)</i> 9.35(1); or</p> <p>(b) (in any other case), the Insurance Group Capital Adequacy Reporting Form (Form 95) in Appendix 9.9 of <i>IPRU(INS)</i></p> <p>For the purposes of (b), <i>rules</i> 9.40(1), 9.40(1A), 9.40(3) and 9.40(4) of <i>IPRU(INS)</i> apply as they would if the <i>insurance conglomerate</i> were an <i>insurance group</i>.</p>		
Note 3	<p>Rather than specifying a standard format for each <i>financial conglomerate</i> to use, each <i>financial conglomerate</i> for which the <i>FSA</i> is the <i>co-ordinator</i> must discuss with the <i>FSA</i> the form of the information to be reported. This should mean that usual information management systems of the <i>financial conglomerate</i> can be used to the extent possible to generate and analyse the information required.</p> <p>When reviewing the <i>risk concentration</i> levels, the <i>FSA</i> will in particular monitor the possible risk of contagion in the <i>financial conglomerate</i>, the risk of a conflict of interests, the risk of circumvention of sectoral <i>rules</i>, and the level or volume of risks.</p>		
Note 4	<p>For the purposes of this reporting requirement, an <i>intra-group transaction</i> will be presumed to be significant if its amount exceeds 5% of the total amount of capital adequacy requirements at the level of the <i>financial conglomerate</i>.</p> <p>Rather than specifying a standard format for each <i>financial conglomerate</i> to use, each <i>financial conglomerate</i> for which the <i>FSA</i> is the <i>co-ordinator</i> will need to discuss with the <i>FSA</i> the form of the information to be reported. This should mean that usual information management systems of the <i>financial conglomerate</i> can be used to the extent possible to generate and analyse the information required.</p> <p>When reviewing the <i>intra-group transactions</i>, the <i>FSA</i> will in particular monitor the possible risk of contagion in the <i>financial conglomerate</i>, the risk of a conflict of interests, the risk of circumvention of <i>sectoral rules</i>, and the level or volume of risks.</p>		
Note 5	The frequency and due date will be as follows:		

	<p>(1) <i>banking / investment conglomerate</i>: frequency is half-yearly with due date 45 <i>business days</i> after period end</p> <p>(2) <i>insurance conglomerate</i>: frequency is yearly with due date four months after period end for the capital adequacy return and three months after period end for the report on compliance with <i>GENPRU</i> 3.1.[35]R where it applies.</p>
Note 6	Adequate information must be added as a separate item to the relevant form for sectoral reporting.

Part 5

Amendments to SUP 16 Annexes

SUP 16 Ann 2G

...

Large Exposures (Form LE3)

...

Large Exposures Capital Base (LECB)

...

... Thereafter, instead of the LECB, firms should report, in its place, the figure of capital resources, calculated in accordance with *BIPRU* 10.5.23R, and as reported to the FSA as data element 22A of FSA009, for the same reporting date ~~preceding the current reporting date~~. In that way, the capital resources figure will be continually updated. ~~In the case of reports on a consolidated basis, the capital resources figure will only change half yearly.~~ References to LECB should be regarded as referring to this capital resources figure once firms are reporting on this basis.

...

... Thereafter, instead of that adjusted capital base, firms should report, in its place, the figure of capital resources, calculated in accordance with *BIPRU* 10.5.34R, and reported to the FSA as data element 22A of FSA009, for the same reporting date ~~preceding the current reporting date~~.

...

SUP 16 Ann 4G

...

Building society; quarterly statement QFS1

...

Section L: Exposure analysis: Large exposures – Group

...

1 Basis for reporting Large Exposures on Table L

...

(ii) ...

... Thereafter, firms should instead use the figure of capital resources for the group, calculated in accordance with *BIPRU* 10.5.23R, and reported to the FSA as data element 24A of FSA009 for the same reporting date ~~preceding the current reporting date~~. ...

...

SUP 16 Annex 5R

QUARTERLY FINANCIAL DETAILS

QFS5

...

4. LARGE EXPOSURES (*ISD Firms only*)

Provide details of all Large Exposures outstanding at the end of the period (73)

...

***... Thereafter, instead of the own funds figure, firms should use the figure of capital resources, calculated in accordance with *BIPRU* 10.5.23R and reported to the FSA as data element 22A in FSA009 for the same reporting date ~~preceding the current reporting date~~.

SUP 16 Ann 11G

...

SUP 16 Ann 11G section 4

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

I Summary of reporting requirements

(1) An exposure

...

... Thereafter, instead of the own funds figure (or financial resources and own funds figures), firms should use the figure of capital resources, calculated in accordance with *BIPRU* 10.5.23R, and reported to the FSA as data element 22A of FSA009 for the same reporting date ~~preceding the current reporting date~~. In that way, the capital resources figure will be continually updated. ~~In the case of reports on a consolidated basis, the capital resources figure will only change half yearly.~~ References to own funds, for large exposures purposes, should be regarded as referring to this capital resources figure once firms are reporting on this basis.

...

II The reporting form (LEM) – General, coverage and layout

General

...

Coverage and Layout of Forms LEM 1 and 2

...

... Thereafter, the figure of own funds should be the figure of capital resources, calculated in accordance with *BIPRU* 10.5.23R, and reported to the FSA as data element 22A of FSA009 for the same reporting date ~~preceding the current reporting date~~. The figure of financial resources should then be blank.

...

SUP 16 Annex 16R

Financial returns - UCITS Management Companies

UQFS 5

3. LARGE EXPOSURES (*UCITS Investment Firms only*)

Provide details of all Large Exposures outstanding at the end of the period (72)

...

***... Thereafter, instead of the own funds figure, firms should use the figure of capital resources calculated in accordance with *BIPRU* 10.5.23R and reported to the FSA as data element 22A in FSA009 for the same reporting date ~~preceding the current reporting date~~.

SUP16 Ann 18BG

Notes for completion of the Retail Mediation Activities Return ('RMAR') **RMAR**

...

Section D3: *ISD Personal investment firms*

This section will no longer be applicable for reporting dates after 31 December 2007. Until then, firms should complete this section in accordance with the guidance given below.

...

Section D4: CAD13 quarterly financial resources (*ISD personal investment firms*)

This section will no longer be applicable after 31 December 2007. Until then, firms should complete this section in accordance with the guidance given below.

...

Section D5: reportable *Large Exposures* (*ISD personal investment firms*)

This section will no longer be applicable after 31 December 2007. Until then, firms should complete this section in accordance with the guidance given below.

...

... Thereafter, it should use the figure of capital resources, calculated in accordance with *BIPRU* 10.5.23R, and reported to the FSA as data element 22A of FSA009 for the same reporting date ~~preceding the current reporting date~~. References to own funds, for large exposures purposes, should be regarded as referring to this capital resources figure once firms are reporting on this basis.

Part 6

SUP 16 Annex 24 R

All of the text in this section is new and is not underlined.

FSA001

Balance sheet

1 Is this report on behalf of a UK consolidation group? A B
Yes/No

2 If yes, please list the FSA firm reference numbers of the other firms in the consolidation group.

Index number	FSA FRN
1	
...	
n	

3 If no (to data element 1), is this a solo-consolidated report? Yes/No

4 If no (to data element 1), are you a member of a non-EEA sub-group? (If you answer yes, you are also required to report FSA028.) Yes/No

Assets

	A	B
	Trading book	Non-trading book
5 Cash and balances at central banks (excludes client money)	<input type="text"/>	<input type="text"/>
6 Credit items in the course of collection from banks	<input type="text"/>	<input type="text"/>
7 Treasury bills and other eligible bills	<input type="text"/>	<input type="text"/>
8 Deposits with, and loans to, credit institutions	<input type="text"/>	<input type="text"/>
9 Loans and advances to customers	<input type="text"/>	<input type="text"/>
10 Debt securities	<input type="text"/>	<input type="text"/>
11 Equity shares	<input type="text"/>	<input type="text"/>
12 Investment in group undertakings	<input type="text"/>	<input type="text"/>
13 Reverse repurchase agreements and cash collateral on securities borrowed	<input type="text"/>	<input type="text"/>
14 Derivatives	<input type="text"/>	<input type="text"/>
15 Goodwill	<input type="text"/>	<input type="text"/>
16 Other intangible assets	<input type="text"/>	<input type="text"/>
17 Tangible fixed assets	<input type="text"/>	<input type="text"/>
18 Prepayments and accrued income	<input type="text"/>	<input type="text"/>
19 Other assets	<input type="text"/>	<input type="text"/>
20 Total assets	<input type="text"/>	<input type="text"/>

(both trading and non-trading)

Liabilities

	A
21 Own bank notes issued	<input type="text"/>
22 Items in the course of collection due to other banks	<input type="text"/>
23 Deposits from banks and building societies, including overdrafts and loans from them	<input type="text"/>
24 Customer accounts	<input type="text"/>
25 of which Retail	<input type="text"/>
26 E-money	<input type="text"/>
27 Corporate	<input type="text"/>
28 Intra-group	<input type="text"/>
29 Other	<input type="text"/>
30 Trading liabilities	<input type="text"/>
31 Debt securities in issue, excluding covered bonds	<input type="text"/>
32 Covered bonds	<input type="text"/>
33 Derivatives	<input type="text"/>
34 Liabilities in respect of sale and repurchase agreements, and cash collateral received for securities lent	<input type="text"/>
35 Retirement benefit liabilities	<input type="text"/>
36 Taxation liabilities	<input type="text"/>
37 Provisions	<input type="text"/>

38	Subordinated liabilities	
39	Accruals and deferred income	
40	Other liabilities	
41	Subtotal	
42	Called up share capital, including partnership, LLP and sole trader capital	
43	Reserves	
44	Minority interests	
45	Total liabilities and equity	

Memorandum items

Derivatives

	Notional contract amount	Reporting date value	
		Assets	Liabilities
	A	B	C
46	Foreign exchange		
47	Interest rate		
48	Credit derivatives		
49	Equity and stock index		
50	Commodity		
51	Other		
52	Total		
53	Total after accounting netting		

Other items

54	Direct credit substitutes	
55	Transaction related contingents	
56	Trade-related contingents	
57	Asset sales with recourse	
58	Forward asset purchases	
59	Forward forward deposits placed	
60	Uncalled partly-paid shares and securities	
61	NIFs and RUFs	
62	Endorsement of bills	
63	Other commitments	
64	Client Money	
65	Number of customers	

FSA002

Income statement

	A Of which Trading book	B Total
1 Financial & operating income - total		
2 Interest income		
3 <i>of which</i> on retail secured loans		
4 on retail unsecured loans (including bank deposits)		
5 on card accounts		
6 other		
7 Fee and commission income		
8 <i>of which</i> Gross commission and brokerage		
9 Performance fees		
10 Investment management fees		
11 Investment advisory fees		
12 Corporate finance		
13 UCITS management fees		
14 Other fee and commission income		
15 Trading income (losses)		
16 <i>of which</i> on trading investments		
17 charges on UCITS sales / redemptions		
18 on foreign exchange		
19 other trading income		
20 Gains (losses) arising from non-trading instruments		
21 Realised gains (losses) on financial assets & liabilities (other than HFT and FVTPL)		
22 Dividend income		
23 Other operating income		
24 Gains (losses) on disposals of HFS non-current assets & discontinued operations		
25 Financial & operating charges		
26 Interest paid		
27 <i>of which</i> on bank and building society deposits		
28 on retail deposits		
29 on corporate deposits		
30 on intra-group deposits		
31 on other deposits		
32 Fee and commission expense		
33 Other operating expenses		
34 Other costs		
35 Staff expenses		
36 <i>of which</i> staff costs (ie non-discretionary)		
37 charges for discretionary staff costs		
38 General administrative expenses		
39 Depreciation & amortisation		
40 Impairment/Provisions		
41 Other charges		
42 Share of profit (losses) of associates		
43 Exceptional items		

FSA002 continued

44 **Profit (loss) before tax**

--	--

45 Tax expense (income)

--

46 **Net profit (loss)**

--

Memorandum items

47 Dividends paid during year

--

48 **Give details here of exceptional items**

--

FSA003

Capital adequacy

The firm completing this is subject to the capital rules for (tick one only):

- 1 A UK bank or a building society
- 2 A full scope BIPRU investment firm
- 3 A BIPRU limited activity firm
- 4 A BIPRU limited licence firm, including a UCITS investment firm

- 5 If you are a full scope BIPRU investment firm, do you meet the conditions in BIPRU TP 12.1R?

If you are a BIPRU investment firm, are you a:

- 6 BIPRU 730K firm
- 7 BIPRU 125K firm (excluding UCITS investment firms)
- 8 UCITS investment firm
- 9 BIPRU 50K firm
- 10 Do you have an investment firm consolidation waiver under BIPRU 8.4?
- 11 Have you notified the FSA, at least one month in advance of the date of this report, that you intend to deduct illiquid assets?

- 12 Basis of reporting
 Unconsolidated/Solo-consolidated/Consolidated

If consolidated, please complete data elements 13 and 14, otherwise go straight to data element 15.

- 13 For consolidated reporting, provide
 Group reference Group name

- 14 For consolidated reporting, provide details of all other FSA authorised firms included in this consolidated report.

	A	B
FRN		Name

A	B
Capital resources for all other purposes	Capital resources omitting Stage C

- | 15 | Total capital after deductions | <input type="text"/> |
|----|--------------------------------------------------------------------------------|----------------------|
| 16 | Total tier one capital after deductions | <input type="text"/> |
| 17 | Core tier one capital | <input type="text"/> |
| 18 | Permanent share capital | <input type="text"/> |
| 19 | Profit and loss account and other reserves | <input type="text"/> |
| 20 | Interim net losses | <input type="text"/> |
| 21 | Eligible partnership, LLP or sole trader capital | <input type="text"/> |
| 22 | Share premium account | <input type="text"/> |
| 23 | Externally verified interim net profits | <input type="text"/> |
| 24 | Other tier one capital | <input type="text"/> |
| 25 | Perpetual non-cumulative preference shares subject to limit | <input type="text"/> |
| 26 | Innovative tier one instruments subject to limit | <input type="text"/> |
| 27 | Deductions from tier one capital | <input type="text"/> |
| 28 | Investments in own shares | <input type="text"/> |
| 29 | Intangible assets | <input type="text"/> |
| 30 | Excess on limits for non innovative tier one instruments | <input type="text"/> |
| 31 | Excess on limits for innovative tier one instruments | <input type="text"/> |
| 32 | Excess of drawings over profits for partnerships, LLPs or sole traders | <input type="text"/> |
| 33 | Net losses on equities held in the available-for-sale financial asset category | <input type="text"/> |
| 34 | Material holdings | <input type="text"/> |
| 35 | Total tier two capital after deductions | <input type="text"/> |

	A Capital resources for all other purposes	B Capital resources omitting Stage C
36	Upper tier two capital	
37	Excess on limits for tier one capital transferred to upper tier two capital	
38	Upper tier two capital instruments	
39	Revaluation reserve	
40	General/collective provisions	
41	Surplus provisions	
42	Lower tier two capital	
43	Lower tier two capital instruments	
44	Excess on limits for lower tier two capital	
45	Deductions from tier two capital	
46	Excess on limits for tier two capital	
47	Other deductions from tier two capital	
48	Deductions from total of tiers one and two capital	
49	Material holdings	
50	Expected loss amounts and other negative amounts	
51	Securitisation positions	
52	Qualifying holdings	
53	Contingent liabilities	
54	Reciprocal cross-holdings	
55	Investments that are not material holdings or qualifying holdings	
56	Connected lending of a capital nature	
57	Total tier one capital plus tier two capital after deductions	
58	Total tier three capital	
59	Excess on limits for total tier two capital transferred to tier three capital	
60	Short term subordinated debt	
61	Net interim trading book profit and loss	
62	Excess on limit for tier three capital	
63	Unused but eligible tier three capital (memo)	
64	Total capital before deductions	
65	Deductions from total capital	
66	Excess trading book position	
67	Illiquid assets	
68	Free deliveries	
69	Base capital resources requirement	
70	Total variable capital requirement	
71	Variable capital requirement for UK banks and building societies	
72	Variable capital requirement for full scope BIPRU investment firms	
73	Variable capital requirement for BIPRU limited activity firms	
74	Variable capital requirement for BIPRU limited licence firms	
75	Variable capital requirement for UCITS investment firms	
76	Variable capital requirements to be met from tier one and tier two capital	
77	Total credit risk capital component	
78	Credit risk calculated by aggregation for UK consolidation group reporting	
79	Credit risk capital requirements under the standardised approach	
80	Credit risk capital requirements under the IRB approach	
81	Under foundation IRB approach	
82	Retail IRB	
83	Under advanced IRB approach	
84	Other IRB exposures classes	

	A Capital resources for all other purposes	B Capital resources omitting Stage C
85	Total operational risk capital requirement	
86	Operational risk calculated by aggregation for UK consolidation group reporting	
87	Operational risk basic indicator approach	
88	Operational risk standardised/alternative standardised approaches	
89	Operational risk advanced measurement approaches	
90	Reduction in operational risk capital requirement under BIPRU TP 12.1	
91	Counterparty risk capital component	
92	Capital requirements for which tier three capital may be used	
93	Total market risk capital requirement	
94	Market risk capital requirement calculated by aggregation for UK consolidation group reporting	
95	Position, foreign exchange and commodity risks under standardised approaches (TSA)	
96	Interest rate PRR	
97	Equity PRR	
98	Commodity PRR	
99	Foreign currency PRR	
100	CIU PRR	
101	Other PRR	
102	Position, foreign exchange and commodity risks under internal models (IM)	
103	Concentration risk capital component	
104	Fixed overhead requirement	
105	Capital resources requirement arising from capital floors	
106	Surplus (+) / Deficit (-) of own funds	
107	Solvency ratio (%)	
108	Individual Capital Guidance - total capital resources	
109	Individual Capital Guidance - general purpose capital	
110	Surplus/(deficit) total capital over ICG	
111	Surplus/(deficit) general purposes capital over ICG	
MEMORANDUM ITEMS		
112	Value of portfolio under management - UCITS investment firms	
Prudential filters		
113	Unrealised gains on available-for-sale assets	
114	Unrealised gains (losses) on investment properties	
115	Unrealised gains (losses) on land and buildings	
116	Unrealised gains (losses) on debt instruments held in the available for sale category	
117	Unrealised gains (losses) on cash flow hedges of financial instruments	
118	Unrealised gains (losses) on fair value financial liabilities	
119	Defined benefit asset (liability)	
120	(Deficit reduction amount) if used	
121	Deferred acquisition costs (deferred income) (DACs/DIRs)	
Minority interests		
122	Minority interests included within capital resources	
123	of which: innovative tier one instruments	
Profits		
124	Profits not externally verified at the reporting date but subsequently verified	
125	Total capital after deductions after profits have been externally verified	
Allocation of deductions between tier one and two capital		
126	Material insurance holdings excluded from allocation	
127	Allocated to tier one capital	
128	Allocated to tier two capital	

A
Capital
resources for all
other purposes

B
Capital
resources
omitting
Stage C

Firms on the IRB/AMA approaches

129	Total capital requirement under pre-CRD rules	
130	Total credit risk capital component under pre-CRD	
131	Expected loss amounts - wholesale, retail and purchased receivables	
132	Expected loss amounts - equity	
133	Total value adjustments and provisions eligible for the "EL less provisions" calculation under IRB	
134	Total deductions from tier 1 and tier 2 capital according to pre-CRD rules	

FSA004

Further breakdown of certain credit risk data

	A Capital requirement	B Exposure value
Breakdown under the Standardised Approach by exposure classes		
1 Total		
2 Central governments or central banks		
3 Regional governments or local authorities		
4 Administrative bodies and non-commercial undertakings		
5 Multilateral development banks		
6 International organisations		
7 Institutions		
8 Corporates		
9 Retail		
10 Secured on real estate property		
11 Past due items		
12 Items belonging to regulatory high risk categories		
13 Covered bonds		
14 Securitisation positions		
15 Short term claims on institutions and corporates		
16 Collective investment undertakings		
17 Other items		
Breakdown under the Foundation IRB		
18 Total		
19 Central governments and central banks		
20 Institutions		
21 Corporates		
22 Of which: to companies according to BIPRU 4.4.59 to BIPRU 4.4.60		
Breakdown of Retail IRB		
23 Total		
24 Retail mortgages		
25 Qualifying Revolving Retail Exposures		
26 Retail SME		
27 Other retail		
Breakdown under Advanced IRB		
28 Total		
29 Central governments and central banks		
30 Institutions		
31 Corporates		
32 Of which: to companies according to BIPRU 4.4.59 to BIPRU 4.4.60		
Breakdown of other IRB exposure classes		
33 Total		
34 Equity claims		
35 Securitisation positions		
36 Non-credit obligation assets		

FSA005

Market risk

		A	B	C	D	E	F	G
		USD	GBP	EUR	CHF	YEN	Other	Total
Interest rate risk								
General interest rate risk								
1	Valuations of longs							
2	Valuation of shorts							
3	PRR (as per handbook)							
Specific interest rate risk								
Amount by risk bucket								
4	0.00%							Total
5	0.25%							
6	1.00%							
7	1.60%							
8	8.00%							
9	12.00%							
10	PRR							
11	Securitisation exposures/unrated liquidity facilities PRR							
12	Ordinary CDS PRR							
13	Securitisation CDS PRR							
14	Basic interest rate PRR calculation for equity instruments							
15	Option PRR for interest rate positions							
16	CAD1 PRR for interest rate positions							
17	Other PRR							
18	Total interest rate PRR							
Equity risk								
General equity risk (or simplified)								
19	Valuations of longs							
20	Valuation of shorts							
21	PRR							

FSA005 continued

	A	B	C	D	E	F	G
	USD	GBP	EUR	CHF	YEN	Other	Total
22	Specific equity risk by risk bucket						
	Qualifying equities						
23	Qualifying equity indices						
24	Other equities, equity indices or equity baskets						
25	PRR						
26	Option PRR for equity positions						
27	CAD 1 PRR for equity positions						
28	Other PRR						
29	Total Equity PRR						

	Precious metals	Base metals	softs	energy	other	Total
30	Commodity Risk					
	Valuation of longs					
31	Valuation of shorts					
32	Outright PRR					
33	Spread PRR					
34	Carry PRR					
35	Simplified PRR					
36	Total PRR					
37	Option PRR for commodity positions					
38	CAD 1 PRR for commodity positions					
39	Other PRR					
40	Total Commodity PRR					

	USD	GBP	EUR	CHF	YEN	Other	Total
	Foreign currency risk						
	General foreign currency risk						
41	Total net long positions						
42	Total net short positions						
43	Net gold position						
44	PRR						

FSA005 continued

	A	B	C	D	E	F	G
	USD	GBP	EUR	CHF	YEN	Other	Total
45	Option PRR for foreign currency						
46	CAD 1 PRR for foreign currency						
47	Other						
48	Total foreign currency PRR						
	Collective investment undertaking risk						
	USD	GBP	EUR	CHF	YEN	Other	Total
	General CIU risk						
49	Total net long positions						
50	Total net short positions						
51	PRR						
52	Option PRR for CIU						
53	CAD 1 PRR for CIU						
54	Other PRR						
55	Total CIU PRR						
	Other PRR						
56	Any other PRR						
	VaR model risk						
57	Multiplier						
58	Previous day's VaR PRR						
59	Average of previous 60 days VaR						
60	Incremental Default Risk Surcharge						
61	VaR model based PRR						
62	GRAND TOTAL PRR						

FSA006

Market risk - supplementary data

Daily outturn data

Closing P&L date	VaR confidence level	Holding period (days)	Business unit code	Currency	Value at risk	BIPRU 7.10 cleaned P&L	Starting P&L date	Date on which VaR computed	Last date Var historic data updated	Add-on VaR	BIPRU 7.10 hypothetical P&L
---------------------	----------------------------	--------------------------	-----------------------	----------	---------------	---------------------------	----------------------	----------------------------------	-------------------------------------------	------------	-----------------------------------

1	A	B	C	D	E	F	G	H	J	K	L	M
1												
2												
n												

FSA007
Operational risk

The Standardised Approach (and Alternative Standardised Approach) **Advanced Measurement Approach**

1 **Approach adopted (Yes/No)**
Fill in the columns for each approach that is adopted
Relevant income indicator - 3 year average

A	B

- 2 - corporate finance
- 3 - trading and sales
- 4 - retail brokerage
- 5 - commercial banking
- 6 - retail banking
- 7 - payment and settlement
- 8 - agency services
- 9 - asset management

(Under Alternative Standardised Approach)

Nominal amount of loans and advances - 3 year average

- 10 - retail banking
- 11 - commercial banking

- 12 Capital
- 13 Expected loss
- 14 Total capital alleviation due to risk transfer mechanisms

15 **Capital required - total**

Operational risk losses - AMA firms only

- 16 **Gross loss amount for the whole period**
- 17 **Total number of loss events**

	Date event added to loss database	Date of loss event	Gross Loss Amount	Certainty of loss	Business line	Event type	Commentary
18	A	B	C	D	E	F	G
1							
2							
n							

Large exposures

1 Is this report by a UK consolidation group under BIPRU 8 Ann 1R? **A**

For consolidated reporters only

2 List the FSA Firm Reference Numbers of the members of the UK consolidation group **B**

Index no	FSA FRN
1	
...	
n	

For unconsolidated/solo-consolidated reporters only

3 Is the firm a member of a UK integrated group

Part 1: Large exposures at the reporting date (other than to members of integrated groups under BIPRU 10.8 or BIPRU 10.9)

4 Capital resources under BIPRU 10.5.3R **A**

Capital resources (BIPRU 10.5.4R) **B**

Exposure no	Counterparty name (or group name)	Gross exposure	% of capital resources under BIPRU 10.5.3R	Exposure after credit risk mitigation	Of which							Trading book concentration risk excesses			CNCOM	PD %	LGD %	EL %	Credit risk capital requirement	
					Exempt exposures		Non-exempt exposures					% of capital resources under 10.5.4R	Existed for 10 business days or less %	Persisted for more than 10 business days - %						
					Amount	% of capital resources	Non-trading book	% of capital resources	Trading book	% of capital resources	Aggregate %									
5	A	B	C	D	E	F	G	H	J	K	L	M	N	P	Q	R	S	T	U	V
1																				
...																				
n																				
Total																				

6 I confirm that the firm has notified the FSA under GENPRU 10.5.9R of all exposures that have exceeded, or will exceed, the limits set out in GENPRU 10.5.6R or 10.5.8R (tick to confirm) **A**

Part 2: Details of connected counterparties at the reporting date (excluding to members of integrated groups under BIPRU 10.8 or BIPRU 10.9)

Exposure no	Individual counterparties (each individually above 2.5% capital resources)	Gross exposure	% of capital resources under BIPRU 10.5.3R	Exposure after credit risk mitigation	Of which							
					Exempt exposures		Non-exempt exposures					
					Amount	%	Non-trading book	%	Trading book	%	Aggregate %	
7	A	B	C	D	E	F	G	H	J	K	L	M
1	Individually <2.5% of capital resources											
2												
...												
n												

Part 3: Trading book concentration risk excesses since the last reporting date (excluding any that exist in Part 1 at the reporting date)

8	Exposure no A	Counterparty name B	Gross exposure C	% of capital resources under BIPRU 10.5.3R D	Exposure after credit risk mitigation E	Of which			Is it a member of a diverse block or residual block? J
						Non-exempt exposures			
						Non-trading book amount F	Trading book amount G	Amount in excess of 25% of capital resources under BIPRU 10.5.4R H	
1									
...									
<i>n</i>									

Unconsolidated or solo-consolidated reporters only

Part 4: Significant transactions with the mixed activity holding company and its subsidiaries

9	Transaction no A	Counterparty name B	Transaction or exposure value C	% of capital resources D
1				
...				
<i>n</i>				

FSA010 Mismatch liquidity

Part 1 - marketable assets

	Mark to market		Discount where denominated in Zone A currency (%)	Discount where denominated in Zone B currency (%)	Discounted to	
	Zone A currencies	Zone B currencies			8 days and under	over 8 days to 1 month
	A	B			C	D
1 Cash held						
Debt instruments issued in Zone A countries						
2 Central government/central government guaranteed, including Treasury bills, eligible Local Authority paper and eligible bank bills with a residual maturity of up to 1 year			0	20		
3 Central government/central government guaranteed and Local Authority marketable debt of 1 to 5 years			5	25		
4 Central government/central government guaranteed and Local Authority marketable debt of over 5 years			10	30		
5 Non-government of 6 months or less			5	25		
6 Non-government of 6 months to 5 years			10	30		
7 Non-government of over 5 years			15	35		
Debt instruments issued in Zone B countries						
8 Central government/central government guaranteed with a residual maturity of up to 1 year			20	20		
9 Central government/central government guaranteed of 1 to 5 years			30	30		
10 Central government/central government guaranteed of over 5 years			40	40		
11 Eligible non-government of 6 months or less			30	30		
12 Eligible non-government of 6 months to 5 years			40	40		
13 Eligible non-government of over 5 years			50	50		
14 Brady bonds			20	40		
15 Highly liquid equities/equity indices			20	40		
16 Total discounted amount						

FSA010 continued

Part 2 - contractual basis:residual maturity

Inflows

A	B	C	D	E	F	G
Overdue	Demand (incl. next day)	8 days and under (excl. next day)	Over 8 days to 1 month	Over 1 months to 3 months	Over 3 months to 6 months	Total

Retail

17	Mortgages					
18	Personal loans					
19	Overdrafts					
20	Credit card inflows					
21	Repayment of advances					
22	Other retail inflows					

Wholesale

23	Non-marketable securities and debt instruments and marketable assets maturing within 1 month					
24	Intragroup / connected					
25	Interbank (excluding any intragroup)					
26	Corporate (non interbank, non intragroup)					
27	Government / Public sector					
28	Repos / reverse repos					
29	Trade related letters of credit.....					
30	Overdrafts					
31	Swaps and FRAs					
32	Forward foreign exchange					
33	Forward sales and purchases					
34	Other off balance sheet					
35	Fees and other income					
36	Other funding sources					
37	Total inflows					

FSA010 continued

Outflows

Retail

- 38 Time deposits
- 39 No notice / current accounts
- 40 Additional advances committed

B C D E F G

Wholesale

- 41 Non-marketable securities and debt instruments and marketable assets maturing within 1 month
- 42 Additional advances committed
- 43 Intragroup / Connected
- 44 Interbank (excluding any intragroup)
- 45 Corporate (non-interbank and non-intragroup)
- 46 Government / Public sector
- 47 Repos / Reverse Repos
- 48 Trade related letters of credit

- 49 Swaps and FRAs
- 50 Forward foreign exchange
- 51 Forward sales and purchases
- 52 Other off balance sheet

- 53 Dividends, tax, other costs and outflows

--	--	--	--	--	--	--

54 Total outflows

--	--	--	--	--	--	--

Memo Items

- 55 Option inflows
- 56 Option outflows
- 57 Undrawn committed facilities granted to the bank
- 58 Undrawn committed facilities granted by the bank
- 59 Commitments to lend under credit card and other revolving credit type facilities
- 60 **Total deposits**

A

- 61 Undrawn treasury concessions granted by the bank
- 62 Amount of total cash inflows in arrears

FSA010 continued

Part 3 - Behavioural basis

Inflows

A	B	C	D	E	F	G
Overdue	Demand (incl. next day)	8 days and under (excl. next day)	Over 8 days to 1 month	Over 1 months to 3 months	Over 3 months to 6 months	Total

Retail

63	Mortgages					
64	Personal loans					
65	Overdrafts					
66	Credit card inflows					
67	Repayment of advances					
68	Other retail inflows					

Wholesale

69	Non-marketable securities and debt instruments and marketable assets maturing within 1 month					
70	Intragroup / connected					
71	Interbank (excluding any intragroup)					
72	Corporate (non interbank, non intragroup)					
73	Government / Public sector					
74	Repos / reverse repos					
75	Trade related letters of credit					
76	Overdrafts					

77	Swaps and FRAs					
78	Forward foreign exchange					
79	Forward sales and purchases					
80	Other off balance sheet					

81	Fees and other income					
82	Other funding sources					

83	Total inflows					
----	----------------------	--	--	--	--	--

FSA010 continued

Outflows

Retail

- 84 Time deposits
- 85 No notice / current accounts
- 86 Additional advances committed

B C D E F G

Wholesale

- 87 Non-marketable securities and debt instruments and marketable assets maturing within 1 month
- 88 Additional advances committed
- 89 Intragroup / Connected
- 90 Interbank (excluding any intragroup)
- 91 Corporate (non-interbank and non-intragroup)
- 92 Government / Public sector
- 93 Repos / Reverse Repos.
- 94 Trade related letters of credit

- 95 Swaps and FRAs
- 96 Forward foreign exchange
- 97 Forward sales and purchases
- 98 Other off balance sheet

- 99 Dividends, tax, other costs and outflows

--	--	--	--	--	--

- 100 **Total outflows**

--	--	--	--	--	--

Part 4 - Calculation of liquidity mismatches

		B	C	D
		Demand (incl. next day)	8 days and under	1 month and under
Contractual Basis				
Inflows				
101	Cumulative discounted marketable assets			
102	Plus total cumulative standard inflows			
103	Equals total inflows (A)			
Outflows				
104	Total cumulative standard outflows			
105	Plus undrawn commitments to lend granted by the bank			
106	Plus undrawn credit card and other revolving commitments to lend			
107	Equals total outflows (B)			
Mismatch				
108	Net mismatch: standard basis (A - B)			
109	Total deposits (X)			
110	Mismatch as % of deposits [(A-B)/X] (to 2 decimal places)			
Behaviourally Adjusted Basis				
Inflows				
111	Cumulative discounted marketable assets			
112	Plus total cumulative behaviourally adjusted inflows			
113	Plus Y% * committed lines granted to the bank			
114	Y%			
115	Equals total inflows (C)			
Outflows				
116	Total cumulative behaviourally adjusted outflows			
117	Plus undrawn commitments to lend granted by the bank			
118	Z%			
119	Plus undrawn credit card and other revolving commitments to lend			
120	W%			
121	Equals total outflows (D)			
Mismatch				
122	Net mismatch: behaviourally adjusted basis (C - D)			
123	Total deposits (X)			
124	Mismatch as % of deposits [(C-D)/X] (to 2 decimal places)			

FSA010 continued

Exceptions to guidelines

	Date	A	B Sight to 8 days	C Sight to one month
125	1			
...				
n				

FSA011
Building society liquidity

	A	B	C	D	E
	Book value	Ineligible amount	Market value	Discounted value	Amount of prudential liquidity
Liquid assets realisable in up to 8 days					
1 Gilts with residual maturities of <1 year					
2 Gilts with residual maturities 1-5 years					
3 Gilts with residual maturities over 5 years					
4 Total gilts					
5 Other					
6 Liquid assets realisable from 8 days to 3 months					
7 Liquid assets realisable in 3 months and over					
8 Total liquid assets					

9 **SDL at reporting date**

Amounts of prudential liquidity at any time during the month (end of day balance)

	A	B	C
	Amount	As % of	Date
		SDL on	
		that day	
10 Minimum total prudential liquidity during quarter			
11 Maximum total prudential liquidity during quarter			

12 Building society holdings - at reporting date

Specialist data

13 Business assets not FSRP as % of business assets	
14 Deposits and loans as % of SDL	
15 Amount of offshore deposits	
16 Large shareholdings as % of SDL	

FSA012

Non-deposit-taking EEA bank liquidity

	A	B	C	D	E
	Up to 8 days	Up to 1 month	Up to 3 months	Up to 6 months	Up to 9 months
1 Total assets of the branch					
2 Cumulative inflow (outflow)					
3 Cumulative inflow/outflow as % of total assets					

FSA013
Stock liquidity

		A
1	Cash	
2	Operational balances with the Bank of England	
3	UK Treasury bills	
4	Gilts	
5	Other	
6	Total sterling stock	
7	Wholesale sterling net outflow limit	
8	Sterling stock Floor	
9	Wholesale sterling net outflow	
10	Total sterling CDs held	
11	Total discounted CDs	
12	Allowable CDs	
13	Remaining CDs	
14	Sterling retail deposits falling due in next 5 working days	
15	Sterling retail deposits to be covered	
16	Sterling liquidity ratio (LQR)	

FSA014**Forecast data from firms**

A

Profitability (for the financial year)

1	Net interest income	<input type="text"/>
2	Other income	<input type="text"/>
3	Expenditure	<input type="text"/>
4	Impairment / provisions	<input type="text"/>
5	Total profit before tax and minority interests	<input type="text"/>
6	Net profit (loss)	<input type="text"/>

Balance sheet

7	Cash and balances at central banks	<input type="text"/>
8	Loans and advances to customers	<input type="text"/>
9	Investments	<input type="text"/>
10	Customer accounts	<input type="text"/>
11	Deposits by banks, including overdrafts	<input type="text"/>
12	Total assets/liabilities	<input type="text"/>

Capital adequacy

13	Total capital after deductions	<input type="text"/>
14	Variable capital requirement at the end of period	<input type="text"/>

FSA016 Solo consolidation data

Aggregate use of solo-consolidation at the reporting date

		A
1	Number of subsidiaries included in the solo-consolidation	<input type="text"/>
2	Book value of investments included in solo-consolidation - EEA incorporated	<input type="text"/>
3	Book value of investments included in solo-consolidation - non-EEA incorporated	<input type="text"/>
4	Surplus capital in parent firm balance sheet	<input type="text"/>

Top 5 solo-consolidated subsidiaries ranked by book value of investment at the reporting date

	Name of subsidiary A	Country of incorporation B	Brief business descriptor C	Main underlying assets D	Book value of investment in subsidiary E	Capital requirements arising from assets within the subsidiary F
5						
1						
2						
3						
4						
5						

Top 5 solo-consolidated subsidiaries ranked by aggregate exposure of parent to subsidiary at the reporting date

	Name of subsidiary A	Country of incorporation B	Brief business descriptor C	Main underlying assets D	Aggregate exposure of parent to subsidiary E	Exposure of parent to subsidiary with a residual maturity of less than one year F	Capital requirements arising from assets within the subsidiary G
6							
1							
2							
3							
4							
5							

Top 5 solo-consolidated subsidiaries ranked by net flow of funds from parent to subsidiary during the reporting period

	Name of subsidiary A	Country of incorporation B	Brief business descriptor C	Main underlying assets D	Net flow of funds from parent to subsidiary E
7					
1					
2					
3					
4					
5					

FSA017
Interest rate gap report

	A	B	C	D	E	F	G	H	J	K	L	M	N	P	Q
1	Gap sensitivity to parallel shift of:	2%													
	Totals	Overnight to 3 months	3-6 months	6-12 months	1-2 years	2-3 years	3-4 years	4-5 years	5-6 years	6-7 years	7-8 years	8-9 years	9-10 years	Over 10 years	No specific re-pricing
Assets															
2	Monetary balance sheet assets (non-optional) as per contractual re-pricing date														
3	> Adjusted for actual expected re-pricing date														
4	> Pipeline products														
5	Monetary balance sheet assets with option features and with re-pricing maturity determined as per note 1 below														
6	> Adjusted for actual expected re-pricing date														
7	> Pipeline products														
8	Net Trading Book asset														
9	Non-monetary and other assets														
10	Asset sub-total														
11	> Linear derivative contracts														
12	> Non-linear derivative contracts														
13	Asset totals														
Liabilities															
14	Monetary balance sheet liabilities (non-optional) as per contractual re-pricing date														
15	> Adjusted for actual expected re-pricing date														
16	> Pipeline products														
17	Monetary balance sheet liabilities with option features and with re-pricing maturity determined as per note 1 below														
18	> Adjusted for actual expected re-pricing date														
19	> Pipeline products														
20	Net Trading Book Liability														
21	Non Monetary Liabilities														
22	Capital and Reserves														
23	> Adjusted for capital investment term assumptions														
24	Liabilities sub-total														
25	> Linear derivative contracts														
26	> Non-linear derivative contracts														
27	Liability totals														
Gap sensitivity															
28	Net Gap	=0													
29	Gap limits (optional)														
30	Cumulative gap														
31	Reverse cumulative gap														
32	Cumulative gap limits (optional)														
33	Reverse cumulative gap limits (optional)														
34	Period to reprice (mid-point, in years)														
35	Standard discount factors	%													
36	Bespoke discount factors/forward yield curve														
37	Forward yield curve														
38	Sensitivity to + shift (as derived from above data)														
39	Sensitivity to - shift (as derived from above data)														
40	Alternative estimate of sensitivity to + shift														
41	Alternative estimate of sensitivity to - shift														
42	Sensitivity limits (optional)														

Note An option that is IN the money by the percentage value in data elements 38 or 39 or more should be assigned a maturity (i.e re-pricing) date equal to the expiry date of the contract. This affects data elements 12 and 26 (options).

1 An option that is OUT of the money by the percentage value in data elements 38 or 39 or more should be assigned to the 'overnight to 3 month' maturity band. This affects data elements 12 and 26 (options).

An option within these two bounds should have its re-pricing date determined by simple straight line interpolation - e.g. an option exactly at the money, would be assigned a notional maturity date halfway between overnight and the contract expiry date

FSA018

UK integrated groups - large exposures

Exposures at the reporting date to the diverse blocks and residual block

1 Identify the Integrated Group

2 List the FSA Firm Reference Numbers of the members of the integrated group, and the allocation of CNCOM

A	B	C
Index no	FSA FRN	CNCOM
1		
...		
<i>n</i>		
Total		

3 Group capital resources under BIPRU

Exposure no	Wider integrated group diverse blocks, and residual block	Gross exposure	% of capital resources under BIPRU 10.8.10R	Exposure after credit risk mitigation	Of which							CNCOM
					Exempt exposures		Non-exempt exposures					
					Amount	% of capital resources	Non-trading book	% of capital resources	Trading book	% of capital resources	Aggregate %	
A	B	C	D	E	F	G	H	J	K	L	M	N
1												
....												
<i>n</i>												
Total												

FSA019 Pillar 2 information

B
yes/no

1 Does GENPRU 1.2 apply to your firm?

If so, please answer all the following questions:

000s

2 What is the internal capital amount that you consider adequate for the nature, scale and complexity of your firm's activities in line with its Internal Capital Adequacy Assessment Process (ICAAP)?

3 What is the actual amount of internal capital your firm holds at the accounting reference date?

yes/no

4 Have you documented your ICAAP?

dd/mm/yy

5 When did you last review the ICAAP?

yes/no

6 Have your external auditors audited your firm's financial statement in the 12 months?

7 If so, has any audit opinion you received in the last year been qualified in any respect?

%

8 What is the ratio of dealing errors in relation to the total number of transactions your firm has undertaken in the past 12 months?

yes/no

9 Have you considered your firm's risk appetite when developing its ICAAP?

In your ICAAP, have you considered the impact of an economic downturn on:

10 · your firm's financial position?

11 · your business plans?

Is the firm exposed to the risks listed below? And if so, what amount of internal capital have you allocated to each of them?

yes/no
A

000s
B

	yes/no A	000s B
12 · market risk	<input type="text"/>	<input type="text"/>
13 · credit risk	<input type="text"/>	<input type="text"/>
14 · operational risk	<input type="text"/>	<input type="text"/>
15 · liquidity risk	<input type="text"/>	<input type="text"/>
16 · securitisation risk	<input type="text"/>	<input type="text"/>
17 · insurance risk	<input type="text"/>	<input type="text"/>
18 · pension obligation risk	<input type="text"/>	<input type="text"/>
19 · concentration risk	<input type="text"/>	<input type="text"/>
20 · residual risk	<input type="text"/>	<input type="text"/>
21 · business risk	<input type="text"/>	<input type="text"/>
22 · interest rate risk	<input type="text"/>	<input type="text"/>
23 · other	<input type="text"/>	<input type="text"/>

FSA019 continued

24	Does your firm have any professional indemnity insurance cover? If so,	yes/no []
25	What is the limit of the indemnity in the aggregate?	000s []
26	What is the greatest deductible for any single claim?	[]
27	What is the credit rating of the lead underwriter?	rating []
28	In your firm's ICAAP, do you take account of the results of the stress tests set out in BIPRU 4.3.39R and BIPRU 4.3.40R?	yes/no []
29	Does your firm deduct illiquid assets as set out in GENPRU 2.2.17R to 2.2.19R?	[]
30	Does your firm have sufficient liquidity to meet your liabilities as they fall due in the circumstances of an orderly wind-down?	[]
31	Report the amount of <i>illiquid assets</i> .	000s []
32	Do yo use credit risk mitigation techniques?	yes/no []
33	If so, have you considered in your ICAAP the fact that those techniques may not fully work as anticipated?	[]
34	Have you securitised assets in the last 12 months?	[]
35	Do you use an internal model as described in BIPRU 7.10 to calculate regulatory market risk?	[]
36	If so, have you taken the results of the market risk stress tests in your ICAAP into account ?	[]
37	Report the result of a 200 basis point shock to interest rates on your firm's economic value.	000s []
38	Does the result of the above stress test exceed 20% of your economic value?	yes/no []
39	Would the valuation adjustments required under GENPRU 1.3.35G enable you to sell or hedge out your firm's positions within a short period without incurring material losses under normal market conditions?	[]

FSA020
ELMIs balance sheet

	A
1 Cash	<input type="text"/>
2 Zero weighted governments and central banks	<input type="text"/>
3 20% weighted credit institutions	<input type="text"/>
4 Qualifying debt securities	<input type="text"/>
5 Material holdings in financial institutions	<input type="text"/>
6 Investments in own shares	<input type="text"/>
7 Other current assets	<input type="text"/>
8 Intangible assets	<input type="text"/>
9 Other fixed assets	<input type="text"/>
10 Total assets	<input style="border: 2px solid black;" type="text"/>
11 E-money outstandings	<input type="text"/>
12 o/w E money issue price	<input type="text"/>
13 Other current liabilities	<input type="text"/>
14 Non current liabilities (excl provisions)	<input type="text"/>
15 Paid up share capital	<input type="text"/>
16 Share premium account	<input type="text"/>
17 Audited reserves (excluding revaluations)	<input type="text"/>
18 Audited interim profits	<input type="text"/>
19 Partnership capital	<input type="text"/>
20 Initial capital	<input type="text"/>
21 Interim net losses (-ve)	<input type="text"/>
22 Deductions from Tier One	<input type="text"/>
23 Total Tier One capital	<input type="text"/>

FSA020 continued

24 Upper Tier 2 subordinated capital	<input type="text"/>
25 Revaluation reserves	<input type="text"/>
26 Upper Tier 2 capital	<input type="text"/>
27 Lower Tier 2 subordinated capital	<input type="text"/>
28 Tier 2 capital	<input type="text"/>
29 Own Funds	<input type="text"/>
30 Other subordinated debt capital	<input type="text"/>
31 Provisions	<input type="text"/>
32 Unaudited current year's profits	<input type="text"/>
33 Total liabilities	<input type="text"/>

FSA021

Income statement ELMIs

A

Income (including regulated business revenue)

1 Total income

Expenses

2 Total expenses

3 Tax expense

FSA022

ELMIs Capital requirements

A

1 Total own funds

2 E-money outstandings at period end

3 Average daily E-money outstandings over 6 mths

4 Own funds as proportion of the higher of average or closing e-money balances

FSA023

Foreign Exchange Risk (electronic money institutions)

	A	B	C
1	Base currency		
	FX open positions in:	Long	Short
2	Canadian Dollars		
3	Euro		
4	Japanese Yen		
5	Sterling		
6	Swiss Francs		
7	US Dollars		
8	Other		
9	Total Long		
10	Total Short		
11	Net FX open position (larger of long or short)		
12	FX Exposure		
13	Absolute FX limit		
14	FX exposure limit		
15	Unused portion of absolute FX exposure limit		
16	Unused portion of FX exposure limit		

For each breach of limits on a daily basis

	A	B	C
17	Date of breach of absolute FX limit	Date of breach of FX limit	Amount by which limit exceeded
1			
2			
n			

FSA024

Large exposures (electronic money institutions)

For each large exposure, or group of closely related exposures, within 20% weighted credit institutions and qualifying debt securities

	Counterparty, or group, name A	Exposure at reporting date B	% total of own funds C
1			
1			
2			
n			

FSA025

Liquidity (electronic money institutions)

		A
1	Zero weighted assets	<input type="text"/>
2	20% weighted credit institutions	<input type="text"/>
3	Qualifying debt securities	<input type="text"/>
4	Total qualifying liquid assets	<input type="text"/>
5	E money outstandings	<input type="text"/>
6	Liquidity ratio	<input type="text"/>

List, for each derivative instrument held to hedge market risks associated with assets that form part of the e-money float

	Type	Residual maturity in months	Nominal value	Market Value	Hedged assets
7	A	B	C	D	E
1	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
2	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
n	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>

FSA026

ELMI Questions

- 1 Have the firms own funds been equal to or greater than its own funds requirement throughout the reporting period?
- 2 Have the firm's total own funds been equal to or greater than 5% of its qualifying liquid assets that form part of the e-money float and are in the form of sight deposits held with Zone A credit institutions and qualifying debt securities throughout the r
- 3 Have the firms large exposures been within the large exposures reporting limits throughout the reporting period?
- 4 Has the amount of the firms qualifying liquid assets been no less than the amount of its e-money outstandings throughout the reporting period?
- 5 Has the firm complied with the base capital requirements throughout the reporting period?

A YES	B NO	C explanation if NO

Part 7

SUP 16 Annex 25 G

All of the text in this section is new and is not underlined.

FSA001 – Balance sheet

This data item provides the FSA with a snapshot of the assets and liabilities of a firm, and details of items which although not on the balance sheet, nevertheless will have a potential impact on the financial health of the firm if they were to crystallise.

Valuation

Firms should follow their normal accounting practice wherever possible. As there is no direct linkage with FSA003, there is no need for the data to follow the valuation rules applicable for capital adequacy purposes eg in relation to adjustments to the accounting values set out in *GENPRU* 1.3.36R.

Consolidation

When reporting the balance sheet on a *UK consolidation group* basis, firms should where possible treat the consolidation group as a single entity (ie line-by-line) rather than on an aggregation basis. However, for the liabilities, in the same way as for the *capital resources* calculation figure in FSA003, the consolidation should only treat the group as a single entity (ie line-by-line).

Currency

You should report in the currency of your annual audited accounts ie in either Sterling, Euro, US dollars, Canadian dollars, Swedish Kroner, Swiss Francs or Yen. Figures should be reported in 000s.

Data elements

These are referred to by row first, then by column, so data element 2B will be the element numbered 2 in column B.

Assets

These are broken down between trading book assets, and those that are not trading book assets. Hence the items reported in column B will exclude the items reported in column A. If a firm cannot easily identify trading book assets, all assets should be reported in the non-trading book column.

Firms can determine whether they have trading book or not. However, it is expected that a firm that identifies trading book profits in FSA002, or reports trading book profits in FSA003 (in data element 61A), should be able to identify trading book assets.

However, even if a firm does not identify trading book assets, it does not preclude that firm from having foreign exchange and commodities risk in the *market risk capital requirement* (data element 93A) in FSA003.

1 Is this report on behalf of a UK consolidation group?

See *BIPRU* 8.2. Firms should answer yes or no.

2 If yes, please list the FSA firm reference numbers of the other firms in the UK consolidation group.

Firms should list the FSA reference numbers of all the firms included within the *UK consolidation group* in Column B.

3 If no (to data element 1), is this a solo consolidated report?

See *BIPRU* 2.1. Firms that have a solo consolidation waiver should answer yes here.

4 If no (to data element 1) are you a member of a non-EEA sub-group?

See *BIPRU* 8.2. Firms should answer 'yes' or 'no'. A *BIPRU* firm that is the ultimate parent of a group (as a building society will always be) will always report 'no' here.

Firms that answer 'yes' to 4A will be required to report half yearly on FSA028. The figures reported in FSA028 may not necessarily be the same as those reported on FSA003 because the *non-EEA sub-group* may contain firms that are not included within the solo-consolidation. If the coverage is the same, it is likely that no detailed figures will be required on FSA028.

5 Cash and balances at central banks (excluding client money)

This is money physically held by the firm, and money deposited with central banks. Include any gold coin and bullion held.

Any client money held should be reported in data element 64A.

6 Credit items in the course of collection from banks

This data element is only relevant for *UK banks* and *building societies*.

This includes the total amount of cheques, etc drawn on and in the course of collection on other firms, and debit items in transit between domestic offices of the reporting firm in each country. Report cheques that have been credited to customers' accounts but are held overnight before being presented or paid into the reporting firm's account with another firm.

7 Treasury bills and other eligible bills held

Enter here any holdings of treasury bills or other bills eligible for rediscount at *central banks*.

8 Deposits with, and loans to, credit institutions

For *BIPRU investment firms*, this will include any bank balances. Overdrawn accounts with banks should be reported in data element 23A.

It includes funds lent to or placed with customers/counterparties. This includes holdings of certificates of deposit (other than those issued by the firm) and negotiable deposits made on terms identical to those on which a certificate of deposit would have been issued, but for which it has been mutually convenient not to have issued a certificate (these items should be reported on a contract date basis).

It also includes funds lent to or placed with customers/counterparties including:

- (a) assets leased out under finance lease agreements, but legally owned by the firm;
- (b) loans made under conditional sale agreements and hire purchase contracts;
- (c) acceptances discounted;
- (d) advances purchased by or assigned to the firm under a transferable loan facility, purchase and resale agreements, factoring, or similar arrangement; and

- (e) bills (including eligible bills), promissory notes and other negotiable paper owned (including à forfait paper), which should be reported according to the drawee.

9 Loans and advances to customers

This will mainly be relevant for *UK banks* and *building societies*. It covers all funds lent or placed with all counterparties other than credit institutions.

10 Debt securities

Report here only long positions in debt securities. If there is an overall short position, it should be reported in data element 30A.

11 Equity shares

This comprises long holdings of securities. If there is an overall short position, it should be reported in data element 30A.

12 Investment in group undertakings

This will generally only apply for solo and unconsolidated reporting.

When completing this on a *UK consolidation group* basis, investments in subsidiary and associated companies should only include those companies that are excluded from the consolidation.

13 Reverse repurchase agreements and cash collateral on securities borrowed

Report here any reverse repos or stock borrowing.

14 Derivatives

Report here derivatives balances, on the same basis as they are reported on the face of the firm's balance sheet.

15 Goodwill

Report here the amount of any goodwill.

16 Other intangible assets

Include here intangible assets, other than goodwill. The value here may differ from that reported in FSA003 - see *GENPRU 2.2.155R* and *GENPRU 2.2.156G*.

17 Tangible fixed assets

Includes property, real estate, plant and equipment beneficially owned by the firm.

18 Prepayments and accrued income

Include here any sundry debtors arising in the course of the firm's business, including prepayments and accruals.

19 Other assets

Include any other assets not reported elsewhere on FSA001, items in suspense (in the case of *UK banks* and *building societies*), and any assets in respect of trading settlement accounts.

For *UK consolidation group* reports, any assets consolidated other than on a line-by-line basis may be reported here.

Includes exchange traded margins.

20 Total assets

The sum of the trading book total assets plus the non-trading book total assets will equal the sum of total liabilities and equity of the firm in data element 45A.

Liabilities

21A Own bank notes issued

This is only relevant for those banks that can issue bank notes. It is the figure of bank notes in circulation, ie the firm's issue of bank notes less any own notes held.

22A Items in the course of collection due to other banks

This is only likely to be relevant for *UK banks* and *building societies*.

It should include items in the course of transmission.

23A Deposits from banks and building societies, including overdrafts and loans from them

For *BIPRU investment firms*, this element will contain any borrowings made from banks or building societies. Deposit-taking firms will include here deposits from other credit institutions.

24A Customer accounts

This is unlikely to be relevant for *BIPRU investment firms*.

It comprises deposits from all customers other than credit institutions (that are reported in 23A). These should be broken down into retail (excluding e-money), e-money issued (this should be identified where firms have permission to issue e-money), corporate, intra-group and other in data elements 25A to 29A.

Firms should use their best endeavours to allocate customers, but should follow a consistent approach on each reporting date.

30A Trading liabilities

Include here any short positions in equities or debt securities.

31A Debt securities in issue, excluding covered bonds

This data element is unlikely to be relevant to *BIPRU investment firms*.

Report all certificates of deposit issued by the firm, whether at fixed or floating rates, and still outstanding. Also report negotiable deposits taken on terms in all respects identical to those on which a certificate of deposit would have been issued, but for which it has been mutually convenient not to have issued certificates. If a firm holds certificates of deposits which it has itself issued, these should not be reported.

Also report promissory notes, bills and other negotiable paper issued (including commercial paper) by the reporting institution including bills drawn under an acceptance credit facility provided by another firm.

Include unsubordinated FRNs and other unsubordinated market instruments issued by the firm.

Covered bonds should be excluded and reported in data element 32A.

32A Covered bonds

This data element is unlikely to be relevant to *BIPRU investment firms*.

See the Glossary for a definition of *covered bonds*.

33A Derivatives

Report here any derivative liabilities.

34A Liabilities in respect of sale and repurchase agreements and cash collateral received for securities lent

This entry applies to the cash liability on sale and repurchase and stock lending agreements. Where the firm reports assets reversed in on the balance sheet, the liability under such agreements should be reported here. Stock borrowing that is reported on balance sheet should also be included here.

35A Retirement benefit liabilities

Include liabilities arising in respect of pension scheme deficiencies.

36A Taxation liabilities

Deferred tax assets should be reported as an asset in data element 19A or 19B.

37A Provisions

Report general provisions / collective impairment that are held against possible or latent losses but where the losses have not as yet been identified, in line with the accounting practice adopted by the firm.

38A Subordinated liabilities

Include all subordinated debt issued by the firm. *Building societies* should include *PIBS* here.

39A Accruals and deferred income

Include here accruals and deferred income.

40A Other liabilities

Include net short positions in physical commodities where the FSA has agreed that commodity transactions may be included in the non-trading Book.

UK banks and building societies should include items in suspense here.

Includes exchange traded margins.

41A Subtotal

This is the total of data elements 21A, 22A, 23A and 30A to 40A.

42A Called up share capital, including partnership, LLP and sole trader capital

Exclude holdings by the firm of its own shares (although these holdings should be reported in FSA003) and also excess of drawings over profits for partnerships, LLPs or sole traders (which are also reported in FSA003). *Building societies* should exclude *PIBS*, which should be reported in 38A.

43A Reserves

As firms may use figures compiled on the same basis as audited accounts, the figures presented here may differ from those reported in FSA003. This is because of the different valuation basis used for capital adequacy, as set out in *GENPRU* 1.3.

44A Minority interests

As firms may use figures compiled on the same basis as audited accounts, the figures presented here may differ from those reported in FSA003 as a memorandum item. This is because of the different valuation basis used for capital adequacy, as set out in *GENPRU* 1.3.

45A Total liabilities and shareholders' funds

This will equal the sum of trading book plus non-trading book assets (data elements 20A plus 20B), and also the sum of 41A to 44A.

Memorandum items

46-53 Derivatives

This provides further information on OTC derivatives. Firms should allocate the contracts to the bands as accurately as possible but, if some of the breakdowns are not available, they should report on the basis of the predominant type of derivative.

A – Notional contract amount

Firms should provide this amount, if available, or their best estimate of it from internal sources.

B – Assets

Firm should use the value placed on these contracts in the balance sheet, before accounting netting.

C – Liabilities

Firm should use the value placed on these contracts in the balance sheet, before accounting netting.

53B/53C Total after netting

This is the value of derivatives, for columns B and C, after accounting netting. 53B should equal 14A plus 14B, while 53C should equal 33A.

Other items

54A Direct credit substitutes

This is likely to be relevant only for *UK banks* and *building societies*.

Report here those direct credit substitutes which do not appear on the face of the balance sheet.

Direct credit substitutes relate to the financial requirements of a counterparty, where the risk of loss to the firm on the transaction is equivalent to a direct claim on the counterparty, ie the risk of loss depends on the creditworthiness of the counterparty. Report instruments such as:

- (a) acceptances granted and risk participations in bankers' acceptances. Where a firm's own acceptances have been discounted by that institution the nominal value of the bills held should be deducted from the nominal amount of the bills issued under the facility and a corresponding on-balance sheet entry made;
- (b) guarantees given on behalf of customers to stand behind the current obligations of the customer and to carry out these obligations should the customers fail to do so, eg a loan guarantee;
- (c) guarantees of leasing operations;
- (d) guarantees of a capital nature such as undertakings given to firms authorised under the Financial Services and Markets Act 2000 which are considered as capital;
- (e) letters of credit not eligible for inclusion in 54A;
- (f) standby letters of credit, or other irrevocable obligations, serving as financial guarantees where the firm has an irrevocable obligation to pay a third party beneficiary if the customer fails to repay an outstanding commitment, eg letters of credit supporting the issue of commercial paper, delivery of merchandise, or for stock lending (standby letters of credit which are related to non-financial transactions should be reported in 53A below);
- (g) re-insurance or window letters of credit;
- (h) acceptances drawn under letters of credit, or similar facilities where the acceptor does not have specific title to an identifiable underlying shipment of goods (eg sales of electricity); and
- (i) confirmations of letters of credit.

55A Transaction-related contingents

This is likely to be relevant only for *UK banks* and *building societies*.

Report here those transaction-related contingents which do not appear on the face of the balance sheet.

Transaction-related contingents relate to the on-going trading activities of a counterparty where the risk of loss to the firm depends on the likelihood of a future event which is

independent of the creditworthiness of the counterparty. They are essentially guarantees which support particular non-financial obligations rather than supporting customers' general financial obligations. Report such items as:

- (a) performance bonds, warranties and indemnities (indemnities given for lost share certificates or bills of lading and guarantees of the validity of papers rather than of payment under certain conditions should not be reported);
- (b) bid or tender bonds;
- (c) advance payment guarantees;
- (d) VAT, customs and excise bonds. The amount recorded for such bonds should be the firm's maximum liability (normally twice the monthly amount being guaranteed); and
- (e) standby letters of credit relating to a particular contract or to non-financial transactions (including arrangements backing, inter alia, subcontractors' and suppliers' performance. labour and materials, contracts, and construction bids).

56A Trade-related contingents

This is likely to be relevant only for *UK banks* and *building societies*.

Report here those trade-related contingents which do not appear on the face of the balance sheet.

Report short-term, self liquidating trade-related items such as documentary letters of credit issued by the firm which are, or are to be, collateralised by the underlying shipment, ie where the credit provides for the firm to retain title to the underlying shipment.

Letters of credit issued by the firm without provision for the firm to retain title to the underlying shipment or where the title has passed from the firm should be reported under direct credit substitutes (54A). A memorandum of pledge and a trust receipt are not regarded as giving the firm title, and transactions secured by these should be shown under 54A.

Letters of credit issued on behalf of a counterparty back-to back with letters of credit of which the counterparty is a beneficiary ("back-to-back" letters) should be reported in full.

Letters of credit advised by the firm or for which the firm is acting as reimbursement agent should not be reported.

57A Asset sales with recourse

This is likely to be relevant only for *UK banks* and *building societies*.

Report here those asset sales without recourse which do not appear on the face of the balance sheet.

Report put options written where the holder of the asset is entitled to put the asset back to the firm, eg if the credit quality deteriorates. Also report put options written by the firm attached to marketable instruments or other physical assets.

58A Forward asset purchases

This is likely to be relevant only for *UK banks* and *building societies*.

Report here those forward asset purchases which do not appear on the face of the balance sheet.

Include commitments for loans and other on-balance sheet items with certain drawdown. Exclude foreign currency spot deposits with value dates one or two working days after trade date.

59A Forward forward deposits placed

This is likely to be relevant only for *UK banks* and *building societies*.

Report here those forward forward deposits placed which do not appear on the face of the balance sheet.

This covers agreements between two parties whereby one will pay, and the other receive, an agreed rate of interest on a deposit to be placed by one with the other at some predetermined date in the future. Exclude foreign currency spot deposits with value dates one or two working days after trade date.

60A Uncalled partly-paid shares and securities

Only report if there is a specific date for the call on the unpaid part of the shares and securities held. If there is no specific date, the unpaid part should be treated as a long-term commitment (see 63A).

61A NIFs and RUFs

This is likely to be relevant only for *UK banks* and *building societies*.

Report here those NIFs and RUFs which do not appear on the face of the balance sheet.

Note issuance facilities and revolving underwriting facilities should include the total amounts of the firm's underwriting obligations of any maturity. Where the facility has been drawn down by the borrower and the notes are held by anyone other than the firm, the underwriting obligation should continue to be reported at the full nominal amount.

The firm's own holding of the notes should be reported in data elements 8 and 9 and therefore the nominal amount of the notes held should be deducted from the nominal amount of the facility to be shown here.

62A Endorsements of bills

This is likely to be relevant only for *UK banks* and *building societies*.

Report here those endorsed bills which do not appear on the face of the balance sheet.

Endorsements of bills (including per aval endorsements) should be reported at the full nominal amount, less any amount for bills which the firm now holds but had previously endorsed.

63A Other commitments

This is likely to be relevant only for *UK banks* and *building societies*.

Report here other commitments which do not appear on the face of the balance sheet, and are not reported in items 54A to 62A above.

The firm is regarded by the FSA as having a commitment regardless of whether it is revocable or irrevocable, conditional or unconditional and, in particular whether or not it contains a “material adverse change” clause.

Include unused credit card lines.

Commitments for loans and other on-balance sheet items with certain drawdown should not be reported here but under 58A.

64A Client money held

Provide the total amount of client money held at the reporting date. Firms should be identifying this already to ensure compliance with *CASS*.

65A Number of UK retail customers

This is only applicable to *UK banks* and *building societies*.

This is intended to identify the number of UK retail customers. Firms should use their best estimate for this, which might even be based on the number of accounts. It can even be the firms most reasonable approximation, based on whatever information they can use. We recognise that this may lead to firms duplicating customers who have a number of different products or accounts and thus we are provided with the number of total customers, rather than different customers. We do not expect firms to develop systems to give precise numbers, although obviously we would prefer the figures to be as reliable as possible. (We have considered bandings, but that will not give the degree of precision we require.)

FSA001 – Balance sheet validations

Internal validations

Data elements are referenced by row then column.

Validation number	Data element		
1	20A	=	5A + 6A + 7A + 8A + 9A + 10A + 11A + 12A + 13A + 14A + 15A + 16A + 17A + 18A + 19A
2	20B	=	5B + 6B + 7B + 8B + 9B + 10B + 11B + 12B + 13B + 14B + 15B + 16B + 17B + 18B + 19B
3	24A	=	25A + 26A + 27A + 28A + 29A
4	41A	=	21A + 22A + 23A + 24A + 30A + 31A + 32A + 33A + 34A + 35A + 36A + 37A + 38A + 39A + 40A
5	45A	=	41A + 42A + 43A + 44A
6	45A	=	20A + 20B
7	52A	=	46A + 47A + 48A + 49A + 50A + 51A
8	52B	=	46B + 47B + 48B + 49B + 50B + 51B
9	52C	=	46C + 47C + 48C + 49C + 50C + 51C
10	53B	=	14A + 14B
11	53C	=	33A

External validations

There are no external validations for this data item.

FSA002 – Income statement

This data item provides the FSA with information on the main sources of income and expenditure for a firm. It should be completed on a cumulative basis for the firm's current financial year up to the reporting date.

Valuation

Firms should follow their normal accounting practice wherever possible. In this regard, the figure for profits reported here may differ from the figures reported at the same date in FSA003, primarily because of valuation differences that arise from the application of *GENPRU* 1.3.

Currency

You should report in the currency of your annual audited accounts ie in either Sterling, Euro, US dollars, Canadian dollars, Swedish Kroner, Swiss Francs or Yen. Figures should be reported in 000s.

Consolidation

Firms reporting on a *UK consolidation group* basis can use the same accounting basis for consolidation as in their accounts, as long as the group on which it is based accords with the *UK consolidation group*. (On FSA003, such firms will, however, have to report their capital resources on a line-by-line basis under *BIPRU* 8, and firms may prefer to do so here too.)

Data elements

These are referred to by row first, then by column, so data element 2B will be the element numbered 2 in column B.

Trading book

Data elements in column A relate only the trading book. Firms should identify their trading book profits separately from the non-trading book profits wherever possible. Firms that intend to include 'net interim trading book profit and loss' in data element 61A in FSA003 should complete this column. It is optional for other firms. See *BIPRU* 1.2 for the definition of the trading book..

Column B should contain the total (in this regard, it differs from the layout in FSA001).

1B Financial and operating income

This is the total of financial and operating income, which is broken down in more detail in elements 2B, 7B, 15B and 20B to 24B.

Where firms can allocate financial and operating income to the trading book, this should be reported in 1A. Firms that intend to include 'net interim trading book profit and loss' in element 61A of FSA003 should be able to identify the trading book portion separately here.

2B Interest income

Include both interest actually received and interest receivable which has accrued but has not yet been received. Amounts accrued should be based on the latest date to which these

calculations were made; thus for an institution which accrues profits on a daily basis, accruals should include amounts up to and including the reporting date.

Elements 3B to 6B break this down in more detail, but only 4B and 6B are likely to be relevant for *BIPRU investment firms*.

Firms should use their best endeavours to allocate interest income according to the categories shown, and should adopt a consistent approach on each reporting date.

3B Of which: Retail secured loans

This is unlikely to be relevant for *BIPRU investment firms*.

This part of interest income comprises interest received or receivable from any secured lending to retail customers. Firms may use their best estimate to derive this figure, as long as the approach is applied consistently at each reporting date.

4B Of which: Retail unsecured loans (including bank deposits)

For *BIPRU investment firms*, this will include interest paid by banks or building societies on deposits with them.

For deposit takers, this comprises interest received or receivable from retail customers other than on secured lending or card accounts. It includes overdrafts. Firms may use their best estimate to derive this figure, as long as the approach is applied consistently at each reporting date.

Any interest from credit or charge cards should be included in data element 5B.

5B Of which: Card accounts

This is unlikely to be relevant for *BIPRU investment firms*.

This includes any interest received on charge cards accounts. Firms may use their best estimate to derive this figure, as long as the approach is applied consistently at each reporting date.

6B Of which: Other

This comprises all other interest received and receivable and will include all interest receivable on bonds, floating rate notes (FRNs) and other debt instruments as well as interest receivable on repos / reverse repos.

Receipts from security lending / borrowing should only be included when cash collateral is involved – other income from security lending / borrowing should be classified as fees. Exclude any interest paid relating to interest rate swaps, which should be reported under data element 14B.

It also comprises any interest received not reported in items 3B to 5B.

7B Fee and commission income

This covers all fee and commission income, and is broken down in more detail in elements 8B to 14B below. If a firm cannot allocate the income in a precise manner, it should allocate

the income on a best endeavours basis, which should be consistently applied on each reporting date.

Firms should use their best endeavours to allocate fee and commission income according to the categories shown, and should adopt a consistent approach on each reporting date.

8B Of which: Gross commission and brokerage

Include commission and brokerage earned by the firm, before the deduction of commissions shared or paid to third parties (these commissions paid to others should be reported in 32B). It will include income from the provision of foreign exchange facilities.

9B Of which: Performance fees

This will include incentive fees received by the firm.

10B Of which: Investment management fees

Include all underwriting fees and commissions, and fees and commissions from valuations, management of investments and unit trusts and pension funds.

11B Of which: Investment advisory fees

Include all fees arising from investment advice.

12B Of which: Corporate finance

Include all income earned by the firm from corporate finance business.

13B Of which: UCITS management fees

This covers income earned through the management of UCITS.

14B Of which: Other fee and commission income

Report here any other fee and commission income not reported in data elements 8B to 13B.

15B Trading income (losses)

A net loss should be shown with a minus sign to indicate a negative figure.

This is further broken down in elements 16B to 19B.

Firms should use their best endeavours to allocate trading income (losses) according to the categories shown, and should adopt a consistent approach on each reporting date.

16B of which: Trading investments

This portion of 15B includes all profits or losses (including revaluation profits or losses) on investments held for dealing. This will generally exclude profits or losses arising from the sale of investments in subsidiary or associated companies, trade investments or the amortisation of premiums or discounts on the purchase of fixed maturity investments.

17B of which: Charges on UCITS sales / redemptions

This is that part of 15B (dealing profits/losses) arising from charges made to clients for UCITS sales or redemptions.

18B of which: Foreign exchange

This is unlikely to be relevant for *BIPRU investment firms*.

This part of 15B includes revaluations of foreign exchange positions, but excludes fees and commissions relating to foreign exchange business (which should be included under data element 8B).

19B Other trading income (losses)

Report here any other trading income not reported in data elements 16B to 18B.

20B Gains (losses) arising from non-trading instruments

This element is unlikely to be relevant for *BIPRU investment firms*.

Includes gains (losses) arising from non-trading instruments designated at initial recognition to be measured at fair value through profit and loss (FVTPL), commonly referred to as the 'fair value option'.

21B Realised gains (losses) on financial assets & liabilities (other than HFT and FVTPL)

This element is unlikely to be relevant for *BIPRU investment firms*.

This should include gains (losses) on financial assets and liabilities (other than those held for trading ('HFT') or those measured at fair value through profit and loss ('FVTPL')).

22B Dividend income

This includes dividend income on all equity investments.

23B Other operating income

This is unlikely to be relevant for *BIPRU investment firms*.

It includes property rentals and increases in respect of linked liabilities.

24B Gains (losses) on disposals of HFS non-current assets & discontinued operations

This is unlikely to be relevant for *BIPRU investment firms*.

Includes gains (losses) on non-financial items which are 'held for sale' as defined in IFRS 5.

25B Financial & operating charges

This is the total of the firm's operating charges that are broken down in more detail in elements 26B, 32B and 33B.

Where firms can allocate financial and operating charges to the trading book, this should be reported in 25A.

26B Interest paid

This is broken down in further detail in 27B to 31B. Firms should use their best endeavours to allocate interest paid according to the categories shown, and should adopt a consistent approach on each reporting date.

For *BIPRU investment firms*, this is likely to be limited to interest paid, or overdraft charges paid, to banks (also detailed in 27B) or on intra-group loans (detailed in 30B).

Include both interest actually paid and interest payable which has accrued but has not yet been paid.

27B Of which: Bank and building society deposits

In the case of *BIPRU investment firms*, this will include interest payments to banks for loans or overdrafts.

For deposit takers, this will include all interest paid on balances placed by banks, building societies or other financial institutions.

28B Of which: Retail deposits

This will not be relevant for *BIPRU investment firms*.

Deposit takers will include here all interest paid on balances placed by retail customers.

29B Of which: Corporate deposits

This will not be relevant for *BIPRU investment firms*.

Deposit takers will include here all interest paid on balances placed by non-bank, non-connected corporate customers.

30B Of which: Intra-group deposits

This will only be relevant for *BIPRU investment firms* that have borrowed money from other group companies.

Deposit takers will include all interest paid on balances placed by group companies.

31B Of which: On other deposits

This will not be relevant for *BIPRU investment firms*.

Deposit takers will include all interest paid on all other balances not reported in 27B to 30B.

32B Fees and commissions expenses

Include commissions paid or shared with other firms, plus fees, brokerage and other charges paid in relation to the execution, registration or clearing of transactions.

33B Other operating expenses

Include here other expenses (that are not identified elsewhere) that arise in the course of undertaking the firm's activities. However, costs such as electricity and rent should be reported under 38B (general administrative expenses).

34B Other costs

This is the total of other costs and charges that are detailed in items 35B and 38B to 43B below.

Where firms can allocate other costs to the trading book, this should be reported in 34A.

35B Staff expenses

This is the total of the costs broken down in 36B and 37B.

It should exclude general staff benefits, such as subsidised restaurants, which should be included in general administrative expenses in 38B.

36B Of which: Staff costs (ie non-discretionary)

Include salary costs, employer's national insurance contributions and social security costs, the employer's contribution to any pension scheme, and benefits in kind.

37B Of which: Charges for discretionary staff costs

Include discretionary bonuses and profit/performance share and share option schemes.

38B General administrative expenses

This includes rates, rent, insurance of building, lighting, heating, depreciation and maintenance costs. Also include marketing, communications, professional fees including auditor's remuneration and other general overheads of the business.

39B Depreciation and amortisation

This covers the depreciation of property, plant and equipment and includes amortisation of intangibles.

40B Impairment/provisions

This is the total cost of impairment charges and provisions made.

41B Other charges

This will include operating lease rentals.

42B Share of profit (losses) of associates

Firms reporting on a solo or unconsolidated basis should include the dividends from other group companies only.

43B Exceptional items

Include here any significant items which are separately disclosed in your accounts by virtue of their size or incidence to enable a full understanding of the group's financial performance. Transactions which may give rise to exceptional items may include gains or losses on disposal of investments, subsidiaries and early termination of debt instruments. Details relating to these amounts should be provided in data element 48A.

44B Profit (loss) before tax

This is the total financial and operating income (data element 1) less the financial and operating charges (25), and other costs (34). If the profit attributable to the trading book can be calculated, it should be reported in 44A.

45B Tax charge (income)

This comprises current tax charge (income) and deferred tax charge (income). Include any adjustments recognised in the period for current tax of prior periods. It may also include the amount of deferred tax charge (income) relating to the origination and reversal of temporary differences.

46B Net profit (loss)

This is the total profit (loss) after tax, before accounting for any minority interests (which only get reported on FSA003).

Memorandum items**47B Dividends paid during year**

Only those dividends paid in the period should be reported here.

48A Details of exceptional items

Please provide details of any amounts included in data item 43B.

FSA002 – Income statement validations

Internal validations

Data elements are referenced by row then column.

Validation number	Data element		
1	1B	=	2B + 7B + 15B + 20B + 21B + 22B + 23B + 24B
	1A	≤	1B
2	2B	=	3B + 4B + 5B + 6B
3	7B	=	8B + 9B + 10B + 11B + 12B + 13B + 14B
4	15B	=	16B + 17B + 18B + 19B
5	25B	=	26B + 32B + 33B
6	25A	≤	25B
7	26B	=	27B + 28B + 29B + 30B + 31B
8	34B	=	35B + 38B + 39B + 40B + 41B + 42B + 43B
	34A	≤	34B
9	35B	=	36B + 37B
10	39B	=	40B + 41B
11	44A	=	1A – 25A – 34A
12	44B	=	1B – 25B – 34B
13	46B	=	44B – 45B

External validations

There are no external validations for this data item.

FSA003 – Capital adequacy

This data item provides the FSA with information on the solvency of the firm. The data item is intended to reflect the underlying prudential requirements contained in *GENPRU* and *BIPRU* and allows monitoring against the requirements set out there and also those individual requirements placed on firms. We have provided references to the underlying rules to assist in its completion.

This data item is largely based on CEBS' COREP Table CA¹, but reflects the rules and wording in the Handbook, omits elements which are not in our view relevant in the UK, and combines some other elements. The numbers in parenthesis and italics show the corresponding element(s) in CEBS Table CA and are only provided for information purposes to identify the linkage to the CEBS' data.

The data item is designed to be applicable to all *BIPRU firms*. For that reason, the initial elements identify the capital rules which will apply to certain firms (see *GENPRU* 2.1.40R onwards). Also relevant are the waivers which investment firms may have under *BIPRU* TP 5.1R or *BIPRU* 6.1.2G, so these are also identified. In the text below, we have identified where elements are not applicable to all firms.

Columns A and B

There are two different measures of capital resources. For the purposes of the capital resources requirement under *GENPRU* 2.1.40R onwards and for disclosure purposes under *BIPRU* 11, it is calculated and set out in Column B of this data item. This column excludes stage C in the capital resources calculation set out in *GENPRU* 2 Annexes 2R, 3R, 4R, 5R and 6R. For the purposes of *GENPRU* 2.2.17R, capital resources are set out in Column A. The difference between them is in relation to innovative tier one capital (ie Stage C) which, for the purposes of *GENPRU* 2.1.9R, cannot be included (*GENPRU* 2.2.42R).

Valuation

For the general policy on valuation, please see the rules and guidance set out in *GENPRU* 1.3.

Consolidated reports

For calculating capital resources in elements 15 to 68, the group should be treated as a single entity.

However, for calculating the variable capital requirements in elements 70 to 104, the default method of consolidation is aggregation, adding up the solo numbers of the entities included where deemed equivalent in Annex 6 of *BIPRU* 8. Alternatively, the group can be treated as a single entity, using that method on its own or partially in conjunction with aggregation.

Currency

You should report in the currency of your annual audited accounts ie in either Sterling, Euro, US dollars, Canadian dollars, Swedish Kroner, Swiss Francs or Yen. Figures should be reported in 000s.

Data elements

These are referred to by row first, then by column, so data element 2B will be the element numbered 2 in column B.

¹ www.c-eps.org/documents/GL04_CA.xls

1A Is the firm a UK bank or a building society?

This box should be ticked if the report is being completed by a *UK bank* or a *building society*, or a *UK consolidation group* that is subject to the capital rules at Stage 1 of *BIPRU 8 Annex 5R*.

2A Is the firm a full scope BIPRU investment firm?

This box should be ticked if the report is being completed by either a *full scope BIPRU investment firm*, or a *UK consolidation group* that is subject to the capital rules at Stage 2 of *BIPRU 8 Annex 5R*. A *BIPRU limited licence firm* or *BIPRU limited activity firm* that has a waiver under *BIPRU 6.1.2G* or has a variation of *permission* to be treated as a *full scope BIPRU investment firm* should also tick here.

3A Is the firm a BIPRU limited activity firm?

This box should be ticked if the report is being completed by either a *BIPRU limited activity firm*, or a *UK consolidation group* that is subject to the capital rules at Stage 3 of *BIPRU 8 Annex 5R*. A *BIPRU limited activity firm* that has a waiver under *BIPRU 6.1.2G* or has a variation of *permission* to be treated as a *full scope BIPRU investment firm* should tick 2A, unless the waiver or variation had not been granted at the reporting date.

4A Is the firm a BIPRU limited licence firm?

This box should be ticked if the report is being completed by either a *BIPRU limited licence firm*, or a *UK consolidation group* that is subject to the capital rules at Stage 4 of *BIPRU 8 Annex 5R*. *UCITS investment firms* should also tick this box. A *BIPRU limited licence firm* that has a waiver under *BIPRU 6.1.2G* or has a variation of *permission* to be treated as a *full scope BIPRU investment firm* should tick 2A, unless the waiver or variation had not been granted at the reporting date.

5A If you are a full scope BIPRU investment firm, do you meet the conditions in BIPRU TP 12.1R?

This is only relevant for a *full scope BIPRU investment firm*. Only tick this box if you have a waiver under *BIPRU 6* that allows you to calculate your *operational risk capital requirement* in accordance with *BIPRU TP 12*.

6A Are you a BIPRU 730K firm?

This is only relevant if you are a *BIPRU investment firm*. Tick only if you meet the conditions in *BIPRU 1.1.21R*.

7A Are you a BIPRU 125K firm?

This is only relevant if you are a *BIPRU investment firm*. Tick only if you meet the conditions in *BIPRU 1.1.19R*. *UCITS investment firms* should see 8A.

8A Are you a UCITS investment firm?

This box should be ticked if the report is being completed by a *UCITS investment firm*.

9A Are you a BIPRU 50K firm?

This is only relevant if you are a *BIPRU investment firm*. Tick here if you meet the conditions set out in *BIPRU 1.1.20R*.

10A Do you have a waiver from consolidated supervision?

This is only relevant if you are a *BIPRU investment firm*. Tick only if your firm has a waiver from consolidated supervision under *BIPRU 8.4*.

11A Have you notified the FSA, at least one month in advance of the date of this report, that you intend to deduct illiquid assets?

This is only relevant if you are a *BIPRU investment firm*. See *GENPRU 2.2.19R*.

12A Basis of reporting

Firms should enter whether the report is on an unconsolidated basis, solo-consolidated basis, or consolidated basis. If the report is on behalf of a *UK consolidation group* (see *BIPRU 8.4*), firms should also complete 13A, 13B, 14A and 14B.

13A For consolidated reporting, please provide the Group reference number

If 12A is completed as a consolidated report, then please enter the group reference number here.

13B For consolidated reporting, please provide the Group name

If 12A is completed as a consolidated report, then please enter the group name here.

14A For consolidated reporting, please provide the FSA FRNs

List here the FSA firm reference numbers for all FSA authorised firms included within the *UK consolidation group*.

14B For consolidated reporting, please provide the names of the firms included

List here the names (against the FRN) of all FSA authorised firms included within the *UK consolidation group*.

15A Total capital after deductions

Firms should see *GENPRU 2.2.42R* and *GENPRU 2.2.43G* for details of those purposes for which *innovative tier one capital* may be used. In other circumstance, firms should use the *capital resources* figures calculated in column B, which excludes *innovative tier one capital*.

This is equivalent to stage T in:

- *GENPRU 2 Annex 2R*, for a *UK bank*;
- *GENPRU 2 Annex 3R*, for a *building society*;
- *GENPRU 2 Annex 4R* for a *BIPRU investment firm* deducting *material holdings*;
- *GENPRU 2 Annex 5R* for a *BIPRU investment firm* deducting *illiquid assets*; and
- *GENPRU 2 Annex 6R* for a *BIPRU investment firm* with a waiver from consolidated supervision.

This is the capital resources figure that is used under *BIPRU 10.5.4R* for calculating a firm's CNCOM.

[*CEBS' CA 1*]

15B Total capital after deductions

This is equivalent to 15A, but excludes stage C (in *GENPRU 2 Annexes 2R, 3R, 4R, 5R and 6R*). It will only differ from 15A if the firm has issued *innovative tier one capital*.

16A Total tier one capital after deductions

Equivalent to stage F in:

- *GENPRU 2 Annex 2R* for a *UK bank*;

- *GENPRU 2 Annex 3R* for a *building society*;
- *GENPRU 2 Annex 4R* for a *BIPRU investment firm* deducting *material holdings*;
- *GENPRU 2 Annex 5R* for a *BIPRU investment firm* deducting *illiquid assets*; and
- *GENPRU 2 Annex 6R* for a *BIPRU investment firm* with a waiver from consolidated supervision.

See *GENPRU 2.2.9G* and *GENPRU 2.2.10G*. [CEBS' CA 1.1]

16B Total tier one capital after deductions

This is equivalent to 16A, but reflecting *GENPRU 2.2.42R* and *GENPRU 2.2.43G*. It will only differ from 16A if the firm has issued *innovative tier one capital*.

17A Core tier one capital

This element is equivalent to stage A in

- *GENPRU 2 Annex 2R* for a *UK bank*;
- *GENPRU 2 Annex 3R* for a *building society*;
- *GENPRU 2 Annex 4R* for a *BIPRU investment firm* deducting *material holdings*;
- *GENPRU 2 Annex 5R* for a *BIPRU investment firm* deducting *illiquid assets*; and
- *GENPRU 2 Annex 6R* for a *BIPRU investment firm* with a waiver from consolidated supervision.

[CEBS' CA 1.1.1 less 1.1.1.2]

17B Core tier one capital

This will have the same value as 17A.

18A Permanent share capital

See *GENPRU 2.2.83R*. This excludes preference shares and *PIBS* (see 25A below).

[CEBS' CA 1.1.1.1]

19A Profit and loss account and other reserves

See *GENPRU 2.2.85R* to *GENPRU 2.2.90R*, but excluding interim net losses reported in 20A below.

[CEBS' CA 1.1.2.1]

20A Interim net losses

See *GENPRU 2.2.85R*. *UK banks* and *building societies* should include all losses for the current financial year. In the case of *BIPRU investment firms*, only material interim net losses should be reported.

[CEBS' CA 1.1.2.4]

21A Eligible partnership, LLP or sole trader capital

This includes *eligible partnership capital*, *eligible LLP members' capital* and *sole trader capital*. See *GENPRU 2.2.93R* to *GENPRU 2.2.95R*. Excludes *PIBS* and *innovative tier one instruments*, which are reported in 24A below.

[CEBS' CA 1.1.1.4]

22A Share premium account

See *GENPRU 2.2.101R*.

[*CEBS' CA 1.1.1.3*]

23A Externally verified interim net profits

Only include here those profits which have been externally verified at the reporting date. (Profits for the year which have been externally verified between the reporting date and the submission date should be reported in 124A.) See *GENPRU 2.2.102R* and *GENPRU 2.2.103G*.

[*CEBS' CA 1.1.2.3*]

24A Other tier one capital, subject to limits

[*CEBS' CA 1.1.4*]

24B Other tier one capital, subject to limits

This will have the same value as in 24A. (Although innovative tier one capital is not included for CRR purposes, it is included here and the disallowable portion is reported in 31B.)

25A Perpetual non-cumulative preference shares

This data element (after deduction of data element 30A) is equivalent to Stage B in:

- *GENPRU 2 Annex 2R* for a *UK bank*;
- *GENPRU 2 Annex 3R* for a *building society*;
- *GENPRU 2 Annex 4R* for a *BIPRU investment firm* deducting *material holdings*;
- *GENPRU 2 Annex 5R* for a *BIPRU investment firm* deducting *illiquid assets*; and
- *GENPRU 2 Annex 6R* for a *BIPRU investment firm* with a waiver from consolidated supervision.

It includes perpetual non-cumulative preference shares (see *GENPRU 2.2.109R*) and *PIBS* (see *GENPRU 2.2.111R*). See also *GENPRU TP 8.2R* to *GENPRU TP 8.6R*.

[*CEBS' CA 1.1.4.1*]

26A Innovative tier one instruments subject to limit

See *GENPRU 2.2.113R* to *GENPRU 2.2.137R*, before the application of *GENPRU 2.2.30R*. Also see *GENPRU TP 8.7R*.

This data element (after deduction of data element 31A) is equivalent to Stage C in:

- *GENPRU 2 Annex 2R* for a *UK bank*;
- *GENPRU 2 Annex 3R* for a *building society*;
- *GENPRU 2 Annex 4R* for a *BIPRU investment firm* deducting *material holdings*;
- *GENPRU 2 Annex 5R* for a *BIPRU investment firm* deducting *illiquid assets*; and
- *GENPRU 2 Annex 6R* for a *BIPRU investment firm* with a waiver from consolidated supervision.

[*CEBS' CA 1.1.4.2*]

27A Deductions from tier one capital

This data element (excluding 30A and 31A) is equivalent to Stage E in:

- *GENPRU 2 Annex 2R* for a *UK bank*;
- *GENPRU 2 Annex 3R* for a *building society*;
- *GENPRU 2 Annex 4R* for a *BIPRU investment firm* deducting *material holdings*;
- *GENPRU 2 Annex 5R* for a *BIPRU investment firm* deducting *illiquid assets*; and
- *GENPRU 2 Annex 6R* for a *BIPRU investment firm* with a waiver from consolidated supervision.

27B Deductions from tier one capital

This figure will differ from 27A only if a firm has issued *innovative tier one instruments* in 26A.

28A Investments in own shares

See Stage E in:

- *GENPRU 2 Annex 2R* for a *UK bank*;
- *GENPRU 2 Annex 3R* for a *building society*;
- *GENPRU 2 Annex 4R* for a *BIPRU investment firm* deducting *material holdings*;
- *GENPRU 2 Annex 5R* for a *BIPRU investment firm* deducting *illiquid assets*; and
- *GENPRU 2 Annex 6R* for a *BIPRU investment firm* with a waiver from consolidated supervision.

[*CEBS' CA 1.1.1.2, but with the opposite sign*]

28B Investments in own shares

This is the same figure as in 28A.

29A Intangible assets

See *GENPRU 2.2.155R*.

[*CEBS' CA 1.1.5.1, but with the opposite sign*]

29B Intangible assets

This is the same figure as in 29A.

30A Excess on limits for non-innovative tier one instruments

The amount reported in 25A which is in excess of the limits set out in *GENPRU 2.2.29R*. See also *GENPRU 2.2.25R*.

[*CEBS' CA 1.1.5.2, but with the opposite sign*]

30B Excess on limits for non-innovative tier one instruments

This is the same figure as in 30A.

31A Excess on limits for innovative tier one instruments

The amount reported in 26A which is in excess of the limits set out in *GENPRU 2.2.30R*. See also *GENPRU 2.2.25R*. As set out in *GENPRU 2.2.25R* to *GENPRU 2.2.27R*, the excess is however available in *upper tier two capital* in 38A.

[*CEBS' CA 1.1.5.3, but with the opposite sign*]

31B Excess on limits for innovative tier one instruments

In line with *GENPRU 2.2.42R*, *innovative tier one capital* cannot be included in *tier one capital resources*. This figure equates to the whole of the firm's *innovative tier one capital* (26A) with the signs reversed. As set out in *GENPRU 2.2.25R* to *GENPRU 2.2.27R*, the capital is however available in *upper tier two capital* in 38B.

It gives effect to Note (3) in:

- *GENPRU 2 Annex 2R* for a *UK bank*;
- *GENPRU 2 Annex 3R* for a *building society*;
- *GENPRU 2 Annex 4R* for a *BIPRU investment firm* deducting *material holdings*;
- *GENPRU 2 Annex 5R* for a *BIPRU investment firm* deducting *illiquid assets*; and
- *GENPRU 2 Annex 6R* for a *BIPRU investment firm* with a waiver from consolidated supervision.

32A Excess of drawings over profits for partnerships, LLPs and sole traders

See *GENPRU 2.2.100R*.

[*Part of CEBS' CA 1.1.5.4.2, but with the opposite sign*]

32B Excess of drawings over profits for partnerships, LLPs and sole traders

This is the same figure as reported in 32A.

33A Net losses on equities held in the available-for-sale financial assets category

See *GENPRU 2.2.185R (2)*.

33B Net losses on equities held in the available-for-sale financial assets category

This is the same figure as reported in 33A.

34A Material holdings

This is only applicable to a *BIPRU investment firm* with a waiver from consolidated supervision.

See Note (4) to *GENPRU 2 Annex 6R* and also *GENPRU 2.2.208R* to *GENPRU 2.2.215R*.

34B Material holdings

This is the same figure as reported in 34A.

35A Total tier two capital after deductions

This is equivalent to Stage K in:

- *GENPRU 2 Annex 2R* for a *UK bank*;
- *GENPRU 2 Annex 3R* for a *building society*;
- *GENPRU 2 Annex 4R* for a *BIPRU investment firm* deducting *material holdings*;

- *GENPRU 2 Annex 5R* for a *BIPRU investment firm* deducting *illiquid assets*; and
- *GENPRU 2 Annex 6R* for a *BIPRU investment firm* with a waiver from consolidated supervision.

See *GENPRU 2.2.11G*.

[*CEBS' CA 1.2*]

35B Total tier two capital after deductions

This is broadly similar to 35A, except that it takes account of *GENPRU 2.2.42R* where a firm has *innovative tier one capital* that cannot be included in tier one.

36A Upper tier two capital, subject to limits

This data element (after deducting 44A and 46A) is equivalent to Stage G in:

- *GENPRU 2 Annex 2R* for a *UK bank*;
- *GENPRU 2 Annex 3R* for a *building society*;
- *GENPRU 2 Annex 4R* for a *BIPRU investment firm* deducting *material holdings*;
- *GENPRU 2 Annex 5R* for a *BIPRU investment firm* deducting *illiquid assets*; and
- *GENPRU 2 Annex 6R* for a *BIPRU investment firm* with a waiver from consolidated supervision.

[*CEBS' CA 1.2.1*]

36B Upper tier two capital, subject to limits

This data element (after deducting 44B and 46B) is equivalent, after taking account of *GENPRU 2.2.42R* where a firm has *innovative tier one capital*, to Stage G in:

- *GENPRU 2 Annex 2R* for a *UK bank*;
- *GENPRU 2 Annex 3R* for a *building society*;
- *GENPRU 2 Annex 4R* for a *BIPRU investment firm* deducting *material holdings*;
- *GENPRU 2 Annex 5R* for a *BIPRU investment firm* deducting *illiquid assets*; and
- *GENPRU 2 Annex 6R* for a *BIPRU investment firm* with a waiver from consolidated supervision.

37A Excess on limits for tier one capital transferred to upper tier two capital

See *GENPRU 2.2.25R* to *GENPRU 2.2.27R*. This will not exceed the sum of 30A and 31A.

[*CEBS' CA 1.2.1.1*]

37B Excess on limits for tier one capital transferred to upper tier two capital

As 37A, but includes all *innovative tier one capital* as none of it could be included in *tier one capital resources* as a result of *GENPRU 2.2.42R*. This will not exceed the sum of 30B and 31B.

38A Upper tier two capital instruments, subject to limits

Report here perpetual cumulative preference shares, perpetual subordinated debt and perpetual subordinated securities. See *GENPRU 2.2.159R* to *GENPRU 2.2.193R*. See also *GENPRU TP 8.8R*.

[CEBS' CA 1.2.1.6]

38B Upper tier two capital instruments, subject to limits

This is the same figure as reported in 38A.

39A Revaluation reserve

See *GENPRU 2.2.185R*.

[CEBS' CA 1.2.1.3]

39B Revaluation reserve

This is the same figure as reported in 39A.

40A General/collective provisions

See *GENPRU 2.2.197R* to *GENPRU 2.2.189R*.

[CEBS' CA 1.2.1.5]

40B General/collective provisions

This is the same figure as reported in 40A.

41A Surplus provisions

This includes surplus provisions in accordance with *GENPRU 2.2.190R* to *GENPRU 2.2.193R*.

[CEBS' CA 1.2.1.7]

41B Surplus provisions

This is the same figure as reported in 41A.

42A Lower tier two capital

This is equivalent to Stage H at:

- *GENPRU 2 Annex 2R* for a *UK bank*;
- *GENPRU 2 Annex 3R* for a *building society*;
- *GENPRU 2 Annex 4R* for a *BIPRU investment firm* deducting *material holdings*;
- *GENPRU 2 Annex 5R* for a *BIPRU investment firm* deducting *illiquid assets*; and
- *GENPRU 2 Annex 6R* for a *BIPRU investment firm* with a waiver from consolidated supervision.

[CEBS' CA 1.2.2]

42B Lower tier two capital

This figure will differ from 42A if the firm had any *innovative tier one capital* reported in 26A.

43A Lower tier two capital instruments subject to limits

Includes fixed term preference shares, long term subordinated debt (after amortisation) and fixed term subordinated securities.

See *GENPRU 2.2.159R* to *GENPRU 2.2.174R* and *GENPRU 2.2.194R* to *GENPRU 2.2.196R*.

[CEBS' CA 1.2.2.2]

43B Lower tier two capital instruments subject to limits

This is the same figure as reported in 43A.

44A Excess on limits for lower tier two capital

The amount reported in 43A that is in excess of the limits set out in *GENPRU 2.2.46R (2)*.

[CEBS' CA 1.2.2.5, but with the sign reversed]

44B Excess on limits for lower tier two capital

The amount reported in 43B that is in excess of the limits set out in *GENPRU 2.2.46R (2)*. If the firm has not reported *innovative tier one capital instruments* in 26A, this number will be the same as 44A.

45A Deductions from tier two capital

This data element (excluding 46A) is equivalent to Stage J in:

- *GENPRU 2 Annex 2R* for a *UK bank*;
- *GENPRU 2 Annex 3R* for a *building society*;
- *GENPRU 2 Annex 4R* for a *BIPRU investment firm* deducting *material holdings*;
- *GENPRU 2 Annex 5R* for a *BIPRU investment firm* deducting *illiquid assets*; and
- *GENPRU 2 Annex 6R* for a *BIPRU investment firm* with a waiver from consolidated supervision.

[CEBS' CA 1.2.3, but with the sign reversed]

45B Deductions from tier two capital

If the firm has not reported *innovative tier one instruments* in 26A, this number will be the same as 45A.

Otherwise, this data element (excluding 46B) is equivalent to Stage J (after taking account of Note (3)) in:

- *GENPRU 2 Annex 2R* for a *UK bank*;
- *GENPRU 2 Annex 3R* for a *building society*;
- *GENPRU 2 Annex 4R* for a *BIPRU investment firm* deducting *material holdings*;
- *GENPRU 2 Annex 5R* for a *BIPRU investment firm* deducting *illiquid assets*; and
- *GENPRU 2 Annex 6R* for a *BIPRU investment firm* with a waiver from consolidated supervision.

46A Excess on limits for tier two capital

The amounts reported in 36A and 42A in excess of the limits set out *GENPRU 2.2.46R (1)*.

[CEBS' CA 1.2.3.1, but with the sign reversed]

46B Excess on limits for tier two capital

If the firm has not reported *innovative tier one instruments* in 26A, this number will be the same as 46A. Otherwise it is the amounts reported in 36B and 42B in excess of the limits set out *GENPRU 2.2.46R (1)*.

47A Other deductions from tier two capital

Do not report here certain additional deductions made under *GENPRU 2.2.239R* (3) and (4). *BIPRU investment firms* with a waiver from consolidated supervision should see Note (5) of Part 2 of *GENPRU 2 Annex 6R*.

[*CEBS' CA 1.2.3.2, but with the sign reversed*]

47B Other deductions from tier two capital

This is the same figure as reported in 47A.

48A Deductions from total of tiers one and two

This is equivalent to Stage M of:

- *GENPRU 2 Annex 2R* for a *UK bank*;
- *GENPRU 2 Annex 3R* for a *building society*;
- *GENPRU 2 Annex 4R* for a *BIPRU investment firm* deducting *material holdings*;
- *GENPRU 2 Annex 5R* for a *BIPRU investment firm* deducting *illiquid assets*; and
- *GENPRU 2 Annex 6R* for a *BIPRU investment firm* with a waiver from consolidated supervision.

[*CEBS' CA 1.3 minus 1.3.10, but with the sign reversed*]

48B Deductions from total of tiers one and two

This is the same figure as reported in 48A.

49A Material holdings

This is not relevant for a *BIPRU investment firm* that deducts *illiquid assets* under *GENPRU 2.2.19R*.

BIPRU investment firms that have a waiver from consolidated supervision should see Note (5) of Part 2 of *GENPRU 2 Annex 6R*, as well as *GENPRU 2.2.208R* to *GENPRU 2.2.215R*.

BIPRU firms other than those already mentioned should see *GENPRU 2.2.208R* to *GENPRU 2.2.215R*.

Firms should also note the transitional arrangements for material insurance holdings in *GENPRU TP 7*.

[*CEBS' CA 1.3.1, 1.3.2, 1.3.4, and 1.3.5, but with the signs reversed*]

50A Expected loss amounts and other negative amounts

See *GENPRU 2.2.236R*.

[*CEBS' CA 1.3.8, but with the sign reversed*]

51A Securitisation positions

See *GENPRU 2.2.237R*.

[*CEBS' CA 1.3.7, but with the sign reversed*]

52A Qualifying holdings

This is only relevant for *UK banks* and *building societies*.

See *GENPRU 2.2.202R* to *GENPRU 2.2.207R*.

[CEBS' CA 1.3.9, but with the sign reversed]

53A Contingent liabilities

This is only relevant for a *BIPRU investment firm* with a waiver from consolidated supervision. These firms should see Note (6) to Part 2 of *GENPRU 2 Annex 6R*.

[Part of CEBS' CA 1.3.11]

54A Reciprocal cross holdings

See *GENPRU 2.2.217R* to *GENPRU 2.2.220R*.

[CEBS' CA 1.3.3, but with the sign reversed]

55A Investments which are not material holdings or qualifying holdings

This is only relevant for *UK banks* and *building societies*.

See Part 2 of Stage M in *GENPRU 2 Annex 2R* for *UK banks*, and *GENPRU 2 Annex 3R* for *building societies*.

56A Connected lending of a capital nature

This is only relevant for *UK banks*.

See *GENPRU 2.2.221R* to *GENPRU 2.2.233R*.

[Part of CEBS' CA 1.3.6, but with the sign reversed]

57A Total tier one capital plus tier two capital after deductions

This is equivalent to Stage N of:

- *GENPRU 2 Annex 2R* for a *UK bank*;
- *GENPRU 2 Annex 3R* for a *building society*;
- *GENPRU 2 Annex 4R* for a *BIPRU investment firm* deducting *material holdings*;
- *GENPRU 2 Annex 5R* for a *BIPRU investment firm* deducting *illiquid assets*; and
- *GENPRU 2 Annex 6R* for a *BIPRU investment firm* with a waiver from consolidated supervision.

It is also the capital resources used under *BIPRU 10.5.3R* for the purposes of measuring large exposures.

[CEBS' CA 1.4 plus 1.5 minus 1.3.10]

57B Total tier one capital plus tier two capital after deductions

This may differ from 57A if the firm reported *innovative tier one instruments* in 26A.

This is equivalent to Stage N of:

- *GENPRU 2 Annex 2R* for a *UK bank*;
- *GENPRU 2 Annex 3R* for a *building society*;
- *GENPRU 2 Annex 4R* for a *BIPRU investment firm* deducting *material holdings*;
- *GENPRU 2 Annex 5R* for a *BIPRU investment firm* deducting *illiquid assets*; and
- *GENPRU 2 Annex 6R* for a *BIPRU investment firm* with a waiver from consolidated supervision.

Firms should note that if this figure is less than the *base capital resources requirement* (reported in data element 69A), the firm's *capital resources* are less than its *capital resources requirement*. See Note (2) in *GENPRU 2 Annexes 2R, 3R, 4R, 5R and 6R*.

[*CEBS' CA 1.4 plus 1.5 minus 1.3.10*]

58A Total tier three capital

This is equivalent to Stage Q of:

- *GENPRU 2 Annex 2R* for a *UK bank*;
- *GENPRU 2 Annex 3R* for a *building society*;
- *GENPRU 2 Annex 4R* for a *BIPRU investment firm* deducting *material holdings*;
- *GENPRU 2 Annex 5R* for a *BIPRU investment firm* deducting *illiquid assets*; and
- *GENPRU 2 Annex 6R* for a *BIPRU investment firm* with a waiver from consolidated supervision.

58B Total tier three capital

This is broadly similar to 58A, except that it takes account of *GENPRU 2.2.42R* where a firm has *innovative tier one capital* that cannot be included in tier one.

59A Excess on limits for tier two capital transferred to tier three capital

See *GENPRU 2.2.25R* to *GENPRU 2.2.27R*. This will be no greater than the sum of 44A and 46A.

59B Excess on limits for tier two capital transferred to tier three capital

See *GENPRU 2.2.25R* to *GENPRU 2.2.27R*. This will be no greater than the sum of 44B and 46B. If the firm has not reported *innovative tier one instruments*, the figure should be the same as 59A.

60A Short term subordinated debt, subject to limits

See *GENPRU 2.2.241R* to *GENPRU 2.2.245R*

[*CEBS' CA 1.6.3*]

60B Short term subordinated debt, subject to limits

This figure will be the same as 60A.

[*CEBS' CA 1.6.3*]

61A Net interim trading book profit and loss

See *GENPRU 2.2.246R* to *GENPRU 2.2.249R*.

[*CEBS' CA 1.6.2*]

61B Net interim trading book profit and loss

This figure will be the same as 61A.

[*CEBS' CA 1.6.2*]

62A Excess on limit for tier three capital

The amount reported in 59A, 60A and 61A in excess of the limits set out in *GENPRU 2.2.49R* to *GENPRU 2.2.50R*.

[CEBS' CA 1.6.5, but with the sign reversed]

62B Excess on limit for tier three capital

The amount reported in 59B, 60B and 61B in excess of the limits set out in *GENPRU 2.2.49R* to *GENPRU 2.2.50R*. It will only differ from 62A if the firm has reported *innovative tier one capital* in 26A.

63A Unused but eligible tier three capital (memo)

See *GENPRU 2.2.47R*.

This is data element 58A less the amount shown in data element 92A. If the result is negative, enter 0. This is the surplus tier three capital which may only be used for the purposes set out in *BIPRU 2.2.47R*.

[CEBS' CA 1.6.7]

63B Unused but eligible tier three capital (memo)

See *GENPRU 2.2.47R*.

This is the sum of data elements 58B less the amount shown in data element 92A. If the result is negative, enter 0. This is the surplus tier three capital which may only be used for the purposes set out in *BIPRU 2.2.47R*.

It may differ from 63A if the firm has reported *innovative tier one capital* in 26A.

64A Total capital before deductions

This is equivalent to Stage R of:

- *GENPRU 2 Annex 2R* for a *UK bank*;
- *GENPRU 2 Annex 3R* for a *building society*;
- *GENPRU 2 Annex 4R* for a *BIPRU investment firm* deducting *material holdings*;
- *GENPRU 2 Annex 5R* for a *BIPRU investment firm* deducting *illiquid assets*; and
- *GENPRU 2 Annex 6R* for a *BIPRU investment firm* with a waiver from consolidated supervision.

64B Total capital before deductions

This figure will differ from 64A if the firm had any innovative tier one capital reported in 26A.

65A Deductions from total capital

This is equivalent to Stage S of:

- *GENPRU 2 Annex 2R* for a *building society*;
- *GENPRU 2 Annex 3R* for a *building society*;
- *GENPRU 2 Annex 4R* for a *BIPRU investment firm* deducting *material holdings*;
- *GENPRU 2 Annex 5R* for a *BIPRU investment firm* deducting *illiquid assets*; and
- *GENPRU 2 Annex 6R* for a *BIPRU investment firm* with a waiver from consolidated supervision.

[CEBS' CA 1.7]

65B Deductions from total capital

This will be the same value as reported in 65A.

66A Excess trading book position

This is only relevant for *UK banks* and *building societies*.

See *GENPRU 2.2.263R* to *GENPRU 2.2.265R*.

67A Illiquid assets

This is only relevant for a *BIPRU investment firm* deducting *illiquid assets* under *GENPRU 2.2.19R*, or a *BIPRU investment firm* with a waiver from consolidated supervision.

See *GENPRU 2.2.259R* to *GENPRU 2.2.260R*.

68A Free deliveries

See *BIPRU 14.4*.

69A Base capital resources requirement

Enter here the firm's *base capital resources requirement*, converted into the currency of reporting. See *GENPRU 2.1.41R* to *GENPRU 2.1.43G*, *GENPRU 2.1.47R* and *GENPRU 2.1.48R*. *UK banks* authorised before 1993 should also see *GENPRU 2.1.60R* to *GENPRU 2.1.62R*.

If the report is for a *UK consolidation group*, this should be zero – see *BIPRU 8.3.6R*.

70A Total variable capital requirement

This is the variable capital requirement of the firm or *UK consolidations group*, as calculated in 71A to 74A below. Each firm (or *UK consolidation group*) will only fill in one variable capital requirement which will have the correct method of calculating the variable capital requirement in accordance with *GENPRU 2.1.45R* and *GENPRU 2.1.46R* and any relevant waivers or treatment identified through the responses to data elements 5A, 10A and 11A above.

[*CEBS' CA 2*]

71A Variable capital requirement for banks and building societies

This is also relevant for a *UK consolidation group* that is subject to the capital requirements at Stage 1 of *BIPRU 8 Annex 5R*. This is the sum of the *credit risk capital requirement*, the *market risk capital requirement*, and the *operational risk capital requirement*.

72A Variable capital requirement for full scope BIPRU investment firms

This is also relevant for a *UK consolidation group* that is subject to the capital requirements at Stage 2 of *BIPRU 8 Annex 5R*. This is the sum of the *credit risk capital requirement*, the *market risk capital requirement*, and the *operational risk capital requirement* less any reduction in the *operational risk capital requirement* under *BIPRU TP 12.1*.

[*Part of CEBS' CA 2a plus 2b plus 2c*]

73A Variable capital requirement for BIPRU limited activity firms

This is also relevant for a *UK consolidation group* that is subject to the capital requirements at Stage 3 of *BIPRU 8 Annex 5R*. This is the sum of the *credit risk capital requirement*, the *market risk capital requirement*, and the *fixed overheads requirement*.

[*Part of CEBS' CA 2a plus 2b plus 2c*]

74A Variable capital requirement for BIPRU limited licence firms

This is also relevant for a *UK consolidation group* that is subject to the capital requirements at Stage 4 of *BIPRU 8 Annex 5R*. This is the sum of the *credit risk capital requirement* and the *market risk capital requirement*, or the *fixed overheads requirement* if that is higher.

[Part of CEBS' CA 2a plus 2b plus 2c]

75A Variable capital requirement for UCITS investment firms

This is the sum of the *credit risk capital requirement* and the *market risk capital requirement*, or the *fixed overheads requirement* if that is higher.

UCITS investment firms should see *GENPRU 2.1.46R*.

[Part of CEBS' CA 2a plus 2b plus 2c]

76A Variable capital requirements to be met from tier one and tier two capital

See *BIPRU 2.2.44R*. This is the sum of the *credit risk capital component* (data element 77A), the *operational risk capital requirement* (data element 85A) and the *counterparty risk capital component* (data element 91A). It also includes that part of 92A that is not met from tier three capital alone (58A).

77A Total credit risk capital component

See *GENPRU 2.1.39R*, as modified if a firm has an IRB permission.

A further breakdown of this figure is provided quarterly in FSA004 for those firms that are required to report that data item.

[CEBS' CA 2.1]

78A Credit risk calculated by aggregation for UK consolidation group reporting

This is only relevant for *UK consolidation groups*, and then only if they calculate their *credit risk capital component* under *BIPRU 8.7.13R (2)*.

79A Credit risk capital requirements under the standardised approach

The *credit risk capital component* calculated under *BIPRU 3*, using the exposure classes set out in *BIPRU 3.2.9*.

This will agree with data element 1A on FSA004.

[CEBS' CA 2.1.1]

80A Credit risk capital requirements under the IRB approach

The *credit risk capital component* under *BIPRU 3* calculated in accordance with a firm's IRB permission to use the IRB approach and *BIPRU 4*.

[CEBS' CA 2.1.2]

81A Under foundation IRB approach

The *credit risk capital component* under *BIPRU 3* calculated in accordance with a firm's IRB permission to use the foundation IRB approach and *BIPRU 4*. This figure covers the following exposures classes:

- central government and central banks (*BIPRU 4.3.2R (1)*)
- institutions (*BIPRU 3.4.2R (2)*); and

- corporates (*BIPRU 3.4.2R (3)*).

This will agree to data element 18A on FSA004.

[*CEBS' CA 2.1.2.1*]

82A Retail IRB

This covers the *credit risk capital component* under *BIPRU 3* calculated in accordance with a firm's IRB permission to use the advanced IRB approach and *BIPRU 4*, and covers the retail exposure class (*BIPRU 3.4.2R (4)*).

This will agree to data element 23A on FSA004.

83A Under advanced IRB approach

The *credit risk capital component* under *BIPRU 3* calculated in accordance with a firm's IRB permission to use the advanced IRB approach and *BIPRU 4*. This figure covers the following exposure classes:

- central governments and central banks (*BIPRU 4.3.2R (1)*);
- institutions (*BIPRU 4.3.2R (2)*); and
- corporates (*BIPRU 4.3.2R (3)*).

This will agree to data element 28A on FSA004.

[*CEBS' CA 2.1.2.2 minus retail*]

84A Other IRB exposure classes

The *credit risk capital component* under *BIPRU 3* calculated in accordance with a firm's IRB permission to use the IRB approach and *BIPRU 4*. This figure covers the following exposure classes:

- equity claims (*BIPRU 4.3.2R (5)*);
- securitisation positions (*BIPRU 4.3.2R (6)*); and
- non credit-obligation assets (*BIPRU 4.3.2R (7)*).

This will agree to data element 33A on FSA004.

[*CEBS' CA 2.1.2.3 plus 2.1.2.4 plus 2.1.2.5*]

85A Total operational risk capital requirement

This is only relevant for *UK banks, building societies* and *full scope BIPRU investment firms*. It is also relevant for any *BIPRU limited activity firm* or *BIPRU limited licence firm* that has a waiver under *BIPRU 6.1.2G* (to apply an *ORCR* rather than a fixed overheads requirement).

See *BIPRU 6*.

A *full scope BIPRU investment firm* that meets the conditions set out in *BIPRU TP 5.1R* should enter here the full *ORCR* that would have applied but for *BIPRU TP 5.7R*. The reduction as a result of that rule should be reported in data element 90A.

A further breakdown of this figure is provided in FSA007 for firms on the standardised approach, alternative standardised approach or the advanced models approach.

[*CEBS' CA 2.4*]

86A Operational risk calculated by aggregation for UK consolidation group reporting

This is only relevant for *UK consolidation groups* completing data element 89A, and then only if they calculate their *operational risk capital requirement* under *BIPRU* 8.7.13R (2).

87A Operational risk basic indicator approach

This is only relevant for those firms completing data element 85A.

See *BIPRU* 6.3.

[*CEBS' CA 2.4.1*]

88A Operational risk standardised/alternative standardised approach

This is only relevant for those firms completing data element 85A.

See *BIPRU* 6.4.

This will agree to data element 15A on FSA007.

[*CEBS' CA 2.4.2*]

89A Operational risk advanced measurement approaches

This is only relevant for those firms completing data element 85A.

See *BIPRU* 6.5.

This will agree to data element 15B on FSA007.

[*CEBS' CA 2.4.3*]

90A Reduction in operational risk capital requirement under *BIPRU* TP 12.1R.

This is only relevant for a *full scope BIPRU investment firm* that satisfies the conditions set out in *BIPRU* TP 12.1R.

Firms should report here the amount by which the *ORCR* reported in data element 85A is reduced as a result of the calculation in *BIPRU* TP 12.1R (thus data element 85A less this data element will give the reduced *ORCR*).

[*CEBS' CA 2.6.2*]

91A Counterparty risk capital component

See *BIPRU* 14.1.3R.

[*CEBS' CA 2.2*]

92A Capital requirements for which tier three capital may be used

See *GENPRU* 2.2.46R.

This comprises the data elements that are relevant for calculating the variable capital requirement for your firm (see *GENPRU* 2.2.47R) from the data elements 93A (*market risk capital requirement*), 103A (*concentration risk capital component*) and 104A (*fixed overheads requirement*).

93A Total market risk capital requirement

See *BIPRU* 7 and also *GENPRU* 2.2.46R.

A further breakdown of this figure (less 94A in the case of *UK consolidation group* reports) is provided in FSA005 for firms that meet the reporting thresholds defined in *SUP* 16.12.5R

(note 4), *SUP* 16.12.11R (note 4), *SUP* 16.12.15R (note 4), *SUP* 16.12.22R (note 4) and *SUP* 16.12.25R (note 4).

[*CEBS' CA* 2.3]

94A Market risk capital requirement calculated by aggregation for UK consolidation group reporting

This is only relevant for *UK consolidation groups*, and then only if they calculate their *market risk capital component* under *BIPRU* 8.7.13R (2).

95A Position, foreign exchange and commodity risks under TSA

See *BIPRU* 7.

[*CEBS' CA* 2.3.1]

96A Interest rate PRR

See *BIPRU* 7.1.7R to *BIPRU* 7.1.13E, *BIPRU* 7.2, *BIPRU* 7.3, *BIPRU* 7.6, *BIPRU* 7.9, *BIPRU* 7.11.12R and *BIPRU* 7.11.35R.

This will agree with data element 18G on FSA005.

97A Equity PRR

See *BIPRU* 7.1.7R to *BIPRU* 7.1.13E, *BIPRU* 7.3.48R and *BIPRU* 7.3.49G, *BIPRU* 7.6, *BIPRU* 7.9, *BIPRU* 7.11.12R and *BIPRU* 7.11.35R.

This will agree with data element 29G on FSA005.

[*CEBS' CA* 2.3.1.2]

98A Commodity PRR

See *BIPRU* 7.1.7R to *BIPRU* 7.1.13E, *BIPRU* 7.4 and *BIPRU* 7.9.

This will agree with data element 40G on FSA005.

[*CEBS' CA* 2.3.1.4]

99A Foreign currency PRR

See *BIPRU* 7.1.7R to *BIPRU* 7.1.13E, *BIPRU* 7.5, *BIPRU* 7.6 and *BIPRU* 7.9.

This will agree with data element 48G on FSA005.

[*CEBS' CA* 2.3.1.3]

100A CIU PRR

See *BIPRU* 7.1.7R to *BIPRU* 7.1.13E, *BIPRU* 7.6, *BIPRU* 7.7 and *BIPRU* 7.9.

This will agree with data element 55G on FSA005.

101A Other PRR

See *BIPRU* 7.1.7R to *BIPRU* 7.1.13E.

This will agree with data element 56G on FSA005.

102A Position, foreign exchange and commodity risks under internal models

See *BIPRU* 7.10.

This will agree with data element 61G on FSA005.

[CEBS' CA 2.3.2]

103A Concentration risk capital component

This is the CNCOM. See *BIPRU* 10.5.14R to *BIPRU* 10.5.21G for details of how this is calculated.

Figures appearing here should also appear on FSA008 under data element 5R for the same quarterly reporting date.

104A Fixed overheads requirement

This should only be completed by *BIPRU limited activity firms* and *BIPRU limited licence firms*. See *GENPRU* 2.1.41R to *GENPRU* 2.1.46G.

[CEBS' CA 2.5]

105A Capital resources requirement arising from capital floors

This is only relevant for a firm that has adopted the *IRB approach*. Firms should enter the capital resources required to equal or exceed the amounts defined in *BIPRU* TP 2 and *BIPRU* TP 2.3R in particular. When reporting, the scaling factors set out in *BIPRU* TP 2.3R should have been applied.

106A Surplus/deficit of own funds

This is 15A less 70A.

This should be a positive figure, showing the amount of excess capital over that required for the variable capital requirement measured at the reporting date, as well as any requirements.

[CEBS' CA 3.2]

106B Surplus/deficit of own funds

This is 15B less 70A.

This should be a positive figure, showing the amount of excess capital over that required for the risks measured at the reporting date, as well as any requirements.

Firms that have adopted the *IRB approach* for credit risk or *advanced measurement approach* for operational risk should also be monitoring data element 105A against 15B.

Firms should note that although this figure may show a surplus, if this figure reported in data element 57B is less than the *base capital resources requirement* (reported in data element 69A), the firm's *capital resources* are less than its *capital resources requirement*. See Note (2) in *GENPRU* 2 Annexes 2R, 3R, 4R, 5R and 6R.

This should be a positive figure and is the calculation required in *GENPRU* 2.1.40R.

107A Overall solvency ratio

This is 15A divided by 70A, multiplied by 100 and represents the firm's overall solvency.

[CEBS' CA 3.2.a]

107B Overall solvency ratio

This is 15B divided by 70A, multiplied by 100 and represents the firm's overall solvency for CRR purposes.

This ratio represents the firm's solvency in relation to its variable capital requirement under *GENPRU* 2.1.9R(1). In most cases, it may be the same as figure as appears in Column A, but

that will not be the case if data element 15 differs between Column A and Column B because of the different treatment of *innovative tier one instruments* (see *GENPRU 2.2.43R*).

108A Individual capital guidance – total capital resources

Enter the amount of total capital resources that the FSA considers the firm should hold in order to meet *GENPRU 1.2.26R* (adequate financial resources). This amount can be calculated from information provided in the most recent letter the firm has received from the *FSA* setting out Individual Capital Guidance (as described in *GENPRU 2.2.12G*). The amount should be calculated as at the same reporting date as all other information included in this data item. Where this data item is being used to report for a *UK consolidation group*, you should enter the total group capital resources indicated in the ICG letter which will typically be based on the group capital resources requirement (data element 15B) – see *BIPRU 2.2.19G*.

For the purposes of giving individual capital guidance, the FSA may distinguish between capital resources which can be used to meet all risks (general purpose capital, ie stage N in *GENPRU 2 Annexes 2R, 3R, 4R, 5R and 6R* as appropriate) and capital resources which can only be used to meet certain risks, for instance trading book risks. Total capital resources after deductions is defined in *GENPRU 2.2.12R* and is stage T in *GENPRU 2 Annexes 2R, 3R, 4R, 5R and 6R* as appropriate. The amount of total capital resources should be shown in data element 15B. See *GENPRU 2.2.16G*.

This data element should be used where an ICG letter provides guidance on the amount of total capital or is silent on the nature of the capital which can be used to meet the obligation in *GENPRU 1.2.26R*.

If no ICG has been set, firms should enter 0 here.

109A Individual capital guidance – general purpose capital

Enter the amount of general purpose capital that the FSA considers the firm should hold in order to meet *GENPRU 1.2.26R* (adequate financial resources). The amount should be calculated on the same basis set out for data element 15B, but refers only to general purpose capital rather than to total capital. If the firm's ICG letter does not provide guidance on the amount of general capital (or limited purpose capital) that the firm should hold or no ICG has been set for the firm, it should enter 0 here.

110A Surplus/(deficit) total capital over ICG

This is the amount in data element 15B (total capital resources) less the amount in data element 108A. However, if no ICG has been set and data element 108A is 0, this should also be 0.

111A Surplus/(deficit) general purpose capital over ICG

This is the amount in data element 57B less the amount in data element 109A. However, if no ICG has been set and data element 109A is 0, this should also be 0.

Memorandum items

112A Value of portfolio under management

This should only be provided by *UCITS investment firms*.

Prudential filters

Information on these data elements is required so that we can monitor their impact (or potential impact) on capital resources.

113A Unrealised gains on available-for-sale-equities

This is the amount of the gain related to available-for-sale equities included within revaluation reserves reported in 39A and 39B. See *GENPRU 2.2.185R(2)(b)*.

114A Unrealised gains (losses) on investment properties

This is the value of gains (losses) arising from revaluation reserves of investment properties that have been included within *capital resources*. See *GENPRU 2.2.185R(3)*.

115A Unrealised gains (losses) on land and buildings

This is the value of gains (losses) arising from revaluation reserves of land and buildings that have been included within *capital resources*. See *GENPRU 2.2.185R(4)*.

116A Unrealised gains (losses) on debt instruments held in the available-for-sale category

This is the unrealised gains (losses) on debt instruments held in the available-for-sale category that are excluded from *capital resources*. See *GENPRU 1.3.36R(2)(b)*.

117A Unrealised gains (losses) on cash flow hedges of financial instruments

This is the fair value reserves related to gains (losses) on cash flow hedges of financial instruments measured at amortised cost that are excluded from *capital resources*. See *GENPRU 1.3.36R(2)(a)*.

118A Unrealised gains (losses) on fair value financial liabilities

This is the value of unrealised gains (losses) on liabilities designated as at fair value that are excluded from *capital resources*. See *GENPRU 1.3.9R(1)*.

119A Defined pension benefit (liability)

This is the value of any *defined benefit asset (defined benefit liability)*, in respect of a *defined benefit occupational pension scheme*, that has been excluded from *capital resources*. See *GENPRU 1.3.9R(2)*.

120A (Deficit reduction amount) if used

This is the value of any *deficit reduction amount* substituted for a *defined benefit liability* in respect of a *defined benefit occupational pension scheme*. See *GENPRU 1.3.9R(2)(b)*.

121A Deferred acquisition costs (deferred income)

This is the value of assets in respect of deferred acquisition costs (DACs) (liabilities in respect of deferred income – DIRs) that have been excluded from *capital resources*. See *GENPRU 1.3.36R(3)*.

Minority interests

These are included indistinguishably within capital resources.

122A Minority interests included within capital resources

Report here the amount of minority interests included indistinguishably in the components of capital resources. See *BIPRU 8.6.8R* to *BIPRU 8.6.16R*.

123A Of which: innovative tier one instruments

Report here the amount of innovative tier one instruments that are included within minority interests (122A) and also within innovative tier one capital in 26A. See *BIPRU* 8.

Profits

Capital resources calculated above should only include in tier one profits that have been externally verified at the reporting date. This section captures information on profits at the reporting date that have subsequently been verified.

124A Profits not externally verified at the reporting date but subsequently have been

Enter here the amount of profits (for the financial year covered by the reporting date) which were not externally verified at the reporting date but which have subsequently been verified. This amount should not be included within 23A. Also, do not include here any amount already reported in 23A.

This data element may be zero if no profits have been verified between the reporting date and the submission date.

125A Total capital after deductions, including externally verified profits

This figure should be a firm's alternative calculation of data element 15B, based on the figure in 124A being included within tier one capital. It will not necessarily be equivalent to 15B plus 124A, because other components of the capital resources calculation may also have been revised following the external verification.

This cell should be zero if data element 124A is zero.

Allocation of deductions between tiers one and two capital

126A Material insurance company holdings excluded from allocation

This is the value of material insurance holdings (included within 49A) that are not allocated to tier one and two capital under *GENPRU* TP 7.

127A Allocated to tier one capital

Firms should allocate the sum of data elements 49A, 50A and 51A less 126A between tier one capital and tier two capital. See *GENPRU* 2.2.239R(3) and *GENPRU* 2.2.239R(4).

128A Allocated to tier two capital

Firms should allocate the sum of data elements 49A, 50A and 51A less 126A between tier one capital and tier two capital. See *GENPRU* 2.2.239R(3) and *GENPRU* 2.2.239R(4).

Firms on IRB/AMA approaches

129A Total capital requirement under pre-CRD rules

This is only relevant for those firms that have adopted the approaches in *BIPRU* 4 (IRB) or *BIPRU* 6.5 (AMA) for the calculation of their capital requirements.

Firms should report the total capital requirement calculated under whichever part of *IPRU* applies under *BIPRU* TP 1.4R.

130A Total credit risk capital component under pre-CRD rules

This is only relevant for those firms that have adopted the approaches under *BIPRU* 4 (IRB) for the calculation of their capital requirements.

Firms should report the credit risk capital component under whichever part of *IPRU* applies under *BIPRU* TP 1.4R.

131A Expected loss amounts – wholesale, retail and purchased receivables

This is only relevant for firms that have adopted the approaches under *BIPRU* 4 (IRB) for the calculation of their capital requirements.

This is the amount for exposures to sovereigns, institutions, corporate IRB, specialised lending and retail, and for purchased receivables, that result from the calculations under *BIPRU* 4.3.6R (1), (2) and (4).

132A Expected loss amounts – equity

This is only relevant for firms that have adopted the approaches under *BIPRU* 4 (IRB) for the calculation of their capital requirements.

This is the amount for exposures to equities that result from the calculations under *BIPRU* 4.3.6R (3).

133A Total value adjustments and provisions eligible for the “EL less provisions” calculation under IRB

This is only relevant for firms that have adopted the approaches under *BIPRU* 4 (IRB) for the calculation of their capital requirements.

This is the sum of value adjustments and provisions related to exposures in *BIPRU* 4.3.6R (1), (2) and (4) which are eligible for the “EL less provisions” calculation in *BIPRU* 4.3.8R.

134A Total deductions from tier 1 and tier 2 capital according to pre-CRD rules

This is only relevant for firms that have adopted the approaches under *BIPRU* 4 (IRB) or *BIPRU* 6.5 (AMA) for the calculation of their capital requirements.

Firms should report here the deductions calculated under whichever part of *IPRU* applies under *BIPRU* TP 1.4R.

FSA003 – Capital adequacy validations

Internal validations

Data elements are referenced by row then column.

Validation number	Data element		
1	1A		If (2A+3A+4A)=yes, then no, else yes
2	2A		If (1A+3A+4A)=yes, then no, else yes
3	3A		If (1A+2A+4A)=yes, then no, else yes
4	4A		If (1A+2A+3A)=yes, then no, else yes
5	5A		If 2A = no, then no
6	6A		If (3A+4A) = no, then no
7	7A		If (1A+8A+9A)=yes, then no
8	8A		If (1A+7A+9A)=yes, then no
9	9A		If (1A+7A+8A)=yes, then no
10	10A		If 1A = no, then no
11	11A		If 1A = no, then no
12			
13	15A	=	64A – 65A
14	15B	=	64B – 65B
15	16A	=	17A + 24A - 27A
16	16B	=	17B + 24B - 27B
17	17A	=	18A + 19A – 20A +21A +22A + 23A
18	17B	=	17A
19	24A	=	25A + 26A
20	24B	=	24A
21	27A	=	28A + 29A + 30A + 31A + 32A + 33A +34A
22	27B	=	28A + 29B + 30B + 31B + 32B + 33B + 34B
23	28B	=	28A
24	29B	=	29A
25	30B	=	30A
26	31B	=	26A
27	32B	=	32A
28	33B	=	33A

29	34A		If 10A = no, then 0
30	34B	=	34A
31			
32	35A	=	36A + 42A - 45A
33	35B	=	36B + 42B - 45B
34	36A	=	37A + 38A + 39A + 40A + 41A
35	36B	=	37B + 38B + 39B + 40B + 41B
36	37A	≤	30A + 31A
37	37B	≤	30B + 31B
38	38B	=	38A
39	39B	=	39A
40	40B	=	40A
41	41B	=	41A
42	42A	=	43A - 44A
43	42B	=	43B - 44B
44	43B	=	43A
45	45A	=	46A + 47A
46	45B	=	46B + 47B
47	47B	=	47A
48	48A	=	49A + 50A + 51A + 52A + 53A + 54A + 55A + 56A
49	48B	=	48A
50	49A		If 11A = yes, then 0
51	52A		If 1A = no, then 0
52	53A		If 10A = no, then 0
53	55A		If 1A = no, then 0
54	56A		If 1A = no, then 0
55	57A	=	16A + 35A - 48A
56	57B	=	16B + 35B - 48B
57	58A	=	59A + 60A + 61A - 62A
58	58B	=	59B + 60B + 61B - 62B
59	59A	≤	44A + 46A
60	59B	≤	44B + 46B
61	60B	=	60A
62	61B	=	61A

63	63A	=	$59A + 60A + 61A - 62A - 92A$
64	63B	=	$59B + 60B + 61B - 62B - 92B$
65	64A	=	$57A + 58A$
66	64B	=	$57B + 58B$
67	65A	=	$66A + 67A + 68A$
68	65B	=	65A
69	66A		If 1A = no, then 0
70	67A		If 11A = no, then (if 10A = no, then 0)
71	69A		If 12A = consolidated, then 0, else >0
72	70A	=	$71A + 72A + 73A + 74A + 75A$
	71A		If $((72A + 73A + 74A + 75A) > 0$, then 0
	72A		If $((71A + 73A + 74A + 75A) > 0$, then 0
	73A		If $((71A + 72A + 74A + 75A) > 0$, then 0
	74A		If $((71A + 72A + 73A + 75A) > 0$, then 0
	75A		If $((71A + 72A + 73A + 74A) > 0$, then 0
73	71A	=	$76A + 92A$
74	72A	=	$76A + 92A$
75	73A	=	$76A + 92A$
76	74A	=	Max $((77A + 91A + 93A + 103A), 104A)$
77	75A	=	Max $((77A + 91A + 93A + 103A), 104A)$
78	76A	=	$77A + 85A - 90A + 91A$
79			
80	77A	=	$78A + 79A + 80A$
81	78A		If 12A \neq consolidated, then 0
82	80A	=	$81A + 82A + 83A + 84A$
83	85A		$86A + 87A + 88A + 89A$
84	86A		If 12A \neq consolidated, then 0
85	90A		If 5A = no, then 0
86	92A	=	$92A + 103A + 104A$
87	93A	=	$94A + 95A + 102A$
88	94A		If 12A \neq consolidated, then 0
89	95A	=	$96A + 97A + 98A + 99A + 100A + 101A$
90	104A	=	If 1A = yes, then 0, else (if 2A = yes, then 0, else > 0)
91	106A	=	$15A - 70A$

92	106B	=	15B – 70A
93	107A	=	15A/70A
94	107B	=	15B/70A
95	110A		If 108A = 0, then 0, else (15B – 108A)
96	111A	=	If 109A = 0, then 0, else (57B – 109A)
97	112A		If 8A – no, then 0
98	123A	≤	26A
99	127A + 128A	=	51A + 52A + 53A – 126A
100	127A	≤	16B
101	128A	≤	35B

External validations

Validation number	Data element		
1	79A	=	FSA004.1A
2	81A	=	FSA004.18A
3	82A	=	FSA004.23A
4	83A	=	FSA004.28A
	84A	=	FSA004.33A
5	88A	=	FSA007.15A
6	89A	=	FSA007.15B
7	93A – 94A	=	FSA005.62G
8	96A	=	FSA005.18G
9	97A	=	FSA005.29G
10	98A	=	FSA005.40G
11	99A	=	FSA005.48G
12	100A	=	FSA005.55G
13	101A	=	FSA005.56G
14	102A	=	FSA005.61G
15	103A	≥	FSA008.5RT

FSA004 – Credit risk

This data item provides details of the credit risk capital requirements of firms reported in FSA003.

For *UK consolidation groups*, the figures reported should exclude any credit risk capital requirement that has been calculated using aggregation under *BIPRU* 8.7.13R (2).

This data item uses elements from CEBS' COREP Tables CR SA, CR SEC SA, CR IRB, CR EQU IRB and CR SEC IRB¹, but reflects the Rules and wording in the Handbook, omits elements which are not in our view relevant in the UK, and combines some other elements. The numbers in parenthesis and italics show the corresponding element(s) in CEBS Tables CR SA, CR SEC SA, CR IRB, CR EQU IRB and CR SEC IRB and are only provided for information purposes to identify the linkage to the CEBS' data.

Valuation

Unless indicated otherwise, the valuation of data elements should follow *BIPRU* 1.3.

Currency

You should report in the currency of your annual audited accounts ie in either Sterling, Euro, US dollars, Canadian dollars, Swedish Kroner, Swiss Francs or Yen. Figures should be reported in 000s.

Data elements

These are referred to by row first, then by column, so data element 2B will be the element numbered 2 in column B.

Column A

This contains the capital requirement, calculated in accordance with *BIPRU* 3 and *BIPRU* 4, but excluding securitisation positions.

Column B

For firms on the standardised approach, this should be calculated as set out in *BIPRU* 3 and *BIPRU* 5. It equates to the fully adjusted exposures values (E*) after adjustment to off-balance sheet items under *BIPRU* 3.6.1R.

For firms on an IRB approach, this should be calculated in accordance with *BIPRU* 4 and *BIPRU* 5 and is the exposure value before the risk weight is applied.

Breakdown under the standardised approach to credit risk by exposure classes excluding securitisation positions

1A Total capital requirement

This is the same as the capital requirement reported in data element 79A in FSA003.

[*CEBS' CR SA column 22*]

¹ www.c-eps.org/documents/GL04_CR.xls

1B Total exposure value

This is the total exposure value, being the sum of data elements 2B to 17B.

2A Central government or central banks

This is the capital requirement, calculated in accordance with *BIPRU* 3, relating to the asset class defined in *BIPRU* 3.2.9R (1).

[*CEBS' CR SA column 22*]

2B Central government or central banks

This is the exposure value relating to the asset class defined in *BIPRU* 3.2.9R (1).

[*CEBS' CR SA column 20*]

3A Regional governments or local authorities

This is the capital requirement, calculated in accordance with *BIPRU* 3, relating to the asset class defined in *BIPRU* 3.2.9R (2).

[*CEBS' CR SA column 22*]

3B Regional governments or local authorities

This is the exposure value relating to the asset class defined in *BIPRU* 3.2.9R (2).

[*CEBS' CR SA column 20*]

4A Administrative bodies and non-commercial undertakings

This is the capital requirement, calculated in accordance with *BIPRU* 3, relating to the asset class defined in *BIPRU* 3.2.9R (3).

[*CEBS' CR SA column 22*]

4B Administrative bodies and non-commercial undertakings

This is the exposure value relating to the asset class defined in *BIPRU* 3.2.9R (3).

[*CEBS' CR SA column 20*]

5A Multilateral development banks

This is the capital requirement, calculated in accordance with *BIPRU* 3, relating to the asset class defined in *BIPRU* 3.2.9R (4).

[*CEBS' CR SA column 22*]

5B Multilateral development banks

This is the exposure value relating to the asset class defined in *BIPRU* 3.2.9R (4).

[*CEBS' CR SA column 20*]

6A International organisations

This is the capital requirement, calculated in accordance with *BIPRU* 3, relating to the asset class defined in *BIPRU* 3.2.9R (5).

[*CEBS' CR SA column 22*]

6B International organisations

This is the exposure value relating to the asset class defined in *BIPRU* 3.2.9R (5).

[CEBS' CR SA column 20]

7A Institutions

This is the capital requirement, calculated in accordance with *BIPRU* 3, relating to the asset class defined in *BIPRU* 3.2.9R (6).

[CEBS' CR SA column 22]

7B Institutions

This is the exposure value relating to the asset class defined in *BIPRU* 3.2.9R (6).

[CEBS' CR SA column 20]

8A Corporates

This is the capital requirement, calculated in accordance with *BIPRU* 3, relating to the asset class defined in *BIPRU* 3.2.9R (7).

[CEBS' CR SA column 22]

8B Corporates

This is the exposure value relating to the asset class defined in *BIPRU* 3.2.9R (7).

[CEBS' CR SA column 20]

9A Retail

This is the capital requirement, calculated in accordance with *BIPRU* 3, relating to the asset class defined in *BIPRU* 3.2.9R (8).

[CEBS' CR SA column 22]

9B Retail

This is the exposure value relating to the asset class defined in *BIPRU* 3.2.9R (8).

[CEBS' CR SA column 20]

10A Secured on real estate property

This is the capital requirement, calculated in accordance with *BIPRU* 3, relating to the asset class defined in *BIPRU* 3.2.9R (9).

[CEBS' CR SA column 22]

10B Secured on real estate property

This is the exposure value relating to the asset class defined in *BIPRU* 3.2.9R (9).

[CEBS' CR SA column 20]

11A Past due items

This is the capital requirement, calculated in accordance with *BIPRU* 3, relating to the asset class defined in *BIPRU* 3.2.9R (10).

[CEBS' CR SA column 22]

11B Past due items

This is the exposure value relating to the asset class defined in *BIPRU* 3.2.9R (10).

[CEBS' CR SA column 20]

12A Items belonging to regulatory high-risk categories

This is the capital requirement, calculated in accordance with *BIPRU 3*, relating to the asset class defined in *BIPRU 3.2.9R (11)*.

[*CEBS' CR SA column 22*]

12B Items belonging to regulatory high-risk categories

This is the exposure value relating to the asset class defined in *BIPRU 3.2.9R (11)*.

[*CEBS' CR SA column 20*]

13A Covered bonds

This is the capital requirement, calculated in accordance with *BIPRU 3*, relating to the asset class defined in *BIPRU 3.2.9R (12)*.

[*CEBS' CR SA column 22*]

13B Covered bonds

This is the exposure value relating to the asset class defined in *BIPRU 3.2.9R (12)*.

14A Securitisation positions

This is the capital requirement, calculated in accordance with *BIPRU 3*, relating to the asset class defined in *BIPRU 3.2.9R (13)*.

[*CEBS' CR SEC SA column 33*]

14B Securitisation positions

This is the exposure value relating to the asset class defined in *BIPRU 3.2.9R (13)*.

[*CEBS' CR SEC SA column 19*]

15A Short term claims on institutions and corporates

This is the capital requirement, calculated in accordance with *BIPRU 3*, relating to the asset class defined in *BIPRU 3.2.9R (14)*.

[*CEBS' CR SA column 22*]

15B Short term claims on institutions and corporates

This is the exposure value relating to the asset class defined in *BIPRU 3.2.9R (14)*.

[*CEBS' CR SA column 20*]

16A Collective investment undertakings

This is the capital requirement, calculated in accordance with *BIPRU 3*, relating to the asset class defined in *BIPRU 3.2.9R (15)*.

[*CEBS' CR SA column 22*]

16B Collective investment undertakings

This is the exposure value relating to the asset class defined in *BIPRU 3.2.9R (15)*.

[*CEBS' CR SA column 20*]

17A Other items

This is the capital requirement, calculated in accordance with *BIPRU 3*, relating to the asset class defined in *BIPRU 3.2.9R (16)*.

[CEBS' CR SA column 22]

17B Other items

This is the exposure value relating to the asset class defined in *BIPRU* 3.2.9R (16).

Breakdown under the foundation IRB approach to credit risk

18A Total capital requirement

This is the same as the capital requirement reported in data element 81A in FSA003.

[CEBS' CR IRB column 24]

18B Total exposure value

This is the total exposure value, being the sum of 19B to 21B.

19A Central governments and central banks

This is the capital requirement, calculated in accordance with *BIPRU* 4, relating to the asset class defined in *BIPRU* 4.3.2R (1).

[CEBS' CR IRB column 24]

19B Central governments and central banks

This is the exposure value relating to the asset class defined in *BIPRU* 4.3.2R (1).

[CEBS' CR IRB column 11]

20A Institutions

This is the capital requirement, calculated in accordance with *BIPRU* 4, relating to the asset class defined in *BIPRU* 4.3.2R (2).

[CEBS' CR IRB column 24]

20B Institutions

This is the exposure value relating to the asset class defined in *BIPRU* 4.3.2R (2).

[CEBS' CR IRB column 11]

21A Corporates

This is the capital requirement, calculated in accordance with *BIPRU* 4, relating to the asset class defined in *BIPRU* 4.3.2R (3).

[CEBS' CR IRB column 24]

21B Corporates

This is the exposure value relating to the asset class defined in *BIPRU* 4.3.2R (3).

[CEBS' CR IRB column 11]

22A Of which: To companies according to BIPRU 4.4.59R to BIPRU 4.4.60R

This is the capital requirement, calculated in accordance with *BIPRU* 4 using the correlation formula in *BIPRU* 4.4.59R, relating to exposures to the asset class defined in *BIPRU* 4.3.2R (3) that meet the size requirements in *BIPRU* 4.4.59R and *BIPRU* 4.4.60R. It is part of 21A.

[CEBS' CR IRB column 24]

22B Of which: To companies according to BIPRU 4.4.59R to BIPRU 4.4.60R

This is the exposure value relating to exposures to the asset class defined in *BIPRU 4.3.2R (3)* that meet the size requirements in *BIPRU 4.4.59R* and *BIPRU 4.4.60R*. It is part of 21B.

[*CEBS' CR IRB column 11*]

Breakdown of Retail IRB**23A Total capital requirement**

This is the capital requirement, calculated in accordance with *BIPRU 4*, relating to the asset class defined in *BIPRU 4.3.2R (4)*. It is the same as the capital requirement reported in data element 82A in FSA003.

[*CEBS' CR IRB column 24*]

23B Total capital requirement

This is the exposure value relating to the asset class defined in *BIPRU 4.3.2R (4)* and is the sum of 24B to 27B.

[*CEBS' CR IRB column 11*]

24A Retail mortgages

This is the capital requirement, calculated in accordance with *BIPRU 4*, relating to the asset class defined in *BIPRU 4.3.2R (4)* and subject to *BIPRU 4.6.43R*.

[*CEBS' CR IRB column 24*]

24B Retail mortgages

This is the exposure value relating to the asset class defined in *BIPRU 4.3.2R (4)* and subject to *BIPRU 4.6.43R*.

[*CEBS' CR IRB column 11*]

25A Qualifying Revolving Retail Exposures

This is the capital requirement, calculated in accordance with *BIPRU 4*, relating to the asset class defined in *BIPRU 4.3.2R (4)* and subject to *BIPRU 4.6.44R* to *BIPRU 4.6.46R*.

[*CEBS' CR IRB column 24*]

25B Qualifying Revolving Retail Exposures

This is the exposure value relating to the asset class defined in *BIPRU 4.3.2R (4)* and subject to *BIPRU 4.6.44R* to *BIPRU 4.6.46R*.

[*CEBS' CR IRB column 11*]

26A Retail SME

This is the capital requirement, calculated in accordance with *BIPRU 4*, relating to the asset class defined in *BIPRU 4.3.2R (4)* for an exposure to a *Retail SME*.

[*CEBS' CR IRB column 24*]

26B Retail SME

This is the exposure value relating to the asset class defined in *BIPRU 4.3.2R (4)* for an exposure to a *Retail SME*.

[*CEBS' CR IRB column 11*]

27A Other retail

This is the capital requirement, calculated in accordance with *BIPRU* 4, relating to the asset class defined in *BIPRU* 4.3.2R (4) that is not otherwise reported in 24A, 25A or 26A.

[*CEBS' CR IRB column 24*]

27B Other retail

This is the exposure value relating to the asset class defined in *BIPRU* 4.3.2R (4) that is not otherwise reported in 24B, 25B or 26B.

[*CEBS' CR IRB column 11*]

Breakdown under the advanced IRB approach to credit risk

28A Total capital requirement

This is the same as the capital requirement reported in data element 83A in FSA003.

[*CEBS' CR IRB column 24*]

28B Total exposure value

This is the total exposure value, being the sum of 23B to 26B.

29A Central governments and central banks

This is the capital requirement, calculated in accordance with *BIPRU* 4, relating to the asset class defined in *BIPRU* 4.3.2R (1).

[*CEBS' CR IRB column 24*]

29B Central governments and central banks

This is the exposure value relating to the asset class defined in *BIPRU* 4.3.2R (1).

[*CEBS' CR IRB column 11*]

30A Institutions

This is the capital requirement, calculated in accordance with *BIPRU* 4, relating to the asset class defined in *BIPRU* 4.3.2R (2).

[*CEBS' CR IRB column 24*]

30B Institutions

This is the exposure value relating to the asset class defined in *BIPRU* 4.3.2R (2).

[*CEBS' CR IRB column 11*]

31A Corporates

This is the capital requirement, calculated in accordance with *BIPRU* 4, relating to the asset class defined in *BIPRU* 4.3.2R (3).

[*CEBS' CR IRB column 24*]

31B Corporates

This is the exposure value relating to the asset class defined in *BIPRU* 4.3.2R (3).

[*CEBS' CR IRB column 11*]

32A Of which: To companies according to BIPRU 4.4.59R to BIPRU 4.4.60R

This is the capital requirement, calculated in accordance with *BIPRU 4* using the correlation formula in *BIPRU 4.4.59R*, relating to exposures to the asset class defined in *BIPRU 4.3.2R (3)* that meet the size requirements in *BIPRU 4.4.59R* and *BIPRU 4.4.60R*. It is part of 31A.

[*CEBS' CR IRB column 24*]

32B Of which: To companies according to BIPRU 4.4.59R to BIPRU 4.4.60R

This is the exposure value relating to exposures to the asset class defined in *BIPRU 4.3.2R (3)* that meet the size requirements in *BIPRU 4.4.59R* and *BIPRU 4.4.60R*. It is part of 31B.

[*CEBS' CR IRB column 11*]

Other IRB exposure classes

33A Total other exposure classes

This is the same as the capital requirement reported in data element 84A in FSA003. It is the sum of 34A to 36A.

33B Total other exposure classes

This is the total exposure value, being the sum of 34B to 36B.

34A Equity claims

This is the capital requirement, calculated in accordance with *BIPRU 4*, relating to the asset class defined in *BIPRU 4.3.2R (5)*.

[*CEBS' CR EQU IRB column 13*]

34B Equity claims

This is the exposure value relating to the asset class defined in *BIPRU 4.3.2R (5)*.

[*CEBS' CR EQU IRB column 9*]

35A Securitisation positions

This is the capital requirement, calculated in accordance with *BIPRU 4*, relating to the asset class defined in *BIPRU 4.3.2R (6)*.

[*CEBS' CR SEC IRB column 39*]

35B Securitisation positions

This is the exposure value relating to the asset class defined in *BIPRU 4.3.2R (6)*.

[*CEBS' CR SEC IRB column 17*]

36A Non credit-obligation assets

This is the capital requirement, calculated in accordance with *BIPRU 4*, relating to the asset class defined in *BIPRU 4.3.2R (7)*.

[*CEBS' CA 2.1.2.5*]

36B Non credit-obligation assets

This is the exposure value relating to the asset class defined in *BIPRU 4.3.2R (7)*. It is calculated as the figure in 36A divided by 8%.

FSA004– Credit risk validations

Internal validations

Data elements are referenced by row then column.

Validation number	Data element		
1	1A	=	2A+3A+4A+5A+6A+7A+8A+9A+10A+11A+12A+13A+14A+15A+16A+17B
2	1B	=	2B+3B+4B+5B+6B+7B+8B+9B+10B+11B+12B+13B+14B+15B+16B+17B
3	18A	=	19A+20A+21A
4	18B	=	19B+20B+21B
5	22A	≤	21A
6	22B	≤	21B
7	23A	=	24A+25A+26A+27A
8	23B	=	24B+25B+26B+27B
9	28A	=	29A+30A+31A
10	28B	=	29B+30B+31B
11	32A	≤	31A
12	32B	≤	31B
13	36B	=	36A/8%

External validations

Validation number	Data element		
1	1A	=	FSA003.83A
2	18A	=	FSA003.85A
3	23A	=	FSA003.86A
4	28A	=	FSA003.87A
5	33A	=	FSA003.88A

FSA005 – Market risk

This data item provides the FSA with information on the market risk capital requirement under *GENPRU 2.1.40R*. The data item is intended to reflect the underlying prudential requirements contained in *GENPRU* and *BIPRU* and allows monitoring against the requirements set out there and also those individual requirements placed on firms. We have provided references to the underlying rules to assist in its completion.

For *UK consolidation groups*, the figures reported should exclude any market risk capital requirement that has been calculated using aggregation under *BIPRU 8.7.13R (2)*.

This data item has similarities to CEBS' COREP Tables MKR SA TDI, MKR SA EQU, MKR SA FX, MKR SA COM and MKR IM¹, but reflects the Rules and wording in the Handbook, omits elements which are not in our view relevant in the UK, and combines some other elements. The numbers in parenthesis and italics show the corresponding element(s) in CEBS' Tables and are only provided for information purposes to identify the linkage to the CEBS' data.

Valuation

For the general policy on valuation, please see the rules and guidance set out in *GENPRU 1.3*.

Currency

You should report in the currency of your annual audited accounts ie in either Sterling, Euro, US dollars, Canadian dollars, Swedish Kroner, Swiss Francs or Yen. Figures should be reported in 000s.

Data elements

These are referred to by row first, then by column, so data element 2B will be the element numbered 2 in column B.

Interest rate risk

See *BIPRU 7.2*.

1 Valuation of longs

Report the long positions.

[*CEBS' MKR SA TDI, items 1 and 2 combined, column 1*]

2 Valuation of shorts

Report the short positions.

[*CEBS' MKR SA TDI, items 1 and 2 combined, column 2*]

3 PRR

See *BIPRU 7.2.52R*

¹ www.c-ebs.org/documents/GL04_MKR.xls

[CEBS' MKR SA TDI, items 1 and 2 combined, column 9]

4 Specific interest rate risk – 0% risk bucket

Enter the amounts subject to this risk bucket weighting. See BIPRU 7.2.43R to BIPRU 7.2.51G

[CEBS' MKR SA TDI item 3.1, column 8]

5 Specific interest rate risk – 0.25% risk bucket

Enter the amounts subject to this risk bucket weighting. See BIPRU 7.2.43R to BIPRU 7.2.51G.

[CEBS' MKR SA TDI item 3.2a, column 8]

6 Specific interest rate risk – 1.00% risk bucket

Enter the amounts subject to this risk bucket weighting. See BIPRU 7.2.43R to BIPRU 7.2.51G.

[CEBS' MKR SA TDI item 3.2b, column 8]

7 Specific interest rate risk – 1.60% risk bucket

Enter the amounts subject to this risk bucket weighting. See BIPRU 7.2.43R to BIPRU 7.2.51G.

[CEBS' MKR SA TDI item 3.2c, column 8]

8 Specific interest rate risk – 8.00% risk bucket

Enter the amounts subject to this risk bucket weighting. See BIPRU 7.2.43R to BIPRU 7.2.48G.

[CEBS' MKR SA TDI item 3.3, column 8]

9 Specific interest rate risk – 12.00% risk bucket

Enter the amounts subject to this risk bucket weighting. See BIPRU 7.2.43R to BIPRU 7.2.48G.

[CEBS' MKR SA TDI item 3.4, column 8]

10 Specific interest rate PRR

See BIPRU 7.2.43R.

[CEBS' MKR SA TDI items 3.1 to 3.4, column 9]

11 Securitisation exposures/unrated liquidity facilities PRR

See BIPRU 7.2.47R.

[CEBS' MKR SA TDI item 3.5, column 9]

12 Ordinary CDS PRR

See BIPRU 7.11.24R.

[Part of CEBS' MKR SA TDI item 3, columns 6 and 7]

13 Securitisation CDS PRR

See BIPRU 7.11.35R.

[Part of CEBS' MKR SA TDI item 3, columns 6 and 7]

14 Basic interest rate PRR calculation for equity instruments

See *BIPRU 7.3*.

15 Option PRR for interest rate positions

See *BIPRU 7.6*.

[*Part of CEBS' MKR SA TDI item 7 column 9*]

16 CAD1 PRR for interest rate positions

See *BIPRU 7.9*.

[*Part of CEBS' MKR SA TDI item 7 column 9*]

17 Other PRR for interest rate risk

Where a 'prudent' uplift is required under *BIPRU 7.2.46R* or PRR arising from other non-standard transactions as required by *BIPRU 7.1.7R* to *BIPRU 7.1.13E* and that is attributable to interest rate risk

18 Total interest rate PRR

This is the sum of the general interest rate, specific interest rate, basic interest rate, options, CAD1 and other PRRs.

This will have the same value as data element 96A in FSA003.

[*CEBS' MKR SA TDI column 9 total less item 4 column 9*]

Equity risk

See *BIPRU 7.3*.

General equity risk (or simplified)

See *BIPRU 7.3.26G* to *BIPRU 7.3.30R* and *BIPRU 7.3.40R* to *BIPRU 7.3.43G*.

19 Valuation of longs

This is the sum of the notional long positions. See *BIPRU 7.3.9G* to *BIPRU 7.3.25G*.

[*CEBS' MKR SA EQU item 1, column 1*]

20 Valuation of shorts

This is the sum of the notional short positions. See *BIPRU 7.3.9G* to *BIPRU 7.3.25G*.

[*CEBS' MKR SA EQU item 1, column 2*]

21 PRR

This is the PRR under the simplified equity method. See *BIPRU 7.3.29R* to *BIPRU 7.3.30R*.

[*CEBS' MKR SA EQU item 1, column 7*]

Specific equity risk by risk bucket

See *BIPRU 7.3.31R* to *BIPRU 7.3.39R*.

22 Qualifying equities

Enter the valuation of the instruments. See *BIPRU 7.3.35R* to *BIPRU 7.3.37G*.

[*CEBS' MKR SA EQU item 2.1, column 6*]

23 Qualifying equity indices

Enter the valuation of the instruments. See *BIPRU 7.3.38R* to *BIPRU 7.3.39R*.

24 Other equities

Enter the valuation of all other equities, equity indices or equities baskets.

[*CEBS' MKR SA EQU item 2.2, column 6*]

25 PRR for specific equity risk

Enter the total PRR calculated in accordance with *BIPRU 7.3.33R* and *BIPRU 7.3.34R*.

[*CEBS' MKR SA EQU item 2, column 7*]

26 Option PRR for equity positions

See *BIPRU 7.6*.

[*Part of CEBS' MKR SA EQU item 6 column 7*]

27 CAD1 PRR for equity positions

See *BIPRU 7.9*.

[*Part of CEBS' MKR SA EQU item 6 column 7*]

28 Other PRR

This covers, for instance, where a firm nets off positions and is required to cover the risk of the derivative not moving with its constituent equities – see *BIPRU 7.3.48R* and *BIPRU 7.3.49G*.

It also includes PRR arising from other non-standard transactions as required by *BIPRU 7.1.7R* to *BIPRU 7.1.13E* that is attributable to equity risk.

29 Total equity PRR

This is the sum of the general equity, specific equity, option, CAD1 and other PRRs.

This will have the same value as data element 97A in FSA003.

[*CEBS' MKR SA EQU column 7 total less item 3 column 7*]

Commodity risk

See *BIPRU 7.4*.

30 Valuation of longs

Enter the valuation of the derived notional long positions. See *BIPRU 7.4.7G* to *BIPRU 7.4.19G*.

[*CEBS' MKR SA COM items 1-2, column 1*]

31 Valuation of shorts

Enter the valuation of the derived notional short positions. See *BIPRU 7.4.7G* to *BIPRU 7.4.19G*.

[*CEBS' MKR SA COM items 1-2, column 2*]

32 Outright PRR

See *BIPRU 7.4.25R* to *BIPRU 7.4.30G* (for maturity ladder approach) or *BIPRU 7.4.31R* to *BIPRU 7.4.37G* (for extended maturity ladder approach).

[CEBS' MKR SA COM items 1c and 2c, column 8]

33 Spread PRR

See BIPRU 7.4.25R to BIPRU 7.4.30G (for maturity ladder approach) or BIPRU 7.4.31R to BIPRU 7.4.37G (for extended maturity ladder approach).

[CEBS' MKR SA COM items 1a and 2a, column 8]

34 Carry PRR

See BIPRU 7.4.25R to 7.4.30G (for maturity ladder approach) or BIPRU 7.4.31R to BIPRU 7.4.37G (for extended maturity ladder approach).

[CEBS' MKR SA COM items 1b and 2b, column 8]

35 Simplified PRR

See BIPRU 7.4.24R.

[CEBS' MKR SA COM item 3, column 8]

36 Total PRR

This is the sum of the outright, spread and carry PRRs.

[CEBS' MKR SA COM items 1a to 1c plus 2a to 2c plus item 3 column 8]

37 Option PRR for commodity positions

See BIPRU 7.6.

[Part of CEBS' MKR SA COM item 6, column 8]

38 CAD1 PRR for commodity positions

See BIPRU 7.9.

[Part of CEBS' MKR SA COM item 6, column 8]

39 Other PRR

See BIPRU 7.4.38R to BIPRU 7.4.40R. It includes PRR arising from other non-standard transactions as required by BIPRU 7.1.7R to BIPRU 7.1.13E that is attributable to commodity risk.

[Includes CEBS' MKR SA COM item 7, column 8]

40 Total commodity PRR

This is the sum of the Total, Option, CAD1 and Other PRRs.

This will have the same value as data element 98A in FSA003.

[CEBS' MKR SA COM column 8 total]

Foreign currency risk

See BIPRU 7.5.

General foreign currency risk

41 Total net long positions

This is the derived net long positions. See BIPRU 7.5.10G to BIPRU 7.5.19R.

[CEBS' MKR SA FX items 1 to 4, column 1]

42 Total net short positions

This is the derived net short positions. See *BIPRU 7.5.10G* to *BIPRU 7.5.19R*.

[*CEBS' MKR SA FX items 1 to 4, column 2*]

43 Net gold positions

See *BIPRU 7.5.20R*.

[*CEBS' MKR SA FX item 5, column 1 minus 2*]

44 PRR

This is the PRR calculated under *BIPRU 7.5.1R*.

[*CEBS' MKR SA FX items 1 to 5, column 10*]

45 Option PRR for foreign currency

See *BIPRU 7.6*.

[*Part of CEBS' MKR SA FX item 6, column 10*]

46 CAD1 PRR for foreign currency

See *BIPRU 7.9*.

[*Part of CEBS' MKR SA FX item 6, column 10*]

47 Other PRR for foreign currency

PRR arising from other non-standard transactions as required by *BIPRU 7.1.7R* to *BIPRU 7.1.13E* that is attributable to foreign currency risk.

48 Total foreign currency PRR

This is the sum of the general, option, CAD1 and other PRRs.

This will have the same value as data element 99A in FSA003.

[*CEBS' MKR SA FX column 10 total*]

Collective investment undertaking risk

See *BIPRU 7.7*.

General CIU risk

49 Total net long positions

This is the value of the net long positions.

[*CEBS' MKR SA TDI item 4 column 1 plus CEBS' MKR SA EQU item 3 column 1*]

50 Total net short positions

This is the value of the net short positions.

[*CEBS' MKR SA TDI item 4 column 2 plus CEBS' MKR SA EQU item 3 column 2*]

51 PRR

See *BIPRU 7.7.5R*

[*CEBS' MKR SA TDI item 4 column 9 plus CEBS' MKR SA EQU item 3 column 7*]

52 Option PRR for CIU

See *BIPRU 7.6*.

53 CAD1 PRR for CIU

See *BIPRU 7.9*.

54 Other PRR for CIU

PRR arising from other non-standard transactions as required by *BIPRU 7.1.7R* to *BIPRU 7.1.13E* that is attributable to CIU risk.

55 Total CIU PRR

This is the sum of the general, option, CAD1 and other PRRs.

This will have the same value as data element 100A in FSA003.

[*CEBS' MKR SA TDI item 4 column 9 plus CEBS' MKR SA EQU item 3 column 7*]

Other PRR

56 Any other PRR

PRR arising from other non-standard transactions as required by *BIPRU 7.1.7R* to *BIPRU 7.1.13E* and that is not attributable to any of the other categories e.g. PRR arising from non-financial spread betting.

This will have the same value as data element 101A in FSA003.

VAR model risk

See *BIPRU 7.10*.

57 Multiplier

This is the multiplication factor set out in *BIPRU 7.10.118R* to *BIPRU 7.10.126G*.

[*CEBS' MKR IM total positions column 7*]

58 Previous day's VaR PRR

This is the VaR under *BIPRU 7.10.115R*.

[*CEBS' MKR IM total positions column 2*]

59 Average of previous 60 days VaR

This equates to item (3) in *BIPRU 7.10.117G*.

[*CEBS' MKR IM total positions column 1 divided by total positions column 7*]

60 Incremental default risk charge

This is the incremental default risk charge under *BIPRU 7.10.116R*. It also includes the specific risk surcharge under *BIPRU 7.10.127G*.

[*CEBS' MKR IM total positions columns 3 and 4*]

61 VaR model based PRR

See *BIPRU 7.10.113R* to *BIPRU 7.10.117G*.

This will have the same value as data element 102A on FSA003.

[*CEBS' MKR IM total positions column 5*]

62 Grand total PRR

This is the sum of the total interest rate PRR, the total equity PRR, the total foreign currency PRR, the total collective investment undertaking PRR, other PRR and the VaR model based PRR.

This figure will have the same value as data element 93A less 94A on FSA003.

FSA005 – Market risk validations

Internal validations

Data elements are referenced by row then column.

Validation number	Data element		
1	3G	=	3A + 3B + 3C + 3D + 3E + 3F
2	10G	=	10A + 10B + 10C + 10D + 10E + 10F
3	18G	=	18A + 18B + 18C + 18D + 18E + 18F
4	18G	=	3G + 10G + 11G + 12G + 13G + 14G + 15H + 16H + 17H
5	21G	=	21A + 21B + 21C + 21D + 21E + 21F
6	25G	=	25A + 25B + 25C + 25D + 25E + 25F
7	25G	=	(22G * 2%) + (24G * 4%)
8	29G	=	29A + 29B + 29C + 29D + 29E + 29F
9	29G	=	21G + 25G + 26G + 27G + 28G
10	30G	=	30A + 30B + 30C + 30D + 30E
11	31G	=	31A + 31B + 31C + 31D + 31E
12	32G	=	32A + 32B + 32C + 32D + 32E
13	33G	=	33A + 33B + 33C + 33D + 33E
14	34G	=	34A + 34B + 34C + 34D + 34E
15	35G	=	35A + 35B + 35C + 35D + 35E
16	36G	=	36A + 36B + 36C + 36D + 36E
17	36A	=	32A + 33A + 34A + 35A
18	36B	=	32B + 33B + 34B + 35B
19	36C	=	32C + 33C + 34C + 35C
20	36D	=	32D + 33D + 34D + 35D
21	36E	=	32E + 33E + 34E + 35E
22	36G	=	32G + 33G + 34G + 35G
23	37G	=	37A + 37B + 37C + 37D + 37E
24	38G	=	38A + 38B + 38C + 38D + 38E
25	39G	=	39A + 39B + 39C + 39D + 39E
26	40G	=	40A + 40B + 40C + 40D + 40E
27	40A	=	36A + 37A + 38A + 39A
28	40B	=	36B + 37B + 38B + 39B

29	40C	=	36C + 37C + 38C + 39C
30	40D	=	36D + 37D + 38D + 39D
31	40E	=	36E + 37E + 38E + 39E
32	40G	=	36G + 37G + 38G + 39G
33	41G	=	41A + 41B + 41C + 41D + 41E + 41F
34	42G	=	42A + 42B + 42C + 42D + 42E + 42F
35	43G	=	43A + 43B + 43C + 43D + 43E + 43F
36	44G	=	44A + 44B + 44C + 44D + 44E + 44F
37	45G	=	45A + 45B + 45C + 45D + 45E + 45F
38	46G	=	46A + 46B + 46C + 46D + 46E + 46F
39	47G	=	47A + 47B + 47C + 47D + 47E + 47F
40	48G	=	48A + 48B + 48C + 48D + 48E + 48F
41	48A	=	44A + 45A + 46A + 47A
42	48B	=	44B + 45B + 46B + 47B
43	48C	=	44C + 45C + 46C + 47C
44	48D	=	44D + 45D + 46D + 47D
45	48E	=	44E + 45E + 46E + 47E
46	48F	=	44F + 45F + 46F + 47F
47	48G	=	44G + 45G + 46G + 47G
48	51G	=	51A + 51B + 51C + 51D + 51E + 51F
49	55G	=	55A + 55B + 55C + 55D + 55E + 55F
50	55G	=	51G + 52G + 53G + 54G
51	62G	=	18G + 29G + 40G + 48G + 55G + 56G + 61G

External validations

Validation number	Data element		
1	18G	=	FSA003.96A
2	29G	=	FSA003.97A
3	40G	=	FSA003.98A
4	48G	=	FSA003.99A
5	55G	=	FSA003.100A
6	56G	=	FSA003.101A
7	61G	=	FSA003.102A
8	62G	=	FSA003.93A – FSA003.94A

FSA006 – Market risk supplementary

This data item provides the FSA with VaR backtesting reports. It contains daily outturn data which is only reported to the FSA quarterly in arrears.

This data item has similarities to CEBS' COREP Tables MKR SA TDI, MKR SA EQU and IM Details¹, but reflects the Rules and wording in the Handbook, omits elements which are not in our view relevant in the UK, and combines some other elements. The numbers in parenthesis and italics show the corresponding element(s) in CEBS' Tables and are only provided for information purposes to identify the linkage to the CEBS' data.

Valuation

For the general policy on valuation, please see the rules and guidance set out in *GENPRU* 1.3.

Currency

You should report in the currency of your annual audited accounts ie in either Sterling, Euro, US dollars, Canadian dollars, Swedish Kroner, Swiss Francs or Yen. Figures should be reported in 000s.

Data elements

These are referred to by row first, then by column, so data element 2B will be the element numbered 2 in column B.

Daily outturn data

1A Closing P&L data

This is the daily figure calculated under *BIPRU* 7.10.100R.

1B VaR confidence level

The number reported here will remain constant throughout the period, and is determined in accordance with *BIPRU* 7.10.98R.

[*CEBS' MKR IM Details column 5*]

1C Holding period (days)

The number reported here will remain constant throughout the period, and is determined in accordance with *BIPRU* 7.10.98R.

[*CEBS' MKR IM Details column 9*]

1D Business unit code

This will record the codes for the major business units, typically ones the firm uses itself, that has previously been agreed with the FSA. See *BIPRU* 7.10.93G.

1E Currency

This identifies the VaR reporting currency. See *BIPRU* 7.10.113R.

¹ www.c-eps.org/documents/GL04_MKR.xls

1F Value at Risk

This is the *One day VaR measure* calculated in accordance with *BIPRU 7.10.98R*.

[*CEBS' MKR IM Details column 12*]

1G BIPRU 7.10 cleaned P&L

This is the figure calculated in under *BIPRU 7.10.100R*.

[*CEBS' MKR IM Details column 15*]

1H Starting P&L date

This is the date defined under *BIPRU 7.10.100R*.

1J Date on which VaR computed

This is the date when the VaR is computed under *BIPRU 7.10.115R*.

1K Last date VaR historic data updated

This is the last date on which this has been updated under *BIPRU 7.10.34R*.

1L Add-on VaR

This is the figure calculated in accordance with *BIPRU 7.10.113R*.

[*Includes CEBS' MKR IM Details column 11*]

1M BIPRU 7.10 hypothetical P&L

This is the figure calculated in accordance with *BIPRU 7.10.112G*.

[*CEBS' MKR IM Details column 14*]

FSA006 – Market risk supplementary validations

Internal validations

There are no validations for this data item.

FSA007 – Operational risk

This data item provides the FSA with information on the operational risk facing a firm. It is intended to reflect the underlying prudential requirements contained in *BIPRU* and allows monitoring against the requirements set out there. We have provided references to the underlying rules to assist in its completion.

This data item is based on CEBS' COREP Table OPR, OPR Details, and OPR LOSS Details¹, but reflects the Rules and wording in the Handbook, and omits items which are not in our view relevant in the UK. The numbers in parenthesis and italics show the corresponding item(s) in CEBS' Table OPR, OPR Details or OPR LOSS Details and are only provided for information purposes to identify the linkage to the CEBS' data.

Valuation

Unless indicated otherwise, the valuation of data elements should follow *GENPRU* 1.3.

Currency

You should report in the currency of your annual audited accounts ie in either Sterling, Euro, US dollars, Canadian dollars, Swedish Kroner, Swiss Francs or Yen. Figures should be reported in 000s.

Data elements

These are referred to by row first, then by column, so data element 2B will be the element numbered 2 in column B. Individual rows within an element are identified as 2B.1, 2B.2 etc.

Definitions

1 Approach adopted (Yes/No)

For each column, enter whether your firm has adopted each approach. See *BIPRU* 6.2.

Relevant income indicator – 3 year average

2A Corporate finance

3A Trading and sales

4A Retail brokerage

5A Commercial banking

6A Retail banking

7A Payment and settlement

8A Agency services

9A Asset management

For each of the above business lines, enter the 3 year average, before the percentages are applied. See *BIPRU* 6.4.14R.

¹ www.c-eps.org/documents/GL04_OR.xls

Nominal amount of loans and advances – 3 year average

10A Retail banking

Enter the three year average of the total nominal amount of loans and advances in this business line, before applying the multiplication factors. See *BIPRU 6.4.18R*.

11A Commercial banking

Enter the three year average of the total nominal amount of loans and advances in this business line, before applying the multiplication factors. See *BIPRU 6.4.18R*.

12B Capital requirements before risk transfer mechanisms and expected loss deductions

This is relevant for firms with an AMA permission. See *BIPRU 6.5*.

[*CEBS' OPR, column 9, item 3*]

13B Expected loss captured in business practice to be excluded from capital

This is relevant for firms with an AMA permission. See *BIPRU 6.5.11R*.

[*CEBS' OPR, column 10, item 3*]

14B Capital alleviation due to risk transfer mechanisms to be excluded from capital

This is relevant for firms with an AMA permission. See *BIPRU 6.5.27R* to *BIPRU 6.5.31R*.

[*CEBS' OPR, Column 11, item 3*]

15A Capital required – total – TSA/ASA approach

This is the operational risk capital requirement arising under *BIPRU 6.4*.

It will agree with data element 88A on FSA003.

[*CEBS' OPR, column 7, items 2 and 3*].

15B Capital required – total – AMA approach

This is the operational risk capital requirement arising under *BIPRU 6.5*.

It will agree with data element 89A on FSA003.

[*CEBS' OPR, column 7, items 2 and 3*].

Operational risk losses – firms on AMA approach only

This section seeks information on all additions to the loss events database occurring in the year, even if they relate to events that took place before the start of the period.

16A Gross loss amount for the whole period

Enter the total amount of loss events recorded in the period.

[*CEBS' OPR Details, column 8 total*]

17A Total number of loss events

Enter the total number of loss events recorded in the period.

[*CEBS' OPR Details, column 8 total*]

18 Loss events

In this section, report individual loss events that have occurred during the reporting period which are greater than 1% of the capital resources reported in data element 16A on data item FSA003 at the previous accounting reference date (in 2008 firms should alternatively use the figure reported in data element 25A on FSA009). List each loss event on a separate line.

18A Date event added to loss database

Enter the date on which the event was added to the loss database since the reporting date in ddmmyy format.

18B Date of loss event

Enter the date of the loss event itself in ddmmyy format.

18C Gross loss amount

Enter the gross loss amount (in 000s).

[*OPR LOSS Details, column 2.*]

18D Certainty of loss

This text field should contain your view of the certainty of the loss amount in this column, for example: amount known with certainty, provisioned amount, management estimate, other.

18E Business line

Enter the business line, as set out in *BIPRU* 6.4.14R, in which the loss was incurred.

Please use the following identifiers:

CF = Corporate finance

TS = Trading and sales

RBr = Retail brokerage

CB = Commercial banking

RB = Retail banking

PS = Payment and settlement

AS= Agency services

AM = Asset management

[*CEBS' OPR LOSS Details, columns 9-16*]

18F Event type

Enter the loss event type, as set out in *BIPRU* 6.5.26R.

Please use the following numbers to identify the loss event types:

1 = Internal fraud

2 = External fraud

3 = Employee Practices and Workplace Safety

4 = Clients, Products & Business Practices

5 = Damage to Physical Assets

6 = Business disruption and system failures

7 = Execution, Delivery & Process Management

[*CEBS' OPR LOSS Details, column 17*]

18G Commentary

Enter a brief commentary to identify the event.

FSA007 – Operational risk validations

Internal validations

Data elements are referenced by row then column.

Validation number	Data element		
1	1A		If 1A = Yes, then $(2A+3A+5A+6A+6A+7A+8A+9A+10A+11A)>0$, else $(2A+3A+5A+6A+6A+7A+8A+9A+10A+11A)=0$
2	15A		If 1A = Yes, then $15A>0$, else $15A = 0$
3	1B		If 1B = Yes, then $15B>0$
4	15B	=	$12B-13B-14B$

External validations

Validation number	Data element		
1	15A	=	FSA003.88A
2	15B	=	FSA003.89A

FSA008 – Large exposures

This data item captures information on *large exposures*, connected exposures within that, exposures by integrated groups, *trading book concentration risk excesses*, and also significant transactions with mixed activity holding companies and their subsidiaries.

Unless indicated otherwise, the valuation of items should follow *GENPRU 1.3*.

Valuation

Unless indicated otherwise, the valuation of data elements should follow *GENPRU 1.3*.

Currency

You should report in the currency of your annual audited accounts ie in either Sterling, Euro, US dollars, Canadian dollars, Swedish Kroner, Swiss Francs or Yen. Figures should be reported in 000s.

Data elements

These are referred to by row first, then by column, so data element 2B will be the element numbered 2 in column B. Individual rows within an element are identified as 2B.1, 2B.2 etc.

General

1A Is this a report for a UK consolidation group under *BIPRU 8 Ann 1R*?

See *BIPRU 8 Ann 1R*. If the answer is ‘no’, the firm can move on to data element 3A. If the answer is ‘yes’, then go to data element 2.

2 FSA Firm Reference Numbers

List the FSA Firm Reference Numbers for all the authorised firms in the *UK consolidation group*. As this report is a joint requirement across all firms that are members of that group, this notifies us of which firms’ requirements are being met by this report. Firms should be listed sequentially in 2A, with the FSA Firm Reference Numbers being entered in 2B.

3A Are you a member of a UK integrated group

This is only relevant for unconsolidated or solo-consolidated reporters.

The answer is either Yes or No.

If the answer to 7A is Yes, one of the members of the *UK integrated group* is also required to submit FSA018 on behalf of all members of the *UK integrated group* for the reporting date.

Part 1 – Large exposures at the reporting date

This section should contain details of all *large exposures* at the reporting date, as defined in *GENPRU 10.5.1R*.

However, where a firm has established a *UK integrated group* (as defined in *BIPRU 10.8*), it should exclude from Part 1 any *large exposures* to members of a wider integrated group (as defined in *BIPRU 10.9*) or to members of each *diverse block* (*BIPRU 10.9*) and the *residual block* (*BIPRU 10.8* and *BIPRU 10.9*) – these exposures will be reported separately on FSA018 by the UK integrated group. They should obviously also be excluded from Part 2 (Connected counterparties) in these circumstances.

Exposures to connected counterparties (other than members of an integrated group) should be reported here in aggregate, with a more detailed breakdown provided in Part 2.

4A Capital resources under *BIPRU 10.5.3R*

This will be the figure calculated by the firm at the reporting date for data element 57A within FSA003 (even if the firm is not required to submit FSA003 at that date, as in the case of a *BIPRU 50K firm* or a *UK consolidation group* that only reports FSA003 half-yearly). For monitoring large exposures during the quarter, firms may either re-calculate their capital resources on a regular basis or use the figure previously reported to the FSA on FSA003. However, at the reporting date, the figure reported should be the firm's latest calculation of capital resources.

This is equivalent to Stage N of:

- *GENPRU 2 Annex 2R* for a *UK bank*;
- *GENPRU 2 Annex 3R* for a *building society*;
- *GENPRU 2 Annex 4R* for a *BIPRU investment firm* deducting *material holdings*;
- *GENPRU 2 Annex 5R* for a *BIPRU investment firm* deducting *illiquid assets*; and
- *GENPRU 2 Annex 6R* for a *BIPRU investment firm* with a waiver from consolidated supervision.

4B Capital resources under *BIPRU 10.5.4R*

This will be the figures reported by the firm at the reporting date for data element 15A in FSA003.

This is equivalent to stage T in:

- *GENPRU 2 Annex 2R*, for a *UK bank*;
- *GENPRU 2 Annex 3R*, for a *building society*;
- *GENPRU 2 Annex 4R* for a *BIPRU investment firm* deducting *material holdings*;
- *GENPRU 2 Annex 5R* for a *BIPRU investment firm* deducting *illiquid assets*; and
- *GENPRU 2 Annex 6R* for a *BIPRU investment firm* with a waiver from consolidated supervision.

5A Exposure number

Please number each *large exposure* consecutively.

5B Counterparty name

List here the names of the *counterparties*, *groups of connected clients*, and *connected counterparties* (as set out in *BIPRU 10.3*) that represent *large exposures* (excluding, as

indicated above, by a member of a *UK integrated group* to members of the diverse blocks and the residual block). Details of individual counterparties comprising the *connected counterparties* will be shown in Part 2, although the aggregate should be shown here. Details of exposures by members of a *UK integrated group* to a members of a *diverse block* within its *wider integrated group* or a member of its *residual block* will be reported in FSA018 and should be excluded from this section.

5C Gross exposure

Report here the gross exposures calculated in accordance with *BIPRU 10.2* and *BIPRU 10.4*.

5D % of capital resources under *BIPRU 10.5.3R*

This is column C as a percentage of data element 5A, and should be 10% or more. It should be entered to two decimal places, omitting the % sign.

5E Exposure after credit risk mitigation

This is the figure reported in column D after *credit risk mitigation*. This figure is subsequently broken down in columns F to M.

5F Amount of the exposure that is exempt

That part of the amount reported in column E that is an exempt under *BIPRU 10.6* and *BIPRU 10.7*.

5G % of capital resources under *BIPRU 10.5.3R*

This is column F as a percentage of data element 4A. It should be entered to two decimal places, omitting the % sign.

5H Amount of the exposure that is not exempt and is in the non-trading book

That part of the exposure reported in column E that is not exempt and is in the non-trading book.

5J % of capital resources under *BIPRU 10.5.3R*

This is column H as a percentage of the capital resources under *BIPRU 10.5.3R*. It should be entered to two decimal places, omitting the % sign.

5K Amount of the exposure that is not exempt and is in the trading book

That part of the exposure reported in column E that is not exempt and is in the trading book.

5L % of capital resources under *BIPRU 10.5.3R*

This is column K as a percentage of the capital resources under *BIPRU 10.5.3R*. It should be entered to two decimal places, omitting the % sign.

5M Aggregate % of capital resources under *BIPRU 10.5.3R*

This is the sum of columns J and L. The total of the column should be monitored against the limit set out in *BIPRU 10.5.6R*. It should be entered to two decimal places, omitting the % sign.

5N Trading book concentration risk excess

This is the *trading book concentration risk excess*, arising under *BIPRU* 10.5.10R, expressed as a percentage of data element 4B. See *BIPRU* 10.5.9R to 10.5.13R for further details. It should be entered to two decimal places, omitting the % sign.

5P Trading book concentration risk excesses that have existed for 10 business days or less

This is the amount of the *trading book concentration risk excesses* that have existed for 10 business days or less, as a percentage of data element 3B. A total is given for this column to monitor it against *BIPRU* 10.5.11R.

5Q Trading book concentration risk excesses that have persisted for more than 10 business days

This is the amount of the *trading book concentration risk excesses* that have persisted for more than 10 business days. A total for this column is given to monitor it against *BIPRU* 10.5.12R.

5R CNCOM

The amount of CNCOM calculated as set out in *BIPRU* 10.5.14R to 10.5.31G. It should agree with the amount reported in data element 103A on FSA003 for the same reporting date, except when the firm is a member of a *UK integrated group* when there may be some additional CNCOM attributable to the firm.

5S Probability of default %

IRB firms should enter the *probability of default* (PD) of the exposure, or that part covered by the IRB approach. This may be reported on whatever basis is easiest for firms ie the average, the mean, or the worst case. However, firms should apply that approach consistently across all exposures, and across reporting dates for this data element.

5T Loss given default %

IRB firms should enter the *loss given default* (LGD) of the exposure, or that part covered by the IRB approach. This may be reported on whatever basis is easiest for firms ie the average, the mean, or the worst case. However, firms should apply that approach consistently across all exposures, and across reporting dates for this data element.

5U Expected loss %

IRB firms should enter the *expected loss* (EL) of the exposure, or that part covered by the IRB approach. This may be reported on whatever basis is easiest for firms ie the average, the mean, or the worst case. However, firms should apply that approach consistently across all exposures, and across reporting dates for this data element.

5V Credit risk capital requirement

This is the credit risk capital requirement for the exposure, calculated in accordance with *BIPRU* 2.1.39R.

6A Confirmation

Firms should confirm that we have been notified of all exposures in accordance with *BIPRU* 10.5.7R.

Part 2 – Details of connected counterparties at the reporting date

Details of connected counterparties

This part sets out details of any *connected counterparties* reported in aggregate in Part 1, but this time showing each counterparty whose individual exposure exceeds 2.5% of the capital resources calculated under *BIPRU* 10.5.3R (data element 4A). As with Part 1, this figure should exclude exposures by a member of a *UK integrated group* to members of a wider integrated group or to members of the diverse blocks and the residual block (which are reported in FSA018).

7A Exposure number

Please number each exposure consecutively. The first exposure will always be the aggregate of those exposures that individually are less than 2.5% of *capital resources* (data element 4A).

7B Individual counterparty names, each individually above 2.5% of capital resources

Report here the individual counterparty names that make up a group of connected counterparties (see *BIPRU* 10.3.9R), where each counterparty's exposure is individually 2.5% or more of *capital resources* (data element 4A). As with Part 1, this figure should exclude exposures by a member of a *UK integrated group* to members of the diverse blocks and the residual block.

Data element 7B.1 (the first line of this data element) will always be the aggregate of those connected exposures that are individually under 2.5% of *capital resources*, where we do not require a further breakdown of individual counterparties.

7C Gross exposure

Report here the gross exposures calculated in accordance with *BIPRU* 10.2.

7D % of capital resources under *BIPRU* 10.5.3R

This is column C as a percentage of data element 4A and should be more than 2.5% (except possible in the case of 7D.1, the first line of the data element). It should be entered to two decimal places, omitting the % sign.

7E Exposure after credit risk mitigation

This is the figure reported in column D after *credit risk mitigation*. This figure is subsequently broken down in columns F to M.

7F Amount of the exposure that is exempt

That part of the amount reported in column E that is an exempt under *BIPRU* 10.6 and *BIPRU* 10.7.

7G % of capital resources under BIPRU 10.5.3R

This is column F as a percentage of data element 4A. It should be entered to two decimal places, omitting the % sign.

7H Amount of the exposure that is not exempt and is in the non-trading book

That part of the exposure reported in column E that is not exempt and is in the non-trading book.

7J % of capital resources under BIPRU 10.5.3R

This is column H as a percentage of data element 4A. It should be entered to two decimal places, omitting the % sign.

7K Amount of the exposure that is not exempt and is in the trading book

That part of the exposure reported in column E that is not exempt and is in the trading book.

7L % of capital resources under BIPRU 10.5.3R

This is column K as a percentage of data element 4A. It should be entered to two decimal places, omitting the % sign.

7M Aggregate % of capital resources under BIPRU 10.5.3R

This is the sum of columns J and L. It should be entered to two decimal places, omitting the % sign.

Part 3 – Trading book concentration risk excesses since the last reporting date

This part provides an analysis of those *trading book concentration risk excesses* that have occurred since the previous reporting date. It should therefore:

- exclude exposures to those counterparties that, at the reporting date, give rise to a *trading book concentration risk excess* (and are shown in Part 1);
- include exposures to counterparties that do not, at the reporting date, give rise to a *trading book concentration risk excess* but are nevertheless shown in Part 1 as there is a *large exposure* at that date; and
- include exposures to counterparties that do not appear in Part 1 (as they did not give rise to a *large exposure* at the reporting date).

If a counterparty gives rise to a *trading book concentration risk excess* on a number of separate occasions during the quarter, it should only be reported once in this Part. The highest gross exposure should be reported. This fulfils the requirements of BIPRU 10.5.13R.

8A Exposure number

Please number each large exposure consecutively.

8B Counterparty names

List here the names of the *counterparties, groups of connected clients, and connected counterparties* (as set out in BIPRU 10.3) that account for *trading book concentration risk*

excesses that have occurred since the previous reporting date but do not exist at the current reporting date.

For those firms that are member so of a *UK integrated group*, they should report those exposures to individual members of the diverse and residual blocks that gave rise to a *trading book concentration risk excess* during the period.

8C Gross exposure

Report here the gross exposures calculated in accordance with *BIPRU 10.2*. This should be the highest value in the period.

8D % of capital resources

This is column C as a percentage of data element 4A and should be more than 25%. It should be entered to two decimal places, omitting the % sign.

8E Exposure after credit risk mitigation techniques

This is the figure reported in column D after *credit risk mitigation*.

8F Non-exempt exposures in the non-trading book

This is the amount of the non-exempt exposures that were in the non-trading book.

8G Non-exempt exposures in the trading book

This is the amount of the non-exempt exposures that were in the trading book.

8H Amount of non-exempted exposures in excess of 25% of capital resources under BIPRU 10.5.4R

This is the amount reported in columns F and G that was in excess of 25% of data element 4B.

8J Is it a member of a diverse block or residual block

This will only be relevant to a firm that answers Yes to data element 3A.

If the firm had a *trading book concentration risk excess* to a member (of the diverse blocks or residual block), it should be marked with an X to show it is a member of one of these blocks.

Part 4 – Significant transactions with the mixed activity holding company and its subsidiaries

This part provides an analysis of significant transactions (other than those resulting in large exposures) with the *mixed activity holding company* and its *subsidiaries*. A transaction is presumed to be significant if its amount exceeds 5% of the total amount of capital resources at the level of the *UK consolidation group* (see *BIPRU 8*).

This section is not completed where the report is for a *UK consolidation group*.

9A Exposure number

Please number each transaction consecutively.

9B Counterparty name

This is the individual counterparty name for each significant transaction (other than one resulting in a *large exposure*).

9C Transaction or exposure value

The amount of each significant transaction (other than one resulting in a *large exposure*) should be entered.

9D % of capital resources

Enter the percentage the figure reported in column C as a percentage of the total amount of *capital resources* at the level of the *UK consolidation group* (see *BIPRU 8*). It will use the figure reported by the *UK consolidation group* at the previous reporting date that coincided with submission of FSA008. So for a *UK consolidation group* that reports to us half yearly on FSA003 on December, the firm should use that figure of *capital resources* for both the March and June submissions.

Each figure should be greater than 5%. It should be entered to two decimal places, omitting the % sign.

FSA008 – Large exposures validations

Internal validations

Data elements are referenced by row then column.

1	1A	≠	1B
2	2B.1		If 1A=Yes, then 2B.1 >1 else 2B.1 = 0
3	3A	>	If 1A=Yes, then 3A=No
4	5D	=	5C/4A
5	5E	≤	5C
6	5F	≤	5E
7	5G	=	5F/4A
8	5H	≤	5E
9	5J	=	5H/4A
10	5K	≤	5E
11	5F+5H+5K	=	5E
12	5L	=	5K/4A
13	5M	=	(5H+5K)/4A
14	5MT	=	Σ5M
15	5N	=	(5H+5K)/4B
16	5P	≤	5N
17	5PT	=	Σ5P
18	5Q	≤	5N
19	5QT	=	Σ5Q
20	5P+5Q	=	5N
21	5RT	=	Σ5R
22	7CT	=	Σ7C
23	7D	=	7C/4A
24	7E	≤	7C
25	7F	≤	7E
26	7G	=	7F/4A
27	7H	≤	7E
28	7J	=	7H/4A
29	7K	≤	7E

30	7F+7H+7K	=	7E
31	7L	=	7K/4A
32	7M	=	(7H+7K)/4A
33	8E	≤	8C
34	8F	≤	8E
35	8F+8G	≤	8E

External validations

Validation number	Data element		
1	5RT		If 3A = no, then (5RT = FSA003.103A)

FSA010 – Liquidity Mismatch

This data item provides details of the liquidity mismatch positions for banks which are subject to IPRU(BANK) Chapter LM.

Valuation

For the general policy on valuation, please see the rules and guidance set out in GENPRU 1.3.

Currency

You should report in the currency of your annual audited accounts ie in either Sterling, Euro, US dollars, Canadian dollars, Swedish Kroner, Swiss Francs or Yen. Figures should be reported in 000s.

Data elements

These are referred to by row first, then by column, so data element 2B will be the element numbered 2 in column B.

Completion and submission to the FSA

Firms may choose whether they report on a trade date or settlement date basis. However, the firm should report consistently on one basis both across the return and between reporting periods.

General

Cash flow approach

- 1 The policy aim is to ensure that firms hold sufficient liquid assets to meet their obligations as they fall due and the FSA agrees mismatch guidelines to help secure the policy objective.
- 2 The data item is there to monitor firms' compliance with their guidelines.
- 3 It does this by including a maturity analysis of known and/or potential cash flows out to six months. Marketable assets with a maturity greater than 1 month should generally be shown separately and not included in the cash flow ladder (but see paragraph 36 below).
- 4 Data elements reported on a cash flow basis should include both interest and principal amounts, together with any other income relating to them.
- 5 Thus cash flows (eg interest payments on a loan) arising from items (however reported) should be entered in the relevant cash flow timebands (ie those which the firm reports) when they fall due.
- 6 Part 2 of this data item is divided into sections asking for details of 'Retail' and 'Wholesale' inflows and outflows. The exact division between the two sections is a matter for individual firms to decide and include within their liquidity policy statement.
- 7 Where the amounts of cash flows are not material in relation to the total cash flows, the firm may agree with their supervisor that they need not be reported. The firm should agree in advance with their supervisor which flows are not considered

‘material’ for the purposes of liquidity reporting. Any such arrangements should be included within the firm’s liquidity policy statement, particularly for the purposes of reports commissioned under Section 166 of the Financial Services and Markets Act 2000.

“Contractual” vs “Behavioural” approach to liquidity position measurement: Parts 2 and 3

- 8 For supervisory monitoring, the FSA will normally wish to assess a firm’s liquidity position on a “worst-case” basis. Therefore, in Part 2 of this return (Contractual basis), cash inflows should be assumed to occur at their latest contractual maturity, while cash outflows should be assumed to occur at their earliest contractual maturity.
- 9 The contractual maturities pertaining to some assets and liabilities do not bear close relation to their actual behavioural characteristics. Examples might be overdrafts and credit card receivables. For this reason, for some limited categories of inflow and outflow, it is considered appropriate for firms to report data on one of two bases. The basis of reporting should be agreed in advance with the FSA. First, the “contractual” basis, under which it will generally be assumed that items behave in accordance with their contractual terms; second, with certain “behavioural” assumptions factored into the calculations. In certain circumstances, the FSA may require a firm to report behavioural adjustments, particularly in respect of overdrafts (see 19A, 19B and 19G and 23A to 36G).
- 10 In instances where firms apply for behavioural treatments, the FSA will expect such applications to be properly supported by empirical data running over an appropriate period of time.

Arrears and overdue

- 11 Where assets or other items giving rise to cash flows are non-performing, poorly performing or there is reasonable doubt about the certainty of receipt of inflows of funds pertaining to them, cash flows arising from them should not be included as receivable in the timeband columns. Rather the items should be reported in the ‘overdue’ column.
- 12 Non-performing or poorly performing assets are described as assets where on any reporting date, the asset or part of it, has passed the due date for repayment by fourteen days or more (or, in the case of lending under unconditional ECGD bank guarantee, ie Buyer Credit and the Supplier Credit Financing Facility, by thirty days or more). Assets, where the firm does not consider there is reasonable doubt over the certainty of receipt of inflows, but which have passed the due date by fourteen days or less (or less than thirty days for lending under unconditional ECGD bank guarantee, ie Buyer Credit and the Supplier Credit Financing Facility), should be entered as ‘next day’.
- 13 Unless the whole of the loan or asset has been formally declared to be in default within the terms of the contract, only that part of a loan/interest or other asset actually overdue should be reported in the ‘overdue’ column on a contractual basis. If the whole of the loan or asset has been formally declared to be in default within the terms of the contract, the firm should exclude any unmatured instalments of a loan which is partially in arrears. The firm should also report the amount of their debt portfolio which is in arrears in data element 62A of the memo items to Part 2.

- 14 Where an asset or cash flow previously reported according to the treatment in paragraphs 12 and 13 is contractually rescheduled according to a written agreement, firms should cease to report these items as 'overdue' and report them according to the new agreed dates for repayment.
- 15 However, certain firms work on a recency basis, ie the customer is not deemed to be in arrears if repayments are still being met, even if one or more payments have been missed. In this case, they may report the debt accordingly on the maturity ladder, ie reporting the number of payments at their prescribed intervals with an extension on the maturity of the loan to account for the missed payments. Such treatment should however be regarded as an exception and firms should contact their supervisor before adopting this method of reporting, which should be shown in the behavioural adjustments section of the data item (Part 3).

Provisions

- 16 Data elements should be reported net of specific/individual provisions. General/collective provisions should not be recorded on this return.

Residual Maturity

- 17 Unless otherwise stated in the reporting instructions, all references to maturity for the purpose of this return refer to residual maturity.
- 18 Cash inflow and outflow items and assets and liabilities should be classified according to their remaining maturity. Cash flows such as receipts of interest on performing loans or payments of interest on deposits should be recorded in the timeband in which they will occur.
- 19 Deposits placed with the firm should - as appropriate - be reported either as outflows occurring on the earliest possible repayment date, or as liabilities maturing at the earliest possible repayment date. In this context, the earliest repayment date means the first rollover date or the shortest period of notice required to withdraw the funds or to exercise a break clause, where applicable.
- 20 Loans made by the firm should - as appropriate - be entered as inflows occurring on the latest possible repayment date or as liabilities maturing at the latest possible repayment date. Purely technical break facilities should be disregarded for fixed term loans. Where the firm has loans outstanding at the reporting date under revolving credit lines and has not received notification that they will be redrawn on maturity, the intermediate date should be taken as the maturity date.
- 21 Where a firm holds a security where the issuer has the option to repay over a range of dates, the last repayment date should be taken as the date of repayment, unless notice has been given of redemption at an earlier date. Where the firm has issued such a security the first repayment date should be taken as the date of repayment, unless notice has been given of redemption at a later date.
- 22 The treatment of spot foreign exchange deals will depend upon whether the firm reports on a trade or settlement date basis. Those reporting on a trade date basis should only include the effect of any transactions which take place on the reporting date, whereas those reporting according to the settlement date may need to report deals from previous days which have yet to settle. This should not affect a firm's decision about the basis on which it should report the data item. As long as the data

element is reported consistently on one basis and between quarters, it will not have any impact on a firm's compliance with its mismatch guidelines.

- 23 Where a firm has entered into a forward deal where it is fully committed (eg a loan/deposit with a start date of two days forward and spot foreign exchange trade) and the cash flows will take place within the sight to 8-day time band, it should be reported on the return as such. However, where the firm intends to enter into an agreement in two days time but has not yet committed itself, this should not be reported as this return is intended to be a snapshot at the end of the quarter.
- 24 The timeband 'next day' comprises cash flows or asset items due, available or maturing on the next business day after the reporting date.
- 25 Cash flows arising or assets/liabilities maturing on a non-business day should be reported as taking place on the following business day.
- 26 Funds callable at one day's notice should be entered as two-day maturity unless notice has been received or given on the reporting date.
- 27 Funds callable at seven days' notice should be entered in the '8 days and under (excluding next day)' maturity band, even if not called.
- 28 Where the period to remaining maturity is to be entered in months, it should be calculated on a calendar month basis starting from the reporting date.
- 29 The following example sets out in which timeband cash flows and assets/liabilities due, available and maturing on the reported dates stated will be reported. All dates are inclusive.

Reporting date	28/29 February	31 May	31 August	30 November
'Demand (inc. next day)' covers:	1 March/next business day	1 June/next business day	1 September/next business day	1 December/next business day
'8 days and under' covers:	Up to 8 March*	Up to 8 June*	Up to 8 September*	Up to 8 December*
'over 8 days – 1 month' covers:	9 - 31 March	9 – 30 June	9 - 30 September	9 - 31 December
'over 1 month – 3 months' covers:	1 April - 31 May	1 July – 31 August	1 October - 30 November	1 January - 28/29 February
'over 3 months - 6 months' covers:	1 June - 31 August	1 September - 30 November	1 December - 28/29 February	1 March - 31 May
'over 6 months - 1 year' covers:	1 September - 28/29 February	1 December - 31 May	1 March - 31 August	1 June - 30 November

* but excluding next day

Netting of debts and claims

- 30 All claims and liabilities should be reported gross. Firms should not net (or offset) claims on counterparties or groups of counterparties against debts owed to those counterparties or groups of counterparties, even where a legal right of set off exists. Where the maturity of the claims and debts falls within the same timeband, the claims and debts will automatically offset each other on the return in the calculation of the mismatch.
- 31 Firms should report long positions in marketable assets on Part 1. Long positions in ‘non-marketable’ items should be entered in Part 2 as inflows. Short positions should be reported on Part 2. Short positions arising from either forward sales/purchases or repos have their own designated lines on Part 2, elements 47B-47G and 51B-51G. An outflow relating to these types of short position should be reported in the timeband corresponding to the maturity of the contract. In the case of short positions arising from anything other than forward sales/purchases or repos, eg short-selling a bond, the outflow should be reported in Part 2 in the line corresponding to the expected counterparty eg 44B-44G (interbank), 45B-45G (corporate) or 46B-46G (government). If the counterparty is not known, the outflow should be reported by default in 44B-44G (interbank). These types of short positions should be reported as outflows in the demand timeband. In the case of marketable assets, firms should enter the marked-to-market value of the asset as an outflow in the demand timeband. Non-marketable assets should be reported in the demand timebands at their redemption value or, where this is unavailable or inappropriate (eg in the case of equities), the book value should be reported.
- 32 For example, assume two months before the reporting date, a firm made a loan to a customer of £1mn for 6 months and that customer placed funds with the firm of £500,000 for three months. The firm should record an inflow of £1mn in the ‘Over 3 months - 6 months’ column under the appropriate category and an outflow of £500,000 in the ‘Over 8 days - 1 month’ column under the appropriate category. In addition, any interim cash flows such as interest payments and receipts should be recorded in the appropriate timebands.

Marketable securities

- 33 In reporting liquidity positions, firms should normally apply “worst case” assumptions about the timing of inflows and outflows of funds. However, some categories of asset are clearly marketable and could be readily converted into cash where necessary. These assets are reported in Part 1, Marketable Assets. Firms should enter the full value of the marketable asset concerned in columns A and B according to the currency of denomination. The following two columns then set out the discount which will need to be applied to the full value of the asset. Discounts are applied to reflect that a firm may realise less than the market price quoted for an asset where the firm is seeking to realise assets quickly because of liquidity problems pertaining either to itself, or to general market conditions, or both. The firm should then allocate the discounted value of the assets to either of columns C or D.
- 34 The timeband into which a marketable asset may be brought is determined by the length of the settlement period for the instrument in question. This reflects the length

of time it would take for a firm to receive the proceeds of any sale. For example, equities quoted in the FTSE 100 index may be reported as funds receivable in the sight - eight days category because settlement for equities sold today occurs in less than eight days. Where the settlement period for items is more than eight days, or where there are other factors which mean that funds would not be received within the sight to eight days category were the asset sold or repo'd today, then the funds should be recorded as receivable in the over eight days to one month column of Part 1. Where settlement or other delays mean that funds would not be received within one month, then the items should be recorded in Part 2 of this return.

- 35 Marketable assets maturing at exactly one month should be reported in Part 1 of the return. Firms however, may include the full value of the asset in the one month timeband and not to discount at all during the life of the asset.
- 36 Where assets have a residual maturity of less than one month, the FSA recognises that it is not relevant to automatically apply a discount to such assets. In general, these assets should be entered as cash flows in the relevant timeband in Part 2 of the form (not Part 1) and no discount will be applied. The FSA acknowledges, however, that certain assets may be marketable right up to the day before they mature, and the agreement of the FSA should be sought before such assets are included in Part 1.
- 37 Assets which do not meet the criteria in paragraph 38 below, or which cannot be fitted into the tables below, are non-marketable assets for the purposes of this return and should be reported in Part 2 of the form according to their residual maturity. This covers:
- (a) Non-investment grade debt instruments (as rated by a recognised credit agency) issued by a Zone B issuer;
 - (b) Non-investment grade debt instruments (as rated by a recognised credit agency) issued by a non-government Zone A issuer;
 - (c) Commercial paper and certificates of deposit that do not meet the definition of marketable assets as set out in paragraph 38 below and Chapter LM (Mismatch liquidity), Section 5.1.3, of IPRU (BANK).
- 38 Marketable assets need to fulfil all the following criteria:
- (a) prices are regularly quoted for the item by a range of counterparties;
 - (b) the item is regularly traded;
 - (c) the item may be sold (or repo'd) either on an exchange or in a deep and liquid market, for payment in cash; and
 - (d) settlement is according to a prescribed timetable rather than a negotiated timetable.
- 39 To avoid double counting, cash flows (of principal or interest) arising from holdings of marketable assets should not be included in Part 2 of this return.
- 40 Where Brady bonds have been issued by Zone A governments, these securities should be reported as zone A government debt under data elements 2A-4B rather than as Brady bonds in elements 14A or 14B.
- 41 The value included at demand-eight days or demand-one month will normally be a discount to the marked-to-market value of the asset (taken from the bid price) at the reporting date. The range of discounts is set out below.

(i) Zone A items issued in zone A currencies

Asset	Discount factor
Central government and central government guaranteed marketable securities, including Treasury bills, eligible local authority paper and eligible bank bills with 0 - 12 months residual maturity. Also Brady Bonds issued by Zone A governments of similar maturity.	0% (20% if denominated in a Zone B currency)
Other central government, central government guaranteed and local authority marketable debt with over 12 months - 5 years residual maturity or issued at variable rates with over 12 months residual maturity. Also Brady Bonds issued by Zone A governments of similar maturity.	5% (25% if denominated in a Zone B currency)
Other central government, central government guaranteed and local authority marketable debt with over five years residual maturity. Also Brady Bonds issued by Zone A governments of similar maturity.	10% (30% if denominated in a Zone B currency)
Non-government debt securities which are either issued by a Zone A credit firm or an investment firm subject to a CAD equivalent regime or which are classified investment grade by a relevant credit ratings agency (see paragraph 42) and which have 0 - 6 months residual maturity.	5% (25% if denominated in a Zone B currency)
Non-government debt securities which are issued by a Zone A credit firm or an investment firm subject to a CAD equivalent regime or which are classified investment grade by a relevant credit ratings agency (see paragraph 42) and which have over 6 months - 5 years residual maturity.	10% (30% if denominated in a Zone B currency)
Non-government debt securities which are issued by a Zone A credit firm or an investment firm subject to a CAD equivalent regime or which are classified investment grade by a relevant credit ratings agency (see paragraph 42) and which have over 5 years residual maturity.	15% (35% if denominated in a Zone B currency)

(ii) Zone B items (irrespective of currency)

Asset	Discount factor
Central government and central government guaranteed marketable securities, including Treasury bills, with 0 - 12 months residual maturity which are classified investment grade by a relevant credit ratings agency (see paragraph 42).	20%
Other central government and central government guaranteed marketable debt with over 12 months - 5 years residual maturity, or at variable rates, which is classified investment grade by a relevant credit ratings agency (see paragraph 42).	30%

Other central government and central government guaranteed marketable debt with over five years residual maturity which is classified investment grade by a relevant credit ratings agency (see paragraph 42).	40%
Non-government debt securities which are classified investment grade by a relevant credit ratings agency (see paragraph 42) and which have 0 - 6 months residual maturity.	30%
Non-government debt securities which are classified investment grade by a relevant credit ratings agency (see paragraph 42) and which have over 6 months - 5 years residual maturity.	40%
Non-government debt securities which are classified investment grade by a relevant credit ratings agency (see paragraph 42) and which have over 5 years residual maturity.	50%

(iii) Brady Bonds

Brady Bonds (other than those issued by Zone A governments)	20% (40% if denominated in a Zone B currency)
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(iv) Equities

Equities which are listed on a recognised stock index (see paragraph 43).	20% (40% if recognised stock index in a Zone B country)
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- 42 A relevant credit ratings agency means an *eligible ECAI*.
- (a) An *eligible ECAI* is defined in the glossary of defined terms used in the Handbook.
- 43 A recognised stock index means a *qualifying equity index*.
- (a) A *qualifying equity index* is defined in the glossary of defined items used in the Handbook.

Collateral/assets pledged

- 44 Where a firm has pledged assets as collateral (ie where those assets remain on the firm's balance sheet but have been charged as collateral), it should no longer count them either as being available for sale as discounted marketable assets (in Part 1 of the form), or at their residual maturity in the timebands (in Part 2 of the form) for the period until they are again available for immediate sale. However, where a firm receives coupon or interest payments arising from pledged assets, it may record those cash flows as receivables in the timeband according to their receipt.
- 45 Where a firm has collateral pledged to it, or does not have full legal title to collateral, it should not count the assets that make up the collateral as available for sale as marketable assets. Only where full legal title to the assets received as collateral has

passed to the firm, and the assets are available for immediate resale, may that firm treat them as marketable assets.

- 46 Where a firm has received assets as collateral but they are not beneficially owned nor available for sale by the firm immediately (for example, unless there is an event of default by the counterparty), they should not be reported as forming part of the firm's stock of marketable assets.

Off balance sheet cash flows

- 47 For forward sales and purchases, when the firm sells forward an asset on Part 1 of the return, that particular asset may continue to be reported in Part 1 of the form until the date of the forward sale, when the asset leaves the firm's ownership. The inflow of the cash and the outflow of the asset should still be reported in Part 2 of the return at the 'residual maturity' of the deal. This treatment is the same as for repos where the asset ceases to appear on Part 1 from the start of the repo (paragraphs 54-58 below).
- 48 Swaps, FRAs and futures should be reported according to the cash flows they entail. Fixed legs of swaps should be recorded as the amount of the known cash flow; floating legs of swaps, FRAs and futures will be recorded according to the cash flow implied by their market value at the reporting date.
- 49 Option inflows and outflows are reported as memo items in data elements 55A and 56A in Part 2 of the return. Firms may use one of two methods (see the instructions for data elements 55A and 56A). Whichever method is adopted, it should be specified in the firm's liquidity policy statement. Margin payments on exchange traded options should be reported according to the treatment outlined in paragraph 52; amounts relating to the principal on exchange traded options should be reported in the same way as other option inflows and outflows.
- 50 Warrants should be reported according to the treatment for options outlined in the previous paragraph.
- 51 Convertible debt securities should be treated as equities where;
- i) the first date at which conversion may take place is less than 3 months ahead, or the next such date (where the first has passed) is less than a year ahead; and
 - ii) the convertible debt security is trading at a premium of less than 10%, where the premium is defined as the current mark-to-market value of the convertible debt security less the mark-to-market value of the underlying equity, expressed as a percentage of the mark-to-market value of the underlying equity.

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

Margin

- 52 Since variation margin payments on exchange traded futures take place every day, no amount should be recorded on the form for these payments. Held options should be reported in the memo items for options (data elements 55A and 56A). For other futures, firms should enter the mark-to-market value of the future in the appropriate band. Where there is no exchange of principal, the firm should only report the flows in the timebands which it reports on a cash flow basis. However, should the firm hold an additional amount at the clearing house to cover variation margin, this should be entered as a demand asset on Part 2 of the form under 'Other inflows'. The amount of initial margin held by the firm at a clearing house should be entered in the 'Corporate'

data element 26A-26G in the relevant timeband according to the residual maturity of the longest delivery date on the account.

- 53 For deposits with brokers, where the broker is acting as an intermediary, the same treatment should be applied to the deposits as that applied to variation and initial margin posted with clearing houses. Where firms cannot distinguish between variation and initial margin, the amount should be entered at the furthest maturity of all contracts on the exchange.

Repos and reverse repos

- 54 The treatment of repos, reverse repos, stock lending and stock borrowing is essentially analogous to that of forward sales and purchases and is described in Appendix 1 to these instructions. Stock lending and borrowing is treated as being analogous to repo and reverse repo where ownership of the items borrowed and loaned is transferred under the transaction; the item borrowed is then available for sale immediately by the borrowing firm. The following treatment should therefore be applied:

- (a) The borrowed item should be reported in Part 1 of the form; the loaned item should cease to be reported in Part 1 of the form.
- (b) Report the discounted value of the loaned item as an inflow; report the discounted value of the borrowed item as an outflow in the 'Repo/Reverse Repo' line at the maturity of the transaction where both are marketable assets.
- (c) Should either asset be classed as 'non-marketable', the relevant adjustments should be made to the non-marketable assets line in Part 2 of the form.

- 55 It has been assumed throughout this definition that the cash leg of the transaction is effected through Nostro accounts.

- 56 Throughout this section of the General Notes, the term 'discounted value of the security' will refer to the value of the security once the supervisory discount has been applied to the market value of the asset.

- 57 During the lifetime of a repo, the discounted value of the asset should be reported in data elements 28A-28G according to the timeband corresponding to the maturity of the repo. Assets repo'd out will re-appear in Part 1 of the form once the asset has been received back by the firm. Reappearance in Part 1 therefore occurs at the settlement date of the asset, which may not necessarily be the next working day.

- 58 For reverse repos, the discounted value of the asset received should only be reported in Part 1 from the first working day after the start of the reversed repo. The asset should be removed from the Form LR on the day of the maturity of the reverse repo not the first working day after the maturity of the reverse repo.

Repo against DBV

- 59 Where a firm has undertaken an (overnight) repo/stock lending in return for unknown collateral, it should report as though non-government debt of over 5 years residual maturity has been received. Only where the quality of the collateral received is constrained and the firm can evidence the constraint should a more favourable treatment be adopted.

Swaps and FRAs

- 60 Firms should report all projected flows associated with a swap (including any bullet payments) during the periods where they report on a cash flow basis. Interest amounts on swaps should only be reported in the cash flow section.
- 61 With currency swaps, where an exchange of principal is effected at the start or maturity of the swap, the two amounts should be treated as a forward foreign exchange contract and reported in both the cash flow and maturity analysis sections of the form, in either data elements 32A-32G or data elements 50B-50G.
- 62 For interest rate swaps, eg a 5-year fixed rate against a 3 month LIBOR swap, firms should report the known amount of the fixed leg of the cash flow out to the last cash flow timeband (initially this will be the 'Over 8 days to 1 month' period, but by the fourth quarter of 2001, this will be the 'Over 3 months to 6 months' timeband). The floating leg should be reported out to the same timeband according to the cash flow implied by yields prevailing at the reporting date (or alternatively a forward LIBOR rate). Both legs should be reported in data elements 31A-31G or 49B-49G.
- 63 For fixed legs, the known amount of the fixed leg should be entered. For floating legs, the amount of the cash flow to be received should be derived from the swap's present value at yields prevailing at the reporting date and entered as an inflow in the relevant timeband. Where the floating leg has been agreed in advance for a specified period, firms should report the cashflow according to this rate.
- 64 Cash flows arising from FRAs should be reported in the cash flow section. The present marked-to-market value of the FRA, or the settlement amount post fixing, should be recorded in the time period based on the actual settlement date of the FRA, ie when the firm makes a payment or receives funds.

REPORTING INSTRUCTIONS

Part 1: Marketable Assets

This section is used for reporting holdings of marketable assets which are in the firm's ownership and available for sale immediately at the reporting date.

Assets should be reported at their mark-to-market value (bid price) at the reporting date. Where the firm's system does not operate on this basis, they may follow their own valuation practice, eg mid market or bid/offer prices. Firms should always report the dirty price ie including accrued interest.

Assets pledged as collateral, or assets not otherwise available for immediate resale, should not be reported in Part 1 as marketable assets. Where a firm has pledged assets as collateral in a transaction and they are no longer available for sale by the firm, they should cease to be reported in the marketable assets section (Part 1) of this form for the period until they are again available immediately for sale. Interest received on these pledged assets, however, may be reported in Parts 2 and 3 of the data item as receivable by the firm in the appropriate line as cash inflows in the period in which they occur.

For the treatment of repo/reverse repo and stock borrowing/lending, see the General Notes (paragraphs 54 to 59) to this data item.

Where assets, which would otherwise be eligible to be included in Part 1 of this data item, mature within one month, they should generally be reported in Part 2 under 'Non marketable capital items and debt instruments maturing within 1 month' (23A-23G) as an inflow/asset in the timeband corresponding to the residual maturity of the asset. Items should then be reported at full marked-to-market value, with no discount applied. The FSA recognises, however, that certain assets might be marketable up to the day they mature. It may agree with firms that it is appropriate for them to include identifiable assets maturing within one month on Part 1 until maturity.

Discount factors

To reflect the risk of price variations, a range of discount factors is applied to the marked-to-market values of assets brought forward in maturity into Part 1 of this form. The range of discount factors is listed in the General Notes (paragraph 41).

Definitions

1C Cash held

This comprises holdings of notes and coin.

2A-2D Central government/central government guaranteed, including Treasury bills, eligible Local Authority paper and eligible bank bills with a residual maturity of up to 1 year

Include:

- Short term central government (including central government guaranteed) paper and paper eligible for discount at the Central Bank issued by either HM Government/another UK issuer or by another Zone A Central Government/ another Zone A issuer;
- Treasury bills;
- Bank of England euro bills;

- Brady bonds issued by Zone A governments.

Both fixed and variable rate securities should be reported. Only record those securities currently in the firm's ownership (including where these are held in a clearing system such as Euroclear).

3A-4D Central government/central government guaranteed and Local Authority marketable debt between 1 year and under 5 years / of 5 years and over

Include central government (including central government guaranteed) paper and paper eligible for discount at the Central Bank issued by HM Government / another UK issuer or by another Zone A Central Government / another Zone A issuer, as well as Brady bonds issued by a Zone A government. Only record those securities currently in the firm's ownership (including where these are held in a clearing system such as Euroclear).

5A-7D Non-government of up to 6 months / between 6 months and 5 years / over 5 years

Non-government debt securities covers those falling within the definition of *qualifying debt security*. A *qualifying debt security* is defined in the glossary of defined terms used in the Handbook.

Only those securities in the firm's ownership, which the firm may freely dispose of at any time with no restrictions (including where these are held in a clearing system such as Euroclear), should be recorded. Those assets pledged to another firm or otherwise encumbered should not be included.

8A-8D Central government/central government guaranteed of up to 1 year

Short term central government (including central government guaranteed) paper and paper eligible for discount at the Central Bank issued by a Zone B Central Government/ another Zone B issuer. Also include Treasury bills, eligible local authority paper and eligible bank bills. Only those securities currently in the firm's ownership (including those which are held in a clearing system such as Euroclear) should be recorded. Securities should only be included in this section if they are classified investment grade by an *eligible ECAI* (see paragraph 42 above).

9A-10D Central government/Central government guaranteed of between 1 year and under 5 years / over 5 years

Central government (including central government guaranteed) paper and paper eligible for discount at the Central Bank issued by a Zone B Central Government/ another Zone B issuer. Include only those securities issued by, or fully guaranteed by, Zone B central governments and central banks with a residual maturity of over 1 year. Only those securities currently in the firm's ownership (including those held in a clearing system such as Euroclear) should be recorded. Securities should only be included in this section if they are classified investment grade by an *eligible ECAI* (see paragraph 42 above).

11A-13D Eligible non-government of up to 6 months / between 6 months and 5 years / over 5 years

Non-government debt securities issued, guaranteed, endorsed or accepted by an entity in a Zone B country and are investment grade. Also include those securities issued, or guaranteed by, an investment firm that is subject to the Capital Adequacy Directive or a *recognised third country investment firm*. Only those securities in the firm's ownership should be recorded (including where these are held in a clearing system such as Euroclear).

- (a) *A recognised third country investment firm* is defined in the glossary of defined terms used in the Handbook.

14A-14D Brady bonds

Brady bonds currently in the firm's ownership (including those held in a clearing system such as Euroclear). Do not include Brady bonds issued by Zone A governments here. These should be discounted and reported as Zone A government debt in lines 2A-2D, 3A-3D or 4A-4D.

15A-15D Highly liquid equities and equity indices

Equities that are eligible for a specific risk weight of 2% or less under the FSA's Implementation of the Capital Adequacy Directive and the amendment to the Basel Accord for Market Risks and which are currently in the firm's possession.

Part 2: Contractual Basis: Residual Maturity

INFLOWS

Where items fall within a timeband which is reported on a cash flow basis, firms should include any interest payments or other cash flows associated with the inflow or outflow. Where the item falls within the maturity analysis of assets and liabilities, the firm should only include any of the associated interest or other payments/receipts that fall due within the cash flow reporting period.

Thus, where cash flows eg interest payments take place during the cash flow timebands, they should be reported on the return regardless of the residual maturity of the instrument. Hence, if a firm has granted a personal loan with a residual maturity of 1 year, it should report, in data element 18A-18G, those cash flows arising during the first six months.

Where a firm has been provided with a committed facility and has notified the provider of a specific draw down date, the amount of the facility which will be drawn down on that date should be included in 23A-30G. Any part of the committed facilities for which notification of draw down has not been given should be reported in data element 57A.

17A-17G Mortgages

This covers any repayments of loans to individuals secured by mortgage on residential properties (both freehold and leasehold) which are or will be occupied by the borrower, or which are rented. Report mortgage loans to housing associations registered with the Housing Corporation, Scottish Homes and Tai Cymru (Housing for Wales) on housing association residential property which is rented.

18A-18G Personal loans

This covers repayments of any personal loans granted by the firm to retail customers.

19A, 19B, 19G Overdrafts

Repayments of any overdrafts granted, including any interest, where appropriate.

Note that the FSA may require firms to complete Part 3 of FSA010 (ie apply a behavioural adjustment) for retail overdrafts.

Wholesale overdrafts should not be included here but should be reported in 30A-30G.

20A-20G Credit card inflows

Report the minimum repayment required by the firm of debt arising from credit cards issued by the firm. Subsequent repayments should be reported according to the minimum percentage repayment required.

21A-21G Repayment of advances

Any other repayments of loans associated with retail banking business that have not already been included in the above.

22A-22G Other retail inflows

Any other retail associated inflows that have not already been included in the above, such as fees and commissions.

WHOLESALE

Behavioural adjustments to these items should be reported in Part 3.

23A-23G Non-marketable securities and debt instruments, and marketable assets maturing within 1 month

Include here any securities which the firm holds or will receive, but which it cannot classify as marketable. A firm should report non-marketable assets according to the redemption value of the asset or alternatively, where the redemption value is unavailable or not appropriate (eg in the case of equities), the book value. This reflects the potential inflow of cash when the asset matures. Marketable assets maturing within one month reported at their full marked-to-market value, ie undiscounted, should also be reported here. The firm may however agree with the FSA that they should be included in Part 1.

Refer to the 'Marketable securities' section of the General Notes (paragraphs 33-43) for further guidance on what should be reported in this line.

24A-24G Intragroup/Connected

Report any inflows from counterparties connected to the firm. Where the firm is reporting on a solo consolidated basis, inflows from entities within the solo-consolidated group should not be reported. Entries should be made in this item rather than any other item in the Wholesale section if any intragroup/connected counterparties are involved.

25A-25G Interbank (excluding any intragroup)

Report inflows arising from placements with other firms, including any funds held in NOSTRO balances. Exclude from this line inflows from other bank entities within the group, which should go in 24A-24G (ie intragroup/connected). Include that element of committed facilities provided to the firm where notification of draw down date has been given.

26A-26G Corporate (non-interbank and intragroup)

Report inflows from non-bank, non-connected corporate counterparties. Initial margins held at clearing houses should be entered here according to their residual maturity. Repayments from leases should also be recorded in this line.

27A-27G Government/Public Sector

Report inflows from central governments, PSEs, local authorities and central banks. Also include funds received from the European Commission, the European Economic Community (EEC), the European Coal and Steel Community (ECSC) and Euratom.

28A-28G Repos/Reverse Repos

This item should include any transactions relating to repos and reverse repos. Firms should also enter any transactions relating to stock borrowing and lending. Refer to the 'Repo/Reverse repo' section of the General Notes (paragraphs 63-68) for further guidance on what should be reported in this item.

29A-29G Trade related letters of credit

Report here any inflows arising from trade related letters of credit.

30A, 30B, 30G Overdrafts

Report here any wholesale overdrafts, irrespective of the counterparty. Any behavioural adjustments to this item should be effected through Part 3, data elements 76A-76G.

31A-31G Swaps and FRAs

For interest rate and currency swaps, enter the receipts of fixed and floating legs in the cashflow section.

For FRAs, enter the marked-to-market receipt in the relevant time period. The amount of receipts should be derived from the contract's present value at yields prevailing at the reporting date.

Refer to the 'Swaps and FRAs' section of the General Notes (paragraphs 60-64) for further guidance on what should be reported in this item.

32A-32G Forward foreign exchange

Enter any cashflows relating to forward purchases of foreign currency, where an exchange of principal is effected at the start or maturity of the swap. The amount received should be entered in the appropriate maturity band.

33A-33G Forward sales and purchases

The cash leg of any forward sales should be treated as an inflow in the timeband corresponding to the date of the forward sale. For forward purchases, where the asset purchased is a marketable asset, the firm should report the sterling (or euro) equivalent discounted value of the security purchased at the maturity of the contract. Where the asset purchased is non-marketable, the firm should enter the sterling (or euro) equivalent discounted value of the security at the maturity of the asset.

34A-34G Other off balance sheet

Include here any other off balance sheet items not included elsewhere, according to their cashflows. For example, the inflow (£100,000) of a three month OTC interest rate future with one month to maturity and a marked-to-market value of £100,000 should be reported in the "over 8 days to 1 month" timeband.

Firms should exclude any cash inflows associated with options and enter these in 55A.

35A-35G Fees and other income

Report here fees, commissions or other income receivable by the firm relating to their wholesale business, according to their known date of receipt. Where the date of receipt is unknown, do not report these flows.

36A-36G Other inflows

Report here any other inflows, which have not been included elsewhere, according to the timing of their cashflows. Also report any inflows from settlement accounts, using the trade date plus the settlement period to determine the appropriate timeband. Where the inflow is later than this date, the amount should be entered as 'overdue'.

37A-37G Total inflows

Report here the sum of data elements 17 to 36 for each column as appropriate.

OUTFLOWS

Where a firm has made a commitment to participate in a syndicated loan arrangement, then it should record an outflow of the amount paid in the relevant box in the outflows section of Part 2. Where for example a firm pays by debiting the NOSTRO balance, it would enter an outflow in 44B-44G. Should the firm have already bought their share of the syndicated loan on the reporting date, the effect will be a reduction in the NOSTRO balance and an increase reflected in the line corresponding to the particular asset purchased.

Where the firm is the lead manager, it can be in one of three positions. First, it can act as the agent – however, this role will not lead to any inflows or outflows since it merely involves setting up a group of firms to buy parts of the issue. Second, it can be an agent and take a share of the issue. In this case, the firm should report the cash flows arising from the latter role. Third, it can also underwrite the issue in conjunction with the previous two options. In this case, it should record the full amount of the issue in 58A as an undrawn committed facility.

RETAIL

38B-38G Time deposits

Include any deposits taken which have a residual maturity of more than overnight or which require prior notice to be given by the customer before withdrawal of funds. Also include deposits which include an agreement within the contract not to withdraw before a certain date. Where a firm has a material number of deposits where the depositor incurs an interest penalty in lieu of notice, it should agree with its supervisor whether it should report these deposits on a behavioural basis. Deposits should be entered in the timeband corresponding to the minimum amount of notice of withdrawal required. Saving deposits, deposit accounts and deposit receipts should also be entered here.

39B, 39G No notice/ current accounts

Include here any amounts in accounts which are not subject to a minimum notice period ie funds which are available on demand. Also include deposits received with a residual maturity of no longer than overnight. Report any balances, whether interest bearing or not, where the entire balance is accessible without penalty either on demand or by close of business on the day following that on which the deposit was made.

40B-40G Additional advances committed

Report here any undrawn commitments to lend made by the firm where the draw down date is known. The full amount of the commitment for the draw down date should be entered in the appropriate maturity band. Where the firm has made a commitment to lend, where the date of draw down is uncertain or not known, these should be reported in data element 58A.

Where notification of draw down (of facilities that can be drawn down on demand) has been received, enter the flows in the 'Demand' timeband.

Also enter on this line any facilities that may be drawn down on demand where no notification of draw down has been received. These facilities should be entered in the '8 days and under' timeband.

Do not include undrawn facilities where no draw down date(s) have been notified or agreed (these should be included in data element 58A of the memo items pertaining to commitments below).

WHOLESALE

41B-41G Non-marketable securities & debt instruments and marketable assets maturing within 1 month

Include here at residual maturity outflows pertaining to maturing securities or debt instruments, which the firm cannot classify as marketable. Marketable assets maturing within one month at their full marked-to-market value, ie undiscounted should also be reported here.

Refer to the 'Marketable securities' section of the General Notes (paragraphs 33-43) for further guidance on what should be reported in this item.

42B-42G Additional advances committed

Enter here commitments to lend, or to take up, bills, certificates of deposit, investments etc, where there has been an agreed date(s) for the draw down of the facility. The full amount of the commitment should be entered. Also include any other contingent liabilities which it is known will actually be called on a specific date (eg performance bonds and guarantees due to be invoked), as well as money market placements and forward deposits.

Where notification of draw down (of facilities that can be drawn down on demand) has been received, enter the flows in the 'Demand' timeband.

Also enter on this line any facilities that may be drawn down on demand where no notification of draw down has been received. These facilities should be entered in the '8 days and under' timeband.

Do not include undrawn facilities where no draw down date(s) have been notified or agreed (these should be included in data element 58A of the memo items pertaining to commitments below).

43B-43G Intragroup/Connected

Report any outflows of funds to counterparties connected to the firm. Where the firm is reporting on a solo consolidated basis, outflows to entities within the solo-consolidated group should not be reported. Entries should be made in this item rather than any other item in the Wholesale section if any intragroup/connected counterparties are involved.

44B-44G Interbank (excluding any intragroup)

Report outflows arising from placements with or from, or repayments of loans to or from, other banks. Exclude from this item loans to, or placements with, or deposits/placements from, other bank entities within the group (these should be reported under "intragroup/connected", data element 51B-51G).

45B-45G Corporate (non-interbank and intragroup)

Report outflows to non-bank, non-connected, corporate counterparties.

46B-46G Government / Public Sector

Report funds lent to central governments, PSEs, local authorities and central banks. Also include funds lent to the European Commission, the European Union (EU), the European Coal and Steel Community (ECSC) and Euratom. Where a firm is required to place funds on deposit with central banks and monetary authorities, these should be entered as an outflow in the relevant time band.

47B-47G Repo/reverse repos

Record in this item any outflows related to repos or reverse repos. Also include any outflows relating to stock borrowing and lending. Refer to the 'Repos and Reverse Repos' section of the General Notes (paragraphs 54-59) for further guidance on what should be reported here.

48B-48G Trade related Letters of Credit

Report here any outflows arising from trade related letters of credit.

49B-49G Swaps and FRAs

For interest rate and currency swaps, enter payments of fixed and floating legs in the cashflow section.

For FRAs, enter the marked-to-market payment in the relevant time period. The amount paid should be derived from the contract's present value at yields prevailing at the reporting date.

Refer to the 'Swaps and FRAs' section of the General Notes (paragraphs 60-64) for further guidance on what should be reported in this item.

50B-50G Forward foreign exchange

Enter any cashflows relating to forward sales of foreign currency, where an exchange of principal is effected at the start or maturity of the swap. The amount paid should be entered in the appropriate maturity band.

51B-51G Forward sales and purchases

For forward sales, the sterling (or euro) equivalent discounted value of the security sold should be recorded as an outflow. The cash leg of any forward purchases should be treated as an outflow in the timeband corresponding to the date of the forward purchase.

52B-52G Other off balance sheet

Report here any outflows relating to off balance sheet items that have not been reported elsewhere on the data item. Firms should exclude any cash outflows associated with options and enter these in data element 56A.

53B-53G Dividends, tax, other costs and outflows

Report any outflows relating to payments of dividends and tax, or any other outflows that have not previously been reported elsewhere. Also report any outflows relating to settlement accounts, using the trade date plus the settlement period to determine the appropriate timeband.

54B-54G Total outflows

Report here the sum of data elements 38 to 53 for each column as appropriate.

MEMO ITEMS**55A, 56A Options**

There are two ways in which options can be reported in 55A and 56A. Firms should be consistent and use the same method for both inflows and outflows. Firms should also inform the FSA of the method adopted, and record this in their liquidity policy statement.

Method 1

Report the inflows and outflows of cash arising from the exercise of the options. It is assumed for reporting purposes that all options are exercised. Any movement of the underlying financial instrument to which the option relates should be ignored.

The 'options inflows' element 55A should contain

- Purchased puts for equity or commodity transactions (if the option is exercised, the firm sells the asset and receives cash);
- Written calls for equity or commodity transactions (if the counterparty exercises its right to buy, the firm sells the asset in question and receives cash);
- All inflows relating to the exercise of interest rate options held/purchased by the firm, whether call options or put options (written interest rate options are not included here but in element 56A).

The 'options outflows' element 56A should contain

- Written puts for equity and commodity transactions (if the counterparty exercises this option, the firm purchases the asset and pays out cash);
- Purchased calls for equity or commodity transactions (if this type of option is exercised by the firm, it purchases an asset and pays out cash).
- All outflows relating to the exercise of interest rate options written by your firm, whether call options or put options.

Method 2

Rather than reporting potential inflows of cash if all the options are exercised (ie method 1), this method of reporting is on the basis of marked-to-market value. Purchased options giving rise to either nothing or inflows are therefore treated as assets. Written options giving rise to either nothing or outflows are seen as liabilities.

The 'options inflows' element 55A should contain

- The marked-to-market value of all purchased options (puts or calls) multiplied by the number of options, irrespective of whether these are in or out of the money (the marked-to-market value should be reported on the reporting date).

The 'options outflows' element 56A should contain

- The marked-to-market value of all sold/written options (puts and calls) multiplied by the number of options, irrespective of whether these are in or out of the money (the marked-to-market value should be used on the reporting date).

57A Undrawn committed facilities granted to the bank

Report any facilities which have been committed to the firm and which, at the reporting date, remain undrawn. Also include any flows arising from standby letters of credit and guarantees. Where a date for draw down has been agreed, the amount should be entered in the appropriate line in the inflows section of Part 2 according to the source of the facility and entered in the corresponding timeband.

58A Undrawn committed facilities granted by the bank

Report any facilities which the firm has committed to provide (including by way of repos) and which, at the reporting date, remain undrawn. Include only those facilities where a date

for draw down has not been agreed. Where a date for draw down has been agreed or where a facility may be drawn down on demand, the amount should be entered in 40B-40G or 42B-42G of Part 2 (depending on whether they are retail or wholesale facilities). Do not include repo liabilities here, refer to the General Notes (paragraphs 54-59) for guidance as to how these should be reported.

59A Commitments under credit card and other revolving credit type facilities

Report any commitments which the firm has entered into under credit cards which have not been drawn down at the reporting date (ie available credit to cardholders).

60A Total deposits

Report the total deposits outstanding as at the reporting date, excluding any liabilities under repo/reverse repo agreements. This figure should be used as the denominator for the mismatch and in the Exceptions to guidelines section (Part 4) of this data item. Include:

- (a) All bank notes issued by the firm;
- (b) No notice/current accounts;
- (c) All time deposits;
- (d) All certificates of deposit issued by the firm, whether at fixed or floating interest rates which are still outstanding;
- (e) Negotiable deposits taken on terms in all respects identical to those on which a certificate of deposit would have been issued, but for which it has been mutually convenient not to have issued a certificate;
- (f) All other issues of commercial paper and medium term notes, bonds, FRNs and other instruments, with the exception of subordinated loan capital of over two years' original maturity;

Exclude:

- (a) Any certificates of deposit which the firm holds which it itself has issued;
- (b) Working capital provided by non-resident offices of the firm.

61A Undrawn treasury concessions granted by the bank

Where a firm has taken on a treasury role on behalf of its group, the institution must notify the FSA of its intention to use the "group treasury concession" for large exposures purposes (see *BIPRU* 10).

62A Amount of total cash inflows in arrears

Where payments on debt are contractually in arrears, the amount of the debt in arrears should be reported in this item. Only that part of the debt, along with any related interest which is in arrears, should be entered here. That part of the loan which is still due and therefore not yet in arrears should be entered in the inflows section of Part 2 in the maturity ladder in the relevant time band, provided that there is not reasonable doubt over the receipt of those inflows. Where reasonable doubt exists, the firm should report these flows in the 'overdue' timeband in the main body of the data item; they should not be entered here until the due date for payment has passed.

Part 3: Behavioural basis

Firms should complete specific items in this section in appropriate cases only. Such cases should be agreed in advance with the FSA.

INFLOWS / OUTFLOWS

Firms should report in this section cash flows after adjustment for the behavioural patterns they expect to occur. Where a firm considers an adjustment is appropriate, it should approach its supervisor who will consider proposed adjustments on an individual firm basis. Firms should be able to provide empirical evidence to support the adjustments they propose. No firm should make behavioural adjustments without the prior written agreement of the FSA.

Where behavioural adjustments are agreed, the firm should report, in the relevant line of Part 3, all the data reported in the equivalent line in Part 2 but adjusted as agreed between the firm and the FSA.

For example, if a firm has one class of no notice accounts which sum to £50mn, and another class of no notice accounts which sum to £30mn, a figure of £80mn will be shown in the appropriate line in Part 2 as a 'demand' outflow. However, the deposits in the first class of account are relatively 'sticky' and a behavioural adjustment is agreed to reflect this. For the purposes of this example, the firm may treat 50% of these outflows as occurring in the 'eight days and under (excl. next day)' timeband. In Part 3, this firm will therefore report a demand outflow of £55mn and an 'eight days and under (excl. next day)' outflow of £25mn. Part 2 will, of course, continue to show a demand outflow of £80mn.

Part 4: Calculation of mismatches and exceptions reporting

Calculation of mismatches

Firms should monitor compliance with their liquidity mismatch guidelines each business day and should report in this section the mismatch on the reporting date, using the data from the previous parts of the return. Where component boxes of this section relate back to an element in the previous three parts of the return, this is clearly shown in the list of validations. The components then sum to form the mismatches for each period.

All mismatch percentages (110A-110C and 121A-121C and also 125B and 125C) should be reported to two decimal places. For example, where a firm had a mismatch of -5%, it should be reported as -5.00 on the form. There is no limit to the size of the field.

The figures that are entered in elements 114A-114C, 118A-118C and 120A-120C should be shown to two decimal places. Thus, if it had been agreed that 15% of undrawn commitments to lend should be included in the 'demand' column, 15.00 should be entered in data elements 118A-118C.

In order for the forms to be processed, mismatch calculations should be completed on both the contractual basis and the behaviourally adjusted basis, even if the final figures (in 110A-110C and 124A-124C) will be the same. Firms should only enter figures in 114A-114C if figures have previously been agreed with the supervisors: if no figures have been agreed, line 113A-113C should be blank. If no behavioural adjustments have been agreed for data elements 118A-118C or 120A-120C, firms should enter the figure 15.00 in these boxes (assuming they have figures in elements 58A or 59A respectively, otherwise the items should remain blank). This will enable them to include the default adjustment of 15% to lines 58A or 59A, mirroring that part of the mismatch calculation on the contractual basis.

Exceptions reporting

Firms are expected to stay within their liquidity mismatch guidelines. Where a firm exceeds its guideline during the reporting period, it should contact the supervisor to inform them of any exception as soon as it occurs. Such breaches should also be reported in the 'Exceptions to guidelines' section.

Dates should be reported in 'ddmm' format, so for example, 18 June would be shown as 1806. Percentages should be reported to two decimal places, so that -5% would be reported as -5.00. Where a firm has an exception to their guideline which lasts longer than one day, it should report each consecutive day's exception separately, ie an exception running from 18 until 20 June would be reported as 18, 19 and 20 June, not 18 and 20 June.

REPOS

MARKETABLE ASSETS

	<u>Marketable asset leg (lent out)</u>	<u>Cash Leg (Received)</u>
IF MARKETABLE ASSET > 1 MONTH RESIDUAL MATURITY		
Start	Cease to be reported as owned by firm. Cease to be reported in Part 1 as marketable asset.	Report according to use of funds subsequent to repo. <i>Timeband – according to date of contract re the subsequent use, not the date of the repo.</i>
During life of repo	Report discounted marked-to-market value of asset in Part 2, data element 28A-28G (Repos/reverse repos) to reflect future inflow. <i>Timeband – corresponding to maturity of repo.</i>	Report full value of repo liability (future outflow of funds include interest) in Part 2, data element 47A-47G (Repos/reverse repos). <i>Timeband – maturity of repo.</i>
Maturity of repo	Day after maturity or at settlement date of the asset Report marked-to-market value of asset (& subsequent discounted value Col C & D) in Part 1.	Day of maturity of repo Reduce Nostro balance Report in Part 2, data elements 25A-25G (cash returned including interest).
IF A MARKETABLE ASSET < 1 MONTH RESIDUAL MATURITY		
Start	Cease to be reported as owned by firm. Cease to be reported in Part 2, data element 23A-23G (full marked-to-market value), or in Part 1 if agreed by the FSA.	Report according to use of funds subsequent to repo. <i>Timeband – according to date of contract re the subsequent use, not the date of the repo.</i>
During life of repo	Report full marked-to-market value of asset in Part 2, data element 28A-28G (Repos/reverse repos) to reflect future inflow. <i>Timeband – corresponding to residual maturity of asset.</i>	Report full value of the repo liability or the cash leg (future outflow of funds include interest) in Part 2, data element 47B-47G (Repos/reverse repos). <i>Timeband – maturity of repo.</i>
Maturity of repo	Day after maturity or more precisely at settlement date of the asset Report marked-to-market value of asset at residual maturity in Part 2, data element 41B-41G (Non-marketable securities and debt instruments and marketable assets maturing within one month) to reflect future outflow <i>Timeband - corresponding to residual maturity of asset (if in Part 2).</i>	Day of maturity of the repo Reduce Nostro balance Report in Part 2, data element 25A-25G (cash returned including interest).

REPOS

NON-MARKETABLE ASSETS

	<u>Non-Marketable asset leg (lent out)</u>	<u>Cash Leg (Received)</u>
Start	<p>Cease to be reported as owned by firm.</p> <p>Cease to be reported in Part 2, data elements 23A-23G (redemption* value).</p>	<p>Report according to use of funds subsequent to repo.</p> <p><i>Timeband – according to date of contract re the subsequent use, not the date of the repo.</i></p>
During the life of repo	<p>Report redemption* value of asset in Part 2, data elements 28A-28G (Repos/reverse repos).</p> <p><i>Timeband – corresponding to residual maturity of asset.</i></p>	<p>Report full value of repo liability or cash leg (future outflow of funds include interest) in Part 2, data elements 47B-47G (Repos/reverse repos).</p> <p><i>Timeband – maturity of repo.</i></p>
Maturity of repo	<p>Day after maturity or more precisely at settlement date of the asset</p> <p>Report redemption* value of asset at residual maturity in Part 2, data elements 23A-23G (Non-marketable securities & debt instruments and marketable assets maturing within one month).</p> <p><i>Timeband - corresponding to residual maturity of asset.</i></p>	<p>Day of maturity of repo</p> <p>Reduce Nostro balance</p> <p>Report in Part 2, data elements 25A-25G (cash returned including interest).</p>

Undated Repo: Maturity of repo is minimum notice period required under terms of contract.

*** Where redemption value of the asset is unavailable or not appropriate (eg in the case of equities), report the book value.**

REVERSE REPOS

MARKETABLE ASSETS

	Marketable asset leg (Borrowed)	Cash leg (paid)
IF MARKETABLE ASSET > 1 MONTH RESIDUAL MATURITY		
Start	Report discounted marked-to-market value of asset received for period of reverse repo in Part 1.	Reflected by decrease in Nostro in Part 2, data elements 25A-25G
During the life of reverse repo	Report discounted marked-to-market value of asset (to reflect future outflow of marketable asset) in Part 2, data elements 47B-47G (Repos/reverse repos). <i>Timeband - day of maturity of reverse repo.</i>	Report full value of funds to be received include interest in Part 2, data elements 28A-28G (Repo/Reverse repo) to reflect future inflow. <i>Timeband – maturity of reverse repo</i>
Maturity of reverse repo	Day of maturity of reverse repo Cease to report discounted marked-to-market value of asset received under reverse repo in Part 1.	Day of maturity of reverse repo Increase in Nostro balance Report in Part 2, data elements 25A-25D (cash received including interest).
IF MARKETABLE ASSET < 1 MONTH RESIDUAL MATURITY		
Start	Report marked-to-market value of marketable asset received for period of reverse repo in Part 2, data elements 23A-23G (Non-marketable securities and debt instruments & marketable assets maturing within one month). <i>Timeband - residual maturity of assets received (if in Part 2).</i>	Reflected by decrease in Nostro Report in Part 2, data elements 25A-25G.
During the life of reverse repo	Report full marked-to-market value of asset (to reflect future outflow of marketable asset) in Part 2, data elements 47B-47G (Repos/reverse repos). <i>Timeband - maturity of reverse repo.</i>	Report full value of funds to be received including interest in Part 2, data elements 28A-28G (Repos/reverse repos). <i>Timeband – maturity of reverse repo.</i>

Maturity of reverse repo	Day of maturity of reverse repo Cease to report marked-to-market value of asset received under reverse repo in Part 1 or Part 2.	Day of maturity of reverse repo Increase in Nostro balance Report in Part 2, data elements 25A-25G (cash received including interest).
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REVERSE REPO

NON-MARKETABLE ASSETS

	Non-Marketable asset leg (Borrowed)	Cash Leg (Paid)
Start	Report redemption* value of non-marketable asset received for period of reverse repo in Part 2: 'Non-marketable securities and debt instruments & marketable assets maturing within one month'. <i>Timeband - at residual maturity of assets received.</i>	Reflected by decrease in Nostro Report in Part 2, data elements 25A-25G.
During life of reverse repo	Report full redemption* value of asset (to reflect outflow of non-marketable asset) in Part 2, data elements 47B-47G (Repo/Reverse repo). <i>Timeband – maturity of reverse repo.</i>	Report full value of funds to be received including interest in Part 2, data elements 28A-28G (Repos/reverse repos). <i>Timeband - maturity of repo.</i>
Maturity of reverse repo	Day of maturity of reverse repo Cease to report redemption* value of asset received under reverse repo in Part 2.	Day of maturity of reverse repo Increase in Nostro balance Report in Part 2, data elements 25A-25G (cash received including interest).

Undated reverse repo: Assume firm has security indefinitely and repo does not as such have a maturity. Return to show decrease in Nostro balance in data elements 25A-25G and an increase in stock of marketable (non-marketable) assets. Nothing further need be reported until the maturity of the reverse repo is known.

* Where redemption value of the asset is unavailable or not appropriate (eg in the case of equities), report the book value.

FSA010 – Mismatch liquidity validations

Internal validations

Data elements are referenced by row then column.

PART 1: MARKETABLE ASSETS

Ref Data elements No

1	$2A + (2B * 0.80)$	$= 2C + 2D$
2	$(3A * 0.95) + (3B * 0.75)$	$= 3C + 3D$
3	$(4A * 0.90) + (4B * 0.70)$	$= 4C + 4D$
4	$(5A * 0.95) + (5B * 0.75)$	$= 5C + 5D$
5	$(6A * 0.90) + (6B * 0.70)$	$= 6C + 6D$
6	$(7A * 0.85) + (7B * 0.65)$	$= 7C + 7D$
7	$(8A + 8B) * 0.80$	$= 8C + 8D$
8	$(9A + 9B) * 0.70$	$= 9C + 9D$
9	$(10A + 10B) * 0.60$	$= 10C + 10D$
10	$(11A + 11B) * 0.70$	$= 11C + 11D$
11	$(12A + 12B) * 0.60$	$= 12C + 12D$
12	$(13A + 13B) * 0.50$	$= 13C + 13D$
13	$(14A * 0.80) + (14B * 0.60)$	$= 14C + 14D$
14	$(15A * 0.80) + (15B * 0.60)$	$= 15C + 15D$
15	16C	$= 1C + 2C + 3C + 4C + 5C + 6C + 7C + 8C + 9C$ $+ 10C + 11C + 12C + 13C + 14C + 15C$
16	16D	$= 2D + 3D + 4D + 5D + 6D + 7D + 8D + 9D +$ $10D + 11D + 12D + 13D + 14D + 15D$

PART 2: CONTRACTUAL BASIS

INFLOWS

Ref No	Item Number	
1	37A	= 17A + 18A + 19A + 20A + 21A + 22A + 23A + 24A + 25A + 26A + 27A + 28A + 29A + 30A + 31A + 32A + 33A + 34A + 35A + 36A
2	37B	= 17B + 18B + 19B + 20B + 21B + 22B + 23B + 24B + 25B + 26B + 27B + 28B + 29B + 30B + 31B + 32B + 33B + 34B + 35B + 36B
3	37C	= 17C + 18C + 20C + 21C + 22C + 23C + 24C + 25C + 26C + 27C + 28C + 29C + 31C + 32C + 33C + 34C + 35C + 36C
4	37D	= 17D + 18D + 20D + 21D + 22D + 23D + 24D + 25D + 26D + 27D + 28D + 29D + 31D + 32D + 33D + 34D + 35D + 36D
5	37E	= 17E + 18E + 20E + 21E + 22E + 23E + 24E + 25E + 26E + 27E + 28E + 29E + 31E + 32E + 33E + 34E + 35E + 36E
6	37F	= 17F + 18F + 20F + 21F + 22F + 23F + 24F + 25F + 26F + 27F + 28F + 29F + 31F + 32F + 33F + 34F + 35F + 36F
7	37G	= 17G + 18G + 19G + 20G + 21G + 22G + 23G + 24G + 25G + 26G + 27G + 28G + 29G + 30G + 31G + 32G + 33G + 34G + 35G + 36G
8	17G	= 17A + 17B + 17C + 17D + 17E + 17F
9	18G	= 18A + 18B + 18C + 18D + 18E + 18F
10	19G	= 19A + 19B
11	20G	= 20A + 20B + 20C + 20D + 20E + 20F
12	21G	= 21A + 21B + 21C + 21D + 21E + 21F
13	22G	= 22A + 22B + 22C + 22D + 22E + 22F
14	23G	= 23A + 23B + 23C + 23D + 23E + 23F
15	24G	= 24A + 24B + 24C + 24D + 24E + 24F
16	25G	= 25A + 25B + 25C + 25D + 25E + 25F
17	26G	= 26A + 26B + 26C + 26D + 26E + 26F
18	27G	= 27A + 27B + 27C + 27D + 27E + 27F
19	28G	= 28A + 28B + 28C + 28D + 28E + 28F
20	29G	= 29A + 29B + 29C + 29D + 29E + 29F

21	30G	= 30A + 30B
22	31G	= 31A + 31B + 31C + 31D + 31E + 31F
23	32G	= 32A + 32B + 32C + 32D + 32E + 32F
24	33G	= 33A + 33B + 33C + 33D + 33E + 33F
25	34G	= 34A + 34B + 34C + 34D + 34E + 34F
26	35G	= 35A + 35B + 35C + 35D + 35E + 35F
27	36G	= 36A + 36B + 36C + 36D + 36E + 36F
28	37G	= 37A + 37B + 37C + 37D + 37E + 37F

PART 2: CONTRACTUAL BASIS

OUTFLOWS

Ref No	Item Number	
1	54B	= 38B + 39B + 40B + 41B + 42B + 43B + 44B + 45B + 46B + 47B + 48B + 49B + 50B + 51B + 52B + 53B
2	54C	= 38C + 40C + 41C + 42C + 43C + 44C + 45C + 46C + 47C + 48C + 49C + 50C + 51C + 52C + 53C
3	54D	= 38D + 40D + 41D + 42D + 43D + 44D + 45D + 46D + 47D + 48D + 49D + 50D + 51D + 52D + 53D
4	54E	= 38E + 40E + 41E + 42E + 43E + 44E + 45E + 46E + 47E + 48E + 49E + 50E + 51E + 52E + 53E
5	54F	= 38F + 40F + 41F + 42F + 43F + 44F + 45F + 46F + 47F + 48F + 49F + 50F + 51F + 52F + 53F
6	54G	= 38G + 39G + 40G + 41G + 42G + 43G + 44G + 45G + 46G + 47G + 48G + 49G + 50G + 51G + 52G + 53G
7	38G	= 38B + 38C + 38D + 38E + 38F
8	39G	= 39B
9	40G	= 40B + 40C + 40D + 40E + 40F
10	41G	= 41B + 41C + 41D + 41E + 41F
11	42G	= 42B + 42C + 42D + 42E + 42F
12	43G	= 43B + 43C + 43D + 43E + 43F
13	44G	= 44B + 44C + 44D + 44E + 44F
14	45G	= 45B + 45C + 45D + 45E + 45F
15	46G	= 46B + 46C + 46D + 46E + 46F
16	47G	= 47B + 47C + 47D + 47E + 47F
17	48G	= 48B + 48C + 48D + 48E + 48F
18	49G	= 49B + 49C + 49D + 49E + 49F
19	50G	= 50B + 50C + 50D + 50E + 50F
20	51G	= 51B + 51C + 51D + 51E + 51F
21	52G	= 52B + 52C + 52D + 52E + 52F
22	53G	= 53B + 53C + 53D + 53E + 53F

23 54G

= 54B + 54C + 54D + 54E + 54F

PART 3: BEHAVIOURAL ADJUSTMENTS

Ref No	Item Number	
1	83A	= 63A + 64A + 65A + 66A + 67A + 68A + 69A + 70A + 71A + 72A + 73A + 74A + 75A + 76A + 77A + 78A + 79A + 80A + 81A + 82A
2	83B	= 63B + 64B + 65B + 66B + 67B + 68B + 69B + 70B + 71B + 72B + 73B + 74B + 75B + 76B + 77B + 78B + 79B + 80B + 81B + 82B
3	83C	= 63C + 64C + 65C + 66C + 67C + 68C + 69C + 70C + 71C + 72C + 73C + 74C + 75C + 76C + 77C + 78C + 79C + 80C + 81C + 82C
4	83D	= 63D + 64D + 65D + 66D + 67D + 68D + 69D + 70D + 71D + 72D + 73D + 74D + 75D + 76D + 77D + 78D + 79D + 80D + 81D + 82D
5	83E	= 63E + 64E + 65E + 66E + 67E + 68E + 69E + 70E + 71E + 72E + 73E + 74E + 75E + 76E + 77E + 78E + 79E + 80E + 81E + 82E
6	83F	= 63F + 64F + 65F + 66F + 67F + 68F + 69F + 70F + 71F + 72F + 73F + 74F + 75F + 76F + 77F + 78F + 79F + 80F + 81F + 82F
7	83G	= 63G + 64G + 65G + 66G + 67G + 68G + 69G + 70G + 71G + 72G + 73G + 74G + 75G + 76G + 77G + 78G + 79G + 80G + 81G + 82G
8	63G	= 63A + 63B + 63C + 63D + 63E + 63F
9	64G	= 64A + 64B + 64C + 64D + 64E + 64F
10	65G	= 65A + 65B + 65C + 65D + 65E + 65F
11	66G	= 66A + 66B + 66C + 66D + 66E + 66F
12	67G	= 67A + 67B + 67C + 67D + 67E + 67F
13	68G	= 68A + 68B + 68C + 68D + 68E + 68F
14	69G	= 69A + 69B + 69C + 69D + 69E + 69F
15	70G	= 70A + 70B + 70C + 70D + 70E + 70F
16	71G	= 71A + 71B + 71C + 71D + 71E + 71F
17	72G	= 72A + 72B + 72C + 72D + 72E + 72F
18	73G	= 73A + 73B + 73C + 73D + 73E + 73F
19	74G	= 74A + 74B + 74C + 74D + 74E + 74F
20	75G	= 75A + 75B + 75C + 75D + 75E + 75F
21	76G	= 76A + 76B + 76C + 76D + 76E + 76F
22	77G	= 77A + 77B + 77C + 77D + 77E + 77F

23	78G	= 78A + 78B + 78C + 78D + 78E + 78F
24	79G	= 79A + 79B + 79C + 79D + 79E + 79F
25	80G	= 80A + 80B + 80C + 80D + 80E + 80F
26	81G	= 81A + 81B + 81C + 81D + 81E + 81F
27	82G	= 82A + 82B + 82C + 82D + 82E + 82F
28	83G	= 83A + 83B + 83C + 83D + 83E + 83F
29	100B	= 84B + 85B + 86B + 87B + 88B + 89B + 90B + 91B + 92B + 93B + 94B + 95B + 96B + 97B + 98B + 99B
30	100C	= 84C + 85C + 86C + 87C + 88C + 89C + 90C + 91C + 92C + 93C + 94C + 95C + 96C + 97C + 98C + 99C
31	100D	= 84D + 85D + 86D + 87D + 88D + 89D + 90D + 91D + 92D + 93D + 94D + 95D + 96D + 97D + 98D + 99D
32	100E	= 84E + 85E + 86E + 87E + 88E + 89E + 90E + 91E + 92E + 93E + 94E + 95E + 96E + 97E + 98E + 99E
33	100F	= 84F + 85F + 86F + 87F + 88F + 89F + 90F + 91F + 92F + 93F + 94F + 95F + 96F + 97F + 98F + 99F
34	100G	= 84G + 85G + 86G + 87G + 88G + 89G + 90G + 91G + 92G + 93G + 94G + 95G + 96G + 97G + 98G + 99G
35	84G	= 84B + 84C + 84D + 84E + 84F
36	85G	= 85B + 85C + 85D + 85E + 85F
37	86G	= 86B + 86C + 86D + 86E + 86F
38	87G	= 87B + 87C + 87D + 87E + 87F
39	88G	= 88B + 88C + 88D + 88E + 88F
40	89G	= 89B + 89C + 89D + 89E + 89F
41	90G	= 90B + 90C + 90D + 90E + 90F
42	91G	= 91B + 91C + 91D + 91E + 91F
43	92G	= 92B + 92C + 92D + 92E + 92F
44	93G	= 93B + 93C + 93D + 93E + 93F
45	94G	= 94B + 94C + 94D + 94E + 94F
46	95G	= 95B + 95C + 95D + 95E + 95F
47	96G	= 96B + 96C + 96D + 96E + 96F
48	97G	= 97B + 97C + 97D + 97E + 97F

49 98G
50 99G
51 100G

= 98B + 98C + 98D + 98E + 98F

= 99B + 99C + 99D + 99E + 99F

= 100B + 100C + 100D + 100E + 100F

PART 4: CALCULATION OF LIQUIDITY MISMATCHES

Ref No	Item No	
1	102B	= 37B
2	103B	= 102B
3	101C	= 16C
4	102C	= 37B + 37C
5	103C	= 101C + 102C
6	101D	= 16C + 16D
7	102D	= 37B + 37C + 37D
8	103D	= 101D + 102D
9	104B	= 54B
10	105B	= 15% x 58A
11	106B	= 15% x 59A
12	107B	= 104B + 105B + 106B
13	104C	= 54B + 54C
14	107C	= 104C
15	104D	= 54B + 54C + 54D
16	107D	= 104D
17	108B	= 103B – 107B
18	109B	= 60A
19	110B	= ((108B/109B) x 100) ± 0.01, to 2 decimal places
20	108C	= 103C – 107C
21	110C	= ((108C/109B) x 100) ± 0.01, to 2 decimal places
22	108D	= 103D – 107D
23	110D	= ((108D/109B) x 100) ± 0.01, to 2 decimal places

24	112B	= the components of 102B substituting, as agreed with supervisors, the individual items within 63B-82B for the corresponding items in 17B-36B respectively, for those lines where the figures in Part 3 Column G are greater than zero ¹
25	113B	= if (114B <> 0, then (114B * 57A / 100) , else no validation)
26	115B	= 112B + 113B
27	111C	= 16C
28	112C	= 112B + (the components of 37C substituting, as agreed with supervisors, the individual items within 63C-82C for the corresponding items in 17C-36C respectively, for those lines where the figures in Part 3 Column G are greater than zero)
29	113C	= if (114C <> 0, then (114C * 57A / 100), else no validation)
30	115C	= 111C + 112C + 113C
31	111D	= 16C + 16D

¹ Expanding this to explain the logic (which also applies to validations 28, 32, 35, 39 and 43 in Part 4), the figures are an adjustment of the contractual basis figures, hence 102B as the starting point in this validation. (The individual item making up 102B (validation 1 on 'Calculation of Liquidity Mismatches') is in turn the sum of various items (validation 2 on 'Contractual basis – Inflows'.) Setting out the validation in detail gives:

- 112B = 102B – 17B + if(63G > 0, then 63B, else 17B)
- 18B + if(64G > 0, then 64B, else 18B)
 - 19B + if(65G > 0, then 65B, else 19B)
 - 20B + if(66G > 0, then 66B, else 20B)
 - 21B + if(67G > 0, then 67B, else 21B)
 - 22B + if(68G > 0, then 68B, else 22B)
 - 23B + if(69G > 0, then 69B, else 23B)
 - 24B + if(70G > 0, then 70B, else 24B)
 - 25B + if(71G > 0, then 71B, else 25B)
 - 26B + if(72G > 0, then 72B, else 26B)
 - 27B + if(73G > 0, then 73B, else 27B)
 - 28B + if(74G > 0, then 74B, else 28B)
 - 29B + if(75G > 0, then 75B, else 29B)
 - 30B + if(76G > 0, then 76B, else 30B)
 - 31B + if(77G > 0, then 77B, else 31B)
 - 32B + if(78G > 0, then 78B, else 32B)
 - 33B + if(79G > 0, then 79B, else 33B)
 - 34B + if(80G > 0, then 80B, else 34B)
 - 35B + if(81G > 0, then 81B, else 35B)
 - 36B + if(82G > 0, then 82B, else 36B)

32	112D	= 112C + (the components of 37D substituting, as agreed with supervisors, the individual items within 63D-82C for the corresponding items in 17D-36D respectively, for those lines where the figures in Part 3 Column G are greater than zero)
33	113D	= if (114D <> 0, then (114D * 57A / 100), else no validation)
34	115D	= 111D + 112D + 113D
35	116B	= the components of 104B substituting, as agreed with supervisors, the individual items within 84B-99B for the corresponding items in 38B-53B respectively, for those lines where the figures in Part 3 Column G are greater than zero
36	117B	= if (118B <> 0, then (118B * 58A / 100), else no validation)
37	119B	= if (120B <> 0, then (120B * 59A / 100), else no validation)
38	121B	= 116B + 117B + 119B
39	116C	= 116B + (the components of 104C substituting, as agreed with supervisors, the individual items within 84C-99C for the corresponding items in 38C-53C respectively, for those lines where the figures in Part 3 Column G are greater than zero)
40	117C	= if (118C <> 0, then (118C * 58A / 100), else no validation)
41	119C	= if (120C <> 0, then (120C * 59A / 100), else no validation)
42	121C	= 116C + 117C + 119C
43	116D	= 116C + (the components of 104D substituting, as agreed with supervisors, the individual items within 84D-99D for the corresponding items in 38D-53D respectively, for those lines where the figures in Part 3 Column G are greater than zero)
44	117D	= if (118D <> 0, then (118D * 58A / 100), else no validation)

45	119D	= if (120D <> 0, then (120D * 59A / 100), else no validation)
46	121D	= 116D + 117D + 119D
47	122B	= 115B – 121B
48	123B	= 60A
49	124B	= ((122B/123B) x 100) ± 0.01, to 2 decimal places
50	122C	= 115C – 121C
51	123B	= 109B
52	124C	= ((122C/123B) x 100) ± 0.01, to 2 decimal places
53	122D	= 115D – 121D
54	124D	= ((122D/123B) x 100) ± 0.01, to 2 decimal places

FSA011 – Building society liquidity

This data item is used to monitor the liquidity position of *building societies* under *IPRU(BSOC)*.

Valuation

For the general policy on valuation, please see the rules and guidance set out in *GENPRU* 1.3.

Currency

You should report in the currency of your annual audited accounts ie in either Sterling, Euro, US dollars, Canadian dollars, Swedish Kroner, Swiss Francs or Yen. Figures should be reported in 000s.

Data elements

These are referred to by row first, then by column, so data element 2B will be the element numbered 2 in column B.

Definitions

Column A Values here should be reported on the same basis as they are reported in the balance sheet (FSA001), except they should include accrued interest for each item. It may include items which are not eligible for inclusion within the prudential liquidity calculation.

Column B These amounts do not qualify as prudential liquidity. See *IPRU(BSOC)* Annex 5 for a list of assets that are ineligible.

Column C These may be the same value as in Column A.

Column D This is the result of applying the discount factors set out in *IPRU(BSOC)* 5.4.4G.

Column E The amount of prudential liquidity.

1-5 Liquid assets realisable in up to 8 days

4 Total gilts

Include all gilt edged securities, according to their residual maturity. This is the sum of rows 1 to 3.

5 Other

Includes cash; current account balances; Treasury, local authority and eligible bank bills; deposits with local authorities, banks and building societies with not more than 8 days notice or within 8 days of maturity; Certificates of Deposit (CDs) issued by credit institutions with 3 months or less to maturity; and commercial paper with a residual maturity up to 1 month.

6 Liquid assets realisable from 9 days to 3 months

This is the portion of those assets defined in *IPRU(BSOC)* Annex 5A that are realisable from 9 days up to 3 months.

7 Liquid assets realisable in 3 months and over

This is the portion of those assets defined in *IPRU(BSOC)* Annex 5A that are realisable in 3 months and over.

8A Book value of total liquid assets

The sum of all liquid assets (data elements 4A to 7A). See *IPRU(BSOC)* Annex 5 for a list of those items that can be regarded as liquid assets.

8B Ineligible liquid assets

The sum of those amounts that are ineligible for inclusion as prudential liquidity (data elements 4B to 7B). See *IPRU(BSOC)* Annex 5 for a list of those items that can be regarded as eligible.

8E Total amount of prudential liquidity

This is the sum of data elements 4E to 7E.

9A SDL at reporting date

This is calculated as the sum of share liabilities including interest accrued, plus deposits and debt securities including interest accrued. See *IPRU(BSOC)* 5.3.2G for a definition of SDL.

10A-10C Minimum total prudential liability in the quarter

This is the minimum amount of total prudential liquidity held, based on end day positions, during the quarter. SDL on the relevant day should be based on the estimated SDL on the relevant day. Dates should be reported in the format 'ddmmyy'.

11A-11C Maximum total prudential liability in the quarter

This is the maximum amount of total prudential liquidity held, based on end day positions, during the quarter. SDL on the relevant day should be based on the estimated SDL on the relevant day. Dates should be reported in the format 'ddmmyy'.

12A Building society holdings at reporting date

This is the total of liquid asset holdings with all other societies in total, and includes any undrawn committed facilities provided to societies. It covers securities and money market instruments issued by and deposits placed with any other building society.

Specialist data

This is the value of funding accounted for by those elements which are restricted (ie funding excluding shares held by individuals).

The purpose of 13A and 14A is to report the actual value of the QE of the statutorily defined percentages relating to the funding and lending nature limits.

13A Business assets not FSRP as % of business assets

This is the value of business assets that are not fully secured on residential property (FSRP) as a % of total business assets. It is monitored under Section 6 of the Building Societies Act 1986.

14A Deposits and loans as % of SDL

These are monitored under Section 7 of the Building Societies Act 1986.

15A Amount of offshore deposits

This is the amount of deposits taken by societies' undertakings doing deposit taking offshore (eg in the Channel Islands or Isle of Man), or other undertakings established in other countries primarily to take deposits.

16A Large shareholdings as % of SDL

This item relates to the aggregate balances on both share and deposit holdings (where a single holding in respect of an individual is the totality of accounts held by that individual), excluding accrued interest, which are each in excess of 0.25% of total SDL.

FSA011 – Building society liquidity validations

Internal validations

Data elements are referenced by row then column.

Validation number	Data element		
1	4A	=	1A + 2A + 3A
2	4C	=	1C + 2C + 3C
3	4D	=	1D + 2D + 3D
4	4E	=	4D
5	5E	=	5A - 5B
6	6E	=	6A - 6B
7	7E	=	7A - 7B
8	8A	=	4A + 5A + 6A + 7A
9	8B	=	5B + 6B + 7B
10	8E	=	4E + 5E + 6E + 7E
11	8E	=	8A - 8B
12	11A	>	10A

FSA012 – Non-deposit taking EEA bank liquidity

This data item is used by the FSA to monitor the liquidity positions of an EEA bank, other than one with permission for cross border services only, that does not have permission to accept deposits.

Currency

You should report in the currency of your annual audited accounts ie in either Sterling, Euro, US dollars, Canadian dollars, Swedish Kroner, Swiss Francs or Yen. Figures should be reported in 000s.

Data elements

These are referred to by row first, then by column, so data element 2B will be the element numbered 2 in column B.

1A Total assets of the branch

Report here the total assets of the branch in the UK.

2A Cumulative net inflow (outflow) up to 8 days

This is the inflows you contractually expect to receive within 8 days, less the payments you are contractually bound to make within 8 days of the reporting date.

2B Cumulative net inflow (outflow) up to 1 month

This is the figure reported in data element 2A, onto which has been added the sum of the inflows you contractually expect to receive after 8 days but within 1 month, less the payments you are contractually bound to make after 8 days but within 1 month of the reporting date.

2C Cumulative net inflow (outflow) up to 3 months

This is the figure reported in data element 2B, onto which has been added the sum of the inflows you contractually expect to receive after 1 month but within 3 months, less the payments you are contractually bound to make after 1 month but within 3 months of the reporting date.

2D Cumulative net inflow (outflow) up to 6 months

This is the figure reported in data element 2C, onto which has been added the sum of the inflows you contractually expect to receive after 3 months but within 6 months, less the payments you are contractually bound to make after 3 months but within 6 months of the reporting date

2E Cumulative net inflow (outflow) up to 9 months

This is the figure reported in data element 2D, onto which has been added the sum of the inflows you contractually expect to receive after 6 months but within 9 months, less the payments you are contractually bound to make after 6 months but within 9 months of the reporting date

3A Cumulative net inflow (outflow) up to 8 days as a % of total assets

This is data element 2A as a percentage of data element 1A, reported to two decimal places.

3B Cumulative net inflow (outflow) up to 1 month as a % of total assets

This is data element 2B as a percentage of data element 1A, reported to two decimal places.

FSA012 – Liquidity mismatch (for EEA branches that do not have permission to accept deposits) validations

Validations

Data elements are referenced by row then column.

Validation number	Data element		
1	3A	=	2A/1A
2	3B	=	2B/1A

FSA013 - Stock liquidity

This data item is used to calculate the level of sterling stock liquidity which the firm should hold against its estimated outflow of funds arising from liabilities to wholesale and retail customers. This level should be maintained at all times. Unless otherwise agreed, the data item should be completed on a consolidated basis. Where a firm wishes to report on a different basis, this should be agreed in advance with the FSA.

Valuation

For the general policy on valuation, please see the rules and guidance set out in *GENPRU* 1.3.

Currency

You should report in the currency of your annual audited accounts ie in either Sterling, Euro, US dollars, Canadian dollars, Swedish Kroner, Swiss Francs or Yen. Figures should be reported in 000s.

Data elements

These are referred to by row first, then by column, so data element 2A will be the element numbered 2 in column A.

1A Cash

Include all sterling notes including Bank of England notes and also notes issued by the Scottish and Northern Irish banks. Include cash which the firm has paid into another *UK bank, EEA bank or non-EEA bank*, or the Banking Department of the Bank of England, which has not yet been credited to the reporting institution's account in the books of the other bank.

Holdings of gold sovereigns should be excluded.

2A Operational balances with the Bank of England

Enter balances with the Head Office of the Bank of England, except special deposits and cash ratio deposits, which should be excluded.

Amounts receivable under finance leases from the Bank of England should be excluded (in contrast to statistical reporting to the Bank of England).

3A UK Treasury Bills

Enter holdings of UK Treasury bills issued by H M Government. UK Treasury bills denominated in euros and Bills for which the Bank of England is obligor may also be included.

4A Gilts

Enter all holdings of sterling and foreign currency denominated stock issued by H M Government and the Irish land purchase stocks. Other British Government-guaranteed stocks should be excluded from this data item.

5A Other

Firms may, with the prior agreement of the FSA, include any of the following

- sterling international bonds issued by EEA governments and certain international financial institutions, where they have been issued directly into the Euroclear and Cedel settlement systems;

- sterling bonds ('bulldogs') of the same issuers, where they have been issued into (and are now held by) the CREST settlement system; and
- Euro denominated bonds of the same issuers where they are eligible for use in ESCB monetary policy operations.

You will find more detailed lists of all three categories of assets on the Bank of England's website under OMO on the "Eligible Securities" page (www.bankofengland.co.uk/markets/money/eligiblecurities.htm).

The FSA will automatically extend the list of assets that it considers appropriate for banks to count as 'sterling liquid assets' in line with the Bank of England's programme of extending its list of 'eligible securities', as described in its notice of 15 October 1998. The Bank will maintain updated lists of the relevant assets on its website.

The international financial institutions whose issues may be included are:

African Development Bank
 Asian Development Bank
 Council of Europe Social Development Fund
 European Atomic Energy Community
 European Bank for Reconstruction and Development
 European Community
 European Coal and Steel Community
 European Investment Bank
 Inter-American Development Bank
 International Bank for Reconstruction and Development/World Bank
 International Finance Corporation
 Nordic Investment Bank

6A Total sterling stock

This is the sum of the 1A to 5A.

7A Wholesale sterling net outflow limit over five working days

Enter the institution's internal limit for the wholesale sterling net outflow over five working days. The limit should be agreed with the FSA. This should be the limit shown in the firm's most recent liquidity policy statement submitted to the FSA unless it has been agreed with the FSA that a different limit is appropriate. This limit should not be changed without the prior agreement of the FSA.

8A Sterling Stock Floor over five working days

Enter the floor for the sterling stock over five working days, as agreed with the FSA. Unless otherwise agreed, the floor should normally be the figure entered in data element 9A multiplied by 0.5, rounded down to an integer where appropriate. The floor should not be changed without the prior agreement of the FSA. It should not exceed 6A.

9A Wholesale sterling net outflow over five working days

Include all deposits from banks and building societies taken via the firm's Treasury Division. Include all other deposits of £1mn or more taken on wholesale market terms. For this purpose, wholesale deposits shall be defined as deposits closely related to money market operations which are made as a result of customers being offered a specific rate for a particular deposit for a particular period. This shall be taken to include interest-bearing funds

deposited either at branches or direct with, for example, the firm's Treasury Division, on the strength of an interest rate quoted on enquiry on each occasion that a deposit is made.

Include sterling certificates of deposit maturing within five working days.

In normal circumstances, data element 9A should not exceed data element 7A. Exceptions should be notified to the normal supervisory contact at the FSA unless the institution has enough surplus stock liquidity, over and above that needed to meet the LQR (data element 16A below), to cover the excess. Where this is the case, the exception should not be reported to the FSA.

Any cases of doubt should be referred to the normal supervisory contact at the FSA.

10A Sterling certificates of deposit held - total

Exclude sterling certificates of deposit maturing within five working days which have been included in data element 9A above.

If a firm holds certificates of deposit which it has itself issued, these should be excluded from this data element.

Include negotiable deposits made on terms identical to those on which a certificate of deposit would have been issued, but for which it is mutually convenient not to issue a certificate.

11A Total discounted certificates of deposit

The figure, which is data element 10A multiplied by 0.85, should be rounded down, where appropriate, to an integer.

12A Allowable certificates of deposit

This figure should be calculated using the figure reported in data element 11A (after any rounding down). The limit, expressed as 50% of data element 9A, should also be rounded down if appropriate.

14A Sterling retail deposits falling due in next five working days

Include all retail deposits with a residual contractual maturity of five working days or less as at the reporting date. Deposits subject to a penalty on withdrawal should only be included if the residual contractual maturity is five working days or less.

For this purpose, retail deposits shall be defined as deposits which arise from customer acceptance of an advertised rate (including nil) for a particular product. This shall be taken to include deposits taken in a firm's branch network on the grounds of an existing or new customer relationship where the rates of interest are not directly linked to interbank rates, and are advertised or displayed at the branch counter or are part of standard tariff terms so that depositors can establish, without further enquiry, the rate applicable to each type of deposit.

Any cases of doubt should be referred to the normal supervisory contact at the FSA.

15A Sterling retail deposits to be covered

The figure (data element 15A multiplied by 0.05) should be rounded up, where appropriate, to an integer (being prudent).

16A Sterling liquidity ratio (LQR)

The sterling liquidity ratio should be 100% or more unless it is appropriate for the firm to maintain a lower ratio (such cases should be agreed with the FSA). The figure should be calculated to two decimal places (rounding .005 and above up, and below .005 down). The

calculated figure should then be multiplied by 100 and reported in this data element as integers.

Repo activity

Where gilts or other assets qualifying for inclusion in the sterling liquidity stock have been acquired as a result of entering into a repo or reverse repo transaction, they can be included in a firm's liquidity stock for the duration that they are held; conversely, the asset sold should be excluded until it is repurchased.

Breaches

Any breaches of the stock liquidity ratio should be reported immediately to the normal supervisory contact at the FSA.

FSA013 – Stock liquidity validations

Internal validations

Data elements are referenced by row then column.

Reference number	Data element		
1	6A	=	$1A+2A+3A+4A+5A$
2	8A	\leq	6A
3	11A	=	$10A*0.85$, rounded down to an integer
4	12A	\leq	$9A/2$, rounded down to an integer
5	12A	\leq	11A
6	13A	=	$11A-12A$
7	15A	=	$14A*0.05$
8	16A	=	If $9A > 0$, then $(6A/(9A-12A+15A))$ multiplied by 100 to 2 decimal places, (rounding 5 and over up, and under 5 down), then multiplied by 100, otherwise $(6A/(0-12A+15A))$ multiplied by 100 to 2 decimal places, (rounding 5 and over up, and under 5 down), then multiplied by 100

FSA014 – Forecast data

This data provides details of a firm's financial forecasts for the year following the reporting date, or an updated forecast at the interim stage. If a firm does not re-forecast (or update the forecast) at the interim stage, then the figures will be the same as previously reported.

The data elements 6A, 12A, 13A and 14A should be provided by all firms as a minimum.

The firm should complete the other data elements to the extent it has the data available. Forecasts should be made on a best endeavours basis, aiming where possible to match with specific data elements in other data items that are provided regularly. Firms should aim for consistency in approach when compiling these data.

Currency

You should report in the currency of your annual audited accounts ie in either Sterling, Euro, US dollars, Canadian dollars, Swedish Kroner, Swiss Francs or Yen. Figures should be reported in 000s.

1A Net interest income

This item should be equivalent to data elements 2B minus 25B on data item FSA002 (Income statement).

2A Other income

This is equivalent to data elements 1B minus 2B on data item FSA002.

3A Expenditure

This is equivalent to data element 25B minus 26B, plus 34B on data item FSA002.

4A Impairment/provisions

This is equivalent to data element 40B on data item FSA002.

5A Total profit before tax

This is equivalent to data element 44B on data item FSA002.

6A Net profit (loss)

This data element should be completed by all firms.

This is equivalent to data element 46B on FSA002.

7A Cash and balances at central banks

This is equivalent to data element 5A plus 5B on data item FSA001 (Balance sheet).

8 Loans and advances to customers

This is equivalent to data elements 9A plus 9B on data item FSA001.

9 Investments

This is equivalent to data elements 10A plus 10B plus 11A plus 11B plus 13A plus 13B plus 14A plus 14B on data item FSA001.

10A Retail deposits

This is equivalent to data element 25A on data item FSA001.

11A Deposits by banks, including overdrafts

This is equivalent to data element 23A on data item FSA001.

12A Total assets/liabilities

This data element should be completed by all firms.

This is equivalent to data elements 20A plus 20B on data item FSA001.

13A Total capital after deductions

This data element should be completed by all firms.

This is equivalent to data element 15A on data item FSA003 (Capital adequacy).

14A Variable capital requirement at end of period

This data element should be completed by all firms.

This is equivalent to data element 70A on data item FSA003.

FSA014 – Forecast data validations

There are no validations for his data item.

FSA016 – Solo consolidation data

This data item collects information on the subsidiaries included within solo-consolidation. It is designed to provide the FSA with sufficient information to understand the impact and profile of the solo-consolidated subsidiaries on the balance sheet of the firm, while at the same time limiting the information to the most material subsidiaries.

Currency

You should report in the currency of your annual audited accounts ie in either Sterling, Euro, US dollars, Canadian dollars, Swedish Kroner, Swiss Francs or Yen. Figures should be reported in 000s.

Data elements

These are referred to by row first, then by column, so data element 2A will be the element numbered 2 in column A.

1A – Number of subsidiaries included in the solo-consolidation

This is the number of firms that are included within the solo-consolidation and for which waivers have been granted.

2A – Book value of investments included in solo-consolidation – EEA incorporated

This is the book value of EEA- incorporated investments that are included within the firm's solo-consolidated reporting under *BIPRU 2.1*, in the unconsolidated accounts of the firm.

3A – Book value of investments included in solo-consolidation – non-EEA incorporated

This is the book value of non-EEA incorporated investments that are included within the firm's solo-consolidated reporting under *BIPRU 2.1*, in the unconsolidated accounts of the firm.

4A Surplus capital in the parent firm

This figure is the total capital after deductions from the solo-consolidated FSA003 (data element 15A) less the value of the investments reported in data elements 2A and 3A above, to which has been added back the value of any investments by the solo-consolidated subsidiaries in their own non solo-consolidated subsidiaries.

5 Top 5 solo-consolidated subsidiaries ranked by book value of investment

For each of the subsidiaries listed, the following details should be provided:

- 5A the name of the subsidiary;
- 5B the country of incorporation;
- 5C a brief business descriptor from a pre-defined list – funding; lending; investment; other;
- 5D the main underlying assets from a predefined list – commercial property; residential property; fixed assets; plant; investment grade debt securities; investment grade equity; debt securities; equity; other;
- 5E the book value of the subsidiary (included within 2A or 3A above); and
- 5F the capital requirements arising from the assets held by the subsidiary.

6 Top 5 solo-consolidate subsidiaries ranked by aggregate exposure of parent to subsidiary

For each of the subsidiaries listed, the following details should be provided:

- 6A the name of the subsidiary;
- 6B the country of incorporation;
- 6C a brief business descriptor from a pre-defined list – funding; lending; investment; other;
- 6D the main underlying assets from a predefined list – commercial property; residential property; fixed assets; plant; investment grade debt securities; investment grade equity; debt securities; equity; other;
- 6E the aggregate exposure of the parent to the subsidiary, including funding in a capital form;
- 6F the exposure of the parent to the subsidiary at the reporting date with a residual maturity of less than one year; and
- 6G the capital requirements arising from the assets held by the subsidiary.

7 Top 5 solo consolidated subsidiaries ranked by net flow of funds from parent to subsidiary during the period

For each of the subsidiaries listed, the following details should be provided:

- 7A the name of the subsidiary;
- 7B the country of incorporation;
- 7C a brief business descriptor from a pre-defined list – funding; lending; investment; other;
- 7D the main underlying assets from a predefined list – commercial property; residential property; fixed assets; plant; investment grade debt securities; investment grade equity; debt securities; equity; other; and
- 7E the net flow of funds from the parent to the subsidiary, including funding in a capital form.

FSA016 – Solo consolidated data validations

Internal validations

There are no internal validations for this data item.

External validation

There are no external validations for this data item.

FSA017 – Interest rate gap

This data item collects information on the interest rate gap. It is designed to provide the FSA with sufficient information to understand the interest rate sensitivity of a firm's assets and liabilities. Some firms may already have sophisticated models capable of showing the impact of a 2% shift in interest rates and, in such cases, these firms may seek a waiver from reporting this data item.

Currency

You should report in the currency of your annual audited accounts ie in either Sterling, Euro, US dollars, Canadian dollars, Swedish Kroner, Swiss Francs or Yen. Figures should be reported in 000s.

Data elements

These are referred to by row first, then by column, so data element 2A will be the element numbered 2 in column A.

Gap analysis is undertaken by examining details of interest sensitive assets and liabilities to establish when they will next reprice (i.e. be subject to a change in interest rate), and then tabulating those which reprice within set time periods (known as 'time buckets', within which all items repricing are grouped together). Interest rate sensitive items are those assets and liabilities that are subject to contractual change in interest rates, or which mature (fall due for repayment) during the period of the return. (Note that the contractual date for repricing purposes is not necessarily the maturity date of the asset/liability. For example, a 3 year loan could be repriced every six months at a spread above 6 month LIBOR. If it was rolled over a month ago then it will reprice in 5 months', not in 3 years', time.)

Those assets and liabilities lacking definitive repricing intervals (e.g. sight deposits or savings accounts) or actual maturities that could vary from contractual maturities (e.g. mortgages with an option for early repayment) should be assigned to repricing time bands according to the judgement and past experience of the firm.

When fixed rate liabilities in an individual time bucket exceed fixed rate assets in the same bucket, a 'negative gap' exists for that period - implying that a rise in interest rates for that period should produce an increase in net interest income, and a fall in rates should give rise to a fall in net interest income. Conversely, when fixed rate assets exceed fixed rate liabilities in the same time bucket, a 'positive gap' exists and net interest income should fall if interest rates increase and rise if rates reduce.

Variable rate items, for which there is no lead time between a change in market rates and a corresponding change in the contracted interest rate (i.e. effectively overnight) should be placed in the "overnight" time bucket. Conventionally, first year time buckets are of shorter duration than later time buckets. However, the precise choice of time buckets is a matter for each firm.

On and off balance sheet items should be allocated to the various time buckets in accordance with their repricing date. The information in respect of balances to be used in this data item should not be fair-valued but should be based on the contractual position (i.e. between the lender and borrower).

Care should be taken in allocating off balance sheet items. Firms need to consider the essential interest-bearing characteristics of these instruments. For example:

Swaps: if a fixed rate mortgage of 3 years maturity is swapped to a 6 month LIBOR rate then the impact on the gap analysis should be shown by placing the notional swapped amount into the 3 year liability time bucket and the same amount in the 6 month asset time bucket.

FRAs: if a deposit is due to reprice in 3 months' time for 3 months and the firm wishes to hedge its exposure, then it might do so by buying an FRA where in 3 months' time it receives an amount of interest covering the further 3 month period (i.e. it will buy a 3v6 FRA). This should be shown as a 6 month liability and a 3 month asset in the gap analysis, reflecting the fact that effectively (a) the firm has locked in now (at time zero) to paying a fixed rate in 3 months' time covering a 3 month period (hence in total 6 months), and (b) the firm has an exposure now for 3 months to the rate at which the receiving leg of the FRA will settle. In 3 months' time, on settlement, the FRA will disappear from the analysis as proceeds, or preferably payments, will have been settled and the derivative interest rate exposure extinguished.

Non interest rate sensitive items (e.g. fixed assets, reserves or interest accruals) should be placed in the most distant time bucket. This should not be included in the sensitivity calculations but remains on the gap report for the sake of balance sheet completeness. The FSA recognises that there are several schools of thought over where to allocate reserves in a gap analysis and will consider other board-approved scenarios which are consistently applied and rationalised.

Where firms fully hedge or match customer products, in theory, there is no gap created. However, in practice, permanent one-for-one matching is not always possible. There may be lead times during which the asset/liability and the related hedge/match are out of step. For example, this may occur when swapping fixed rate mortgages: the mortgages can complete over a period of time, whilst the swap is typically effected in full at a particular point in time. A perfect match or hedge may be disrupted by the early repayment of a fixed rate mortgage or early withdrawal of a fixed rate savings product on the death of an investor.

The FSA recognises that the contractual repricing relating to certain assets and liabilities do not bear a close relationship to their actual behavioural characteristics. So a firm may report its interest rate gap analysis after taking account of these "behavioural" assumptions; these should be included in the rows for "adjusted for actual expected re-pricing date".

Where balances are committed but not yet drawn down, the amount should be included in the relevant row for "pipeline products".

The information in respect of balances to be reported in column A should not be fair-valued but should report the contractual position.

The data item should be completed for all currencies in aggregate.

FSA017 – Interest rate gap report validations

Internal validations

Data elements are referenced first by row then by column.

Validation number	Data element	
1	1A	= 2%
2	2A	= 2B+2C+2D+2E+2F+2G+2H+2J+2K+2L+2M+2N+2P+2Q
3	3A	= 3B+3C+3D+3E+3F+3G+3H+3J+3K+3L+3M+3N+3P+3Q
4	3A	= 2A
5	4A	= 4B+4C+4D+4E+4F+4G+4H+4J+4K+4L+4M+4N+4P+4Q
6	5A	= 5B+5C+5D+5E+5F+5G+5H+5J+5K+5L+5M+5N+5P+5Q
7	6A	= 6B+6C+6D+6E+6F+6G+6H+6J+6K+6L+6M+6N+6P+6Q
8	6A	= 5A
9	7A	= 7B+7C+7D+7E+7F+7G+7H+7J+7K+7L+7M+7N+7P+7Q
10	8A	= 8B
11	9A	= 9Q
12	10A	= 10B+10C+10D+10E+10F+10G+10H+10J+10K+10L+10M+10N+10P+10Q
13	10A	= 2A+4A+5A+7A+8A+9A
14	10B	= 2B+4B+5B+7B+8B
15	10C	= 2C+4C+5C+7C
16	10D	= 2D+4D+5D+7D
17	10E	= 2E+4E+5E+7E
18	10F	= 2F+4F+5F+7F
19	10G	= 2G+4G+5G+7G
20	10H	= 2H+4H+5H+7H
21	10J	= 2J+4J+5J+7J
22	10K	= 2K+4K+5K+7K
23	10L	= 2L+4L+5L+7L
24	10M	= 2M+4M+5M+7M
25	10N	= 2N+4N+5N+7N
26	10P	= 2P+4P+5P+7P
27	10Q	= 2Q+4Q+5Q+7Q
28	11A	= 11B+11C+11D+11E+11F+11G+11H+11J+11K+11L+11M+11N+11P+11Q
29	12A	= 12B+12C+12D+12E+12F+12G+12H+12J+12K+12L+12M+12N+12P+12Q
30	13A	= 13B+13C+13D+13E+13F+13G+13H+13J+13K+13L+13M+13N+13P+13Q
31	13A	= 10A+11A+12A
32	13B	= 10B+11B+12B
33	13C	= 10C+11C+12C
34	13D	= 10D+11D+12D
35	13E	= 10E+11E+12E
36	13F	= 10F+11F+12F
37	13G	= 10G+11G+12G
38	13H	= 10H+11H+12H

39	13J	=	10J+11J+12J
40	13K	=	10K+11K+12K
41	13L	=	10L+11L+12L
42	13M	=	10M+11M+12M
43	13N	=	10N+11N+12N
44	13P	=	10P+11P+12P
45	13Q	=	10Q+11Q+12Q
46	14A	=	14B+14C+14D+14E+14F+14G+14H+14J+14K+14L+14M+14N+14P+14Q
47	15A	=	15B+15C+15D+15E+15F+15G+15H+15J+15K+15L+15M+15N+15P+15Q
48	15A	=	14A
49	16A	=	16B+16C+16D+16E+16F+16G+16H+16J+16K+16L+16M+16N+16P+16Q
50	17A	=	17B+17C+17D+17E+17F+17G+17H+17J+17K+17L+17M+17N+17P+17Q
51	18A	=	18B+18C+18D+18E+18F+18G+18H+18J+18K+18L+18M+18N+18P+18Q
52	18A	=	17A
53	19A	=	19B+19C+19D+19E+19F+19G+19H+19J+19K+19L+19M+19N+19P+19Q
54	20A	=	20B
55	20A	=	8A
56	20B	=	8B
57	21A	=	21Q
58	22A	=	22B+22C+22D+22E+22F+22G+22H+22J+22K+22L+22M+22N+22P+22Q
59	23A	=	23B+23C+23D+23E+23F+23G+23H+23J+23K+23L+23M+23N+23P+23Q
60	23A	=	22A
61	24A	=	24B+24C+24D+24E+24F+24G+24H+24J+24K+24L+24M+24N+24P+24Q
62	24A	=	14A+16A+17A+19A+20A+21A+22A
63	24B	=	14B+16B+17B+19B+20B+22B
64	24C	=	14C+16C+17C+19C+22C
65	24D	=	14D+16D+17D+19D+22D
66	24E	=	14E+16E+17E+19E+22E
67	24F	=	14F+16F+17F+19F+22F
68	24G	=	14G+16G+17G+19G+22G
69	24H	=	14H+16H+17H+19H+22H
70	24J	=	14J+16J+17J+19J+22J
71	24K	=	14K+16K+17K+19K+22K
72	24L	=	14L+16L+17L+19L+22L
73	24M	=	14M+16M+17M+19M+22M
74	24N	=	14N+16N+17N+19N+22N
75	24P	=	14P+16P+17P+19P+22P
76	24Q	=	14Q+16Q+17Q+19Q+22Q
77	25A	=	25B+25C+25D+25E+25F+25G+25H+25J+25K+25L+25M+25N+25P+25Q
78	25A	=	11A
79	26A	=	26B+26C+26D+26E+26F+26G+26H+26J+26K+26L+26M+26N+26P+26Q
80	26A	=	12A
81	27A	=	27B+27C+27D+27E+27F+27G+27H+27J+27K+27L+27M+27N+27P+27Q
82	27A	=	13A
83	27A	=	24A+25A+26A

84	27B	=	24B+25B+26B
85	27C	=	24C+25C+26C
86	27D	=	24D+25D+26D
87	27E	=	24E+25E+26E
88	27F	=	24F+25F+26F
89	27G	=	24G+25G+26G
90	27H	=	24H+25H+26H
91	27J	=	24J+25J+26J
92	27K	=	24K+25K+26K
93	27L	=	24L+25L+26L
94	27M	=	24M+25M+26M
95	27N	=	24N+25N+26N
96	27P	=	24P+25P+26P
97	27Q	=	24Q+25Q+26Q
98	28A	=	28B+28C+28D+28E+28F+28G+28H+28J+28K+28L+28M+28N+28P+28Q
99	28A	=	0
100	28B	=	13B-27B
101	28C	=	13C-27C
102	28D	=	13D-27D
103	28E	=	13E-27E
104	28F	=	13F-27F
105	28G	=	13G-27G
106	28H	=	13H-27H
107	28J	=	13J-27J
108	28K	=	13K-27K
109	28L	=	13L-27L
110	28M	=	13M-27M
111	28N	=	13N-27N
112	28P	=	13P-27P
113	28Q	=	13Q-27Q
114	30B	=	28B
115	30C	=	28B+28C
116	30D	=	28B+28C+28D
117	30E	=	28B+28C+28D+28E
118	30F	=	28B+28C+28D+28E+28F
119	30G	=	28B+28C+28D+28E+28F+28G
120	30H	=	28B+28C+28D+28E+28F+28G+28H
121	30J	=	28B+28C+28D+28E+28F+28G+28H+28J
122	30K	=	28B+28C+28D+28E+28F+28G+28H+28J+28K
123	30L	=	28B+28C+28D+28E+28F+28G+28H+28J+28K+28L
124	30M	=	28B+28C+28D+28E+28F+28G+28H+28J+28K+28L+28M
125	30N	=	28B+28C+28D+28E+28F+28G+28H+28J+28K+28L+28M+28N
126	30P	=	28B+28C+28D+28E+28F+28G+28H+28J+28K+28L+28M+28N+28P
127	30Q	=	28B+28C+28D+28E+28F+28G+28H+28J+28K+28L+28M+28N+28P+28Q
128	31B	=	28B+28C+28D+28E+28F+28G+28H+28J+28K+28L+28M+28N+28P+28Q

129 31C = 28C+28D+28E+28F+28G+28H+28J+28K+28L+28M+28N+28P+28Q

130 31D = 28D+28E+28F+28G+28H+28J+28K+28L+28M+28N+28P+28Q

131 31E = 28E+28F+28G+28H+28J+28K+28L+28M+28N+28P+28Q

132 31F = 28F+28G+28H+28J+28K+28L+28M+28N+28P+28Q

133 31G = 28G+28H+28J+28K+28L+28M+28N+28P+28Q

134 31H = 28H+28J+28K+28L+28M+28N+28P+28Q

135 31J = 28J+28K+28L+28M+28N+28P+28Q

136 31K = 28K+28L+28M+28N+28P+28Q

137 31L = 28L+28M+28N+28P+28Q

138 31M = 28M+28N+28P+28Q

139 31N = 28N+28P+28Q

140 31P = 28P+28Q

141 31Q = 28Q

142 32B = 29B

143 32C = 29B+29C

144 32D = 29B+29C+29D

145 32E = 29B+29C+29D+29E

146 32F = 29B+29C+29D+29E+29F

147 32G = 29B+29C+29D+29E+29F+29G

148 32H = 29B+29C+29D+29E+29F+29G+29H

149 32J = 29B+29C+29D+29E+29F+29G+29H+29J

150 32K = 29B+29C+29D+29E+29F+29G+29H+29J+29K

151 32L = 29B+29C+29D+29E+29F+29G+29H+29J+29K+29L

152 32M = 29B+29C+29D+29E+29F+29G+29H+29J+29K+29L+29M

153 32N = 29B+29C+29D+29E+29F+29G+29H+29J+29K+29L+29M+29N

154 32P = 29B+29C+29D+29E+29F+29G+29H+29J+29K+29L+29M+29N+29P

155 32Q = 29B+29C+29D+29E+29F+29G+29H+29J+29K+29L+29M+29N+29P+29Q

156 33B = 29B+29C+29D+29E+29F+29G+29H+29J+29K+29L+29M+29N+29P+29Q

157 33C = 29C+29D+29E+29F+29G+29H+29J+29K+29L+29M+29N+29P+29Q

158 33D = 29D+29E+29F+29G+29H+29J+29K+29L+29M+29N+29P+29Q

159 33E = 29E+29F+29G+29H+29J+29K+29L+29M+29N+29P+29Q

160 33F = 29F+29G+29H+29J+29K+29L+29M+29N+29P+29Q

161 33G = 29G+29H+29J+29K+29L+29M+29N+29P+29Q

162 33H = 29H+29J+29K+29L+29M+29N+29P+29Q

163 33J = 29J+29K+29L+29M+29N+29P+29Q

164 33K = 29K+29L+29M+29N+29P+29Q

165 33L = 29L+29M+29N+29P+29Q

166 33M = 29M+29N+29P+29Q

167 33N = 29N+29P+29Q

168 33P = 29P+29Q

169 33Q = 29Q

170 36A = 36B+36C+36D+36E+36F+36G+36H+36J+36K+36L+36M+36N+36P+36Q

171 37A = 37B+37C+37D+37E+37F+37G+37H+37J+37K+37L+37M+37N+37P+37Q

172 38A = 38B+38C+38D+38E+38F+38G+38H+38J+38K+38L+38M+38N+38P+38Q

173 39A = 39B+39C+39D+39E+39F+39G+39H+39J+39K+39L+39M+39N+39P+39Q

174	36B	=	28C*34C*1A*45/365
175	36C	=	28D*34D*1A*136/365
176	36D	=	28E*34E*1A*273/365
177	36E	=	28F*34F*1A*1.5
178	36F	=	28G*34G*1A*2.5
179	36G	=	28H*34H*1A*3.5
180	36H	=	28J*34J*1A*4.5
181	36J	=	28K*34K*1A*5.5
182	36K	=	28L*34L*1A*6.5
183	36L	=	28M*34M*1A*7.5
184	36M	=	28N*34N*1A*8.5
185	36N	=	28P*34P*1A*9.5
186	36P	=	28Q*34Q*1A*10
187	37B	=	-36B
188	37C	=	-36C
189	37D	=	-36D
190	37E	=	-36E
191	37F	=	-36F
192	37G	=	-36G
193	37H	=	-36H
194	37J	=	-36J
195	37K	=	-36K
196	37L	=	-36L
197	37M	=	-36M
198	37N	=	-36N
199	37P	=	-36P
200	37Q	=	-36Q

FSA018 – UK integrated group large exposures

This data item captures information on *large exposures*, by a *UK integrated group* to the *diverse blocks* and the *residual block*, under *BIPRU 10.8* and *BIPRU 10.9*. A single report is required for all members of the *UK integrated group*, although each individual member of the *UK integrated group* will need to reflect its share of any CNCOM (reported below in column N) in Part 3 of its FSA003. It reflects the exposures at the reporting date.

Unless indicated otherwise, the valuation of items should follow *GENPRU 1.3*.

Valuation

Unless indicated otherwise, the valuation of data elements should follow *GENPRU 1.3*.

Currency

You should report in the currency of your annual audited accounts ie in either Sterling, Euro, US dollars, Canadian dollars, Swedish Kroner, Swiss Francs or Yen. Figures should be reported in 000s.

Data elements

These are referred to by row first, then by column, so data element 2B will be the element numbered 2 in column B. Individual rows within an element are identified as 2B.1, 2B.2 etc.

General

1 Identify the UK integrated group

[To follow]

2 FSA Firm Reference Numbers

List the FSA Firm Reference Numbers for all the authorised firms in the *UK integrated group*. As this report is a joint requirement across all firms that are members of that group, this notifies us which firms' requirements are being met by this data item. Firms should be listed sequentially in 2A, with the FSA Firm Reference Numbers being entered in 2B.

3A Group capital resources under *BIPRU 10.8.10R*

This is the *capital resources* of the *UK integrated group* calculated in accordance with *BIPRU 10.8.10R*.

4A Exposure number

Please number each exposure consecutively.

4B Counterparty name

List here the *diverse blocks* and *residual block* to which there are exposures at the reporting date.

4C Gross exposure

Report here the gross exposures calculated in accordance with *BIPRU 10.2* and *BIPRU 10.4*.

4D % of capital resources under *BIPRU 10.8.10R*

This is column C as a percentage of data element 3A. It should be entered to two decimal places, omitting the % sign.

4E Exposure after credit risk mitigation

This is the figure reported in column D after *credit risk mitigation*. This figure is subsequently broken down in columns F to M.

4F Amount of the exposure that is exempt

That part of the amount reported in column E that is an exempt under *BIPRU 10.6*.

4G % of capital resources under *BIPRU 10.8.10R*

This is column F as a percentage of data element 3A. It should be entered to two decimal places, omitting the % sign.

4H Amount of the exposure that is not exempt and is in the non-trading book

That part of the exposure reported in column E that is not exempt and is in the non-trading book.

4J % of capital resources under *BIPRU 10.8.10R*

This is column H as a percentage of the capital resources under *BIPRU 10.8.10R*. It should be entered to two decimal places, omitting the % sign.

4K Amount of the exposure that is not exempt and is in the trading book

That part of the exposure reported in column E that is not exempt and is in the trading book.

4L % of capital resources under *BIPRU 10.8.10R*

This is column K as a percentage of the capital resources under *BIPRU 10.8.10R*. It should be entered to two decimal places, omitting the % sign.

4M Aggregate % of capital resources under *BIPRU 10.8.10R*

This is the sum of columns J and L. The total of the column should be monitored against the limit set out in *BIPRU 10.8.7R*. It should be entered to two decimal places, omitting the % sign.

4N CNCOM

This is the amount of CNCOM calculated as set out in *BIPRU 10.10.2R*, before being allocated to individual members of the *UK integrated group* in accordance with *BIPRU 10.10.3R* and *BIPRU 10.10.4R*.

As this will be reported later than each firm's individual FSA008, firms will be expected to have sufficient capital resources at the reporting dates to meet this requirement.

FSA018 – UK integrated group large exposures validations

Internal validations

Data elements are referenced by row then column.

1	2CT	=	$\Sigma 2C$
2	4D	=	$4C/3A$
3	4G	=	$4F/3A$
4	4H	\leq	4E
5	4J	=	$4H/3A$
6	4JT	=	$\Sigma 4J$
7	4K	\leq	4E
8	$4F+4H+4K$	=	4E
9	4L	=	$4K/3A$
10	4LT	=	$\Sigma 4L$
11	4M	=	$(4H+4K)/3A$
12	4NT	=	$\Sigma 4N$
13	4NT	=	2CT

FSA019 – Pillar 2 questionnaire

This data, supplemented by other relevant data, will be used to inform the intensity of our risk assessment of a firm, or its group, under the Supervisory Review and Evaluation Process (SREP). It will allow us to reduce supervisory time by helping us to identify those firms with a risk profile for which we will carry out additional individual or thematic work.

Valuation

For the general policy on valuation, please see the rules and guidance set out in *GENPRU* 1.3.

Currency

You should report in the currency of your annual audited accounts ie in either Sterling, Euro, US dollars, Canadian dollars, Swedish Kroner, Swiss Francs or Yen. Figures should be reported in 000s.

Data elements

These are referred to by row first, then by column, so data element 2B will be the element numbered 2 in column B.

1B Does GENPRU 1.2 apply to your firm?

See *GENPRU* 1.2.1R and *GENPRU* 1.2.44G to *GENPRU* 1.2.59R. The answer is either ‘Yes’ or ‘No’.

Subsequent sections are only completed if the answer to 1B is ‘Yes’.

2B What is the internal capital amount that you consider adequate?

See *GENPRU* 1.2.26R. Enter the figure in 000s.

3B What is the actual amount of internal capital that your firms holds at the accounting reference date?

See *GENPRU* 1.2.26R. Enter the figure in 000s.

4B Have you documented your ICAAP?

See *GENPRU* 1.2.60R. The answer is either ‘Yes’ or ‘No’.

5B When did you last review the ICAAP?

See *GENPRU* 1.2.39R and *GENPRU* 1.2.40G. The answer should be in ‘ddmmyy’ format.

6B Have your external auditors audited your firm’s financial statements in the last 12 months?

The answer is either ‘Yes’ or ‘No’.

7B If so, has any audit opinion you received in the last year been qualified in any respect?

This question should only be answered if the response to data element 6B was 'Yes'. The answer to this question is either 'Yes' or 'No'.

8B What is the ratio of dealing errors in relation to the total number of transactions your firm has undertaken in the last 12 months?

See *GENPRU* 1.2.30R. This figure should be a percentage to one decimal place.

9B Have you considered your firm's risk appetite when developing its ICAAP?

See *GENPRU* 1.2.75G (2). The answer is either 'Yes' or 'No'.

10B and 11B In your ICAAP, have you considered the impact of an economic downturn on your firm's financial capital, and your business plans?

See *GENPRU* 1.2.30R (1) and *GENPRU* 1.2.73R (1). The answer to each question is either 'Yes' or 'No'.

12A to 23A Is your firm exposed to the risks listed

See *GENPRU* 1.2.30R. The answer to each question is either 'Yes' or 'No'.

12B to 23B If so, what is the amount of internal capital you have allocated to each of them?

For each answer in Column A that is 'Yes', enter the amount in column B in 000s.

24B Does your firm have any professional indemnity insurance?

The answer is either 'Yes' or 'No'.

25B If so, what is the limit of the indemnity in the aggregate?

If the answer to data element 24B is 'Yes', enter the amount here in 000s.

26B What is the greatest deductible single claim?

If the answer to data element 24B is 'Yes', enter the amount here in 000s.

27B What is the credit rating of the lead underwriter?

Only answer if you answered 'Yes' to data element 24B. This is a text field to accept any value.

28B In your firm's ICAAP, do you take account of the results of the stress tests set out in BIPRU 4.3.39R and BIPRU 4.3.40R?

See *BIPRU* 4.3.39R and *BIPRU* 4.3.40R. The answer is either 'Yes' or 'No'.

29B Does your firm deduct illiquid assets as set out in GENPRU 2.2.17R to GENPRU 2.2.19R?

See *GENPRU 1.2.30R*, *GENPRU 2.2.17R* to *GENPRU 2.2.19R*, and *GENPRU 2.2.260R* to *GENPRU 2.2.262G*. The answer is either ‘Yes’ or ‘No’.

30B Does your firm have sufficient liquidity to meet your liabilities as they fall due in the circumstances of an orderly wind down?

See *GENPRU 1.2.30R*. The answer is either ‘Yes’ or ‘No’.

31B Report the amount of illiquid assets

See *GENPRU 1.2.30R*, and *GENPRU 2.2.260R* to *GENPRU 2.2.262G*. This number should be entered in integers.

32B Do you use credit risk mitigation techniques?

See *GENPRU 1.2.30R*. The answer is either ‘Yes’ or ‘No’.

33B If so, have you considered in your ICAAP the fact that those techniques may not fully work as anticipated?

This is only relevant if you answered ‘Yes’ to data element 32B. See *GENPRU 1.2.30R*. The answer is either ‘Yes’ or ‘No’.

34B Have you securitised assets in the last 12 months?

See *GENPRU 1.2.30R*. The answer is either ‘Yes’ or ‘No’.

35B Do you use an internal model as described in BIPRU 7.10 to calculate your regulatory market risk?

See *BIPRU 7.10*. The answer is either ‘Yes’ or ‘No’.

36B If so, have you taken the results of the market risk stress tests in your ICAAP into account?

This is only relevant if you answered ‘Yes’ to data element 35B. See *BIPRU 7.10*, *BIPRU 7.10.72R* and *BIPRU 7.10.73G*. The answer is either ‘Yes’ or ‘No’.

37B Report the result of a 200 basis point shock to interest rate on your firm’s economic value

See *BIPRU 2.3.7R (2)*. Enter the figure in 000s.

38B Does the result of the above stress test exceed 20% of your economic value?

See *BIPRU 2.3.7R (3)*. The answer to this is either ‘Yes’ or ‘No’.

39B Would the valuation adjustments required under GENPRU 1.3.35G enable you to sell out of hedge your firm's positions within a short period without incurring material losses under normal market conditions?

See *GENPRU* 1.3.29R to *GENPRU* 1.3.35G. The answer to this is either 'Yes' or 'No'.

FSA019 – Pillar 2 questionnaire validations

Internal validations

There are no validations for this data item.

FSA020 – Balance sheet (ELMIs)

There are no definitions for this data item.

FSA020 – Balance sheet (ELMIs) validations

Internal validations

Data elements are referenced by row then column.

Validation number	Data elements		
1	10A	=	1A+2A+3A+4A+5A+6A+7A+8A+9A
2	12A	≤	11A
3	20A	=	15A+16A+17A+18A+19A
4	23A	=	20A+21A-22A
5	26A	=	24A+25A
6	28A	=	26A+27A
7	29A	=	23A+28A
8	33A	=	11A+13A+20A+21A+28A+30A+31A+32A
9	33A	=	10A

External validations

Validation number	Data elements		
1	11A	=	FSA022.2A
2	29A	=	FSA022.1A

FSA021 – Income statement (ELMIs)

There are no definitions for this data item.

FSA021 – Income statement (ELMIs) validations

Internal validations

There are no validations for this data item.

FSA022 – Capital adequacy (ELMIs)

There are no definitions for this data item.

FSA022 – Capital adequacy (ELMIs) validations

Internal validations

Data elements are referenced first by row then by column.

Validation number	Data element		
1	4A	=	1A/(maximum 2A, 3A)

External validations

Validation number	Data element		
1	1A	=	FSA020.29A
2	2A	=	FSA020.11A

FSA023 – Foreign exchange risk (ELMIs)

There are no definitions for this data item

FSA023 – Foreign exchange risk (ELMIs) validations

Internal validations

Data elements are referenced first by row then by column.

Validation number	Data element		
1	9A	=	1A+2A+3A+4A+5A+6A+7A+8A
2	10B	=	1B+2B+3B+4B+5B+6B+7B+8B
3	11C	=	Maximum 9A, 10B
4	12C	=	8A*8%

FSA024 – Large exposures (ELMIs)

There are no definitions for this data item.

FSA024 – Large exposures (ELMIs) validations

Internal validations

There are no validations for this data item.

FSA025 – Liquidity (ELMIs)

There are no definitions for this data item.

FSA025 – Liquidity (ELMIs) validations

Internal validations

Data elements are referenced first by row then by column.

Validation number	Data elements		
1	1A	=	FSA021.1A+FSA021.2A
2	6A	=	4A/5A (≥ 1)
3	4A	=	1A+(min (FSA021.29A*20%), (2A+3A))

External validations

Validation number	Data elements		
1	2A	=	FSA020.3A
2	3A	=	FSA020.4A
3	5A	=	FSA020.11A

FSA026 – ELM I questions

There are no definitions for this data item.

FSA026 – ELMI questions validations

Internal validations

There are no validations for this data item.

Annex D

Amendments to Credit Union sourcebook (CRED)

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

...

7A.2.4 R For the purposes of *CRED* 7A.2.1R and *CRED* 7A.2.2R, the total shareholdings in a *credit union* at any time must be taken to be the total shareholding as shown in the most recent annual return sent to the FSA under *SUP* 16.7.62R or *SUP* 16.12.5R (see *CRED* 14.7.10G).

...

8.2.1 R ...
(7) ...
(a) the amount standing to the credit of any such reserve in the balance sheet in the most recent annual return to have been sent to the *FSA* under *SUP* 16.7.62R or *SUP* 16.12.5R (see *CRED* 14.10.7G); or

...

...

10.3.4A G For the purpose of calculating the maximum loan in *CRED* 10.3.4R, the *credit union* may use the amount of total shares as shown in the most recent annual return to have been sent to the *FSA* under *SUP* 16.7.62R or *SUP* 16.12.5R (see *CRED* 14.10.7G) if that is the latest reliable figure available.

...

14.10.1 G This section, ~~*SUP* 16.7.1G – *SUP* 16.7.4G~~, and ~~*SUP* 16.7.15AR – *SUP* 16.7.15DR~~ *SUP* 16.12.1R – *SUP* 16.12.4R apply to all *credit unions*.

...

14.10.4D G If a *credit union* fails to submit a complete annual report by the date on which it is due in accordance with the rules under *SUP* ~~16.7~~ 16.12 and any prescribed submission procedures, the credit union must pay an administrative fee of £250 (see *SUP* 16.3.14R). Failure to submit the report in accordance with *SUP* ~~16.7~~ 16.12 may also lead to the imposition of a financial penalty and other disciplinary sanctions (see *ENF* 13.5 and *CRED* 15.5).

...

14.10.5 G ~~*SUP* 16.7.62~~ 16.12.5R states that a *credit union* must submit a quarterly return.

...

14.10.7 G ~~*SUP* 16.7.62~~ 16.12.5R states that a *credit union* must submit an annual return.

...

14.10.10 R ...
(2) ...

- (b) accompany the annual return submitted to the FSA under ~~SUP16.7.62~~ 16.12.5R (see *CRED* 14.10.7G), unless they have been submitted already.

Annex E

Amendments to the Glossary of definitions

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

...

investment management firm (1) (~~except in SUP 16~~ and subject to *BIPRU* TP 1.3R (Revised definition of investment management firm for certain transitional purposes)), ...

(2) (~~in SUP 16~~) as in (1) but excluding the words '*BIPRU investment firm*'.

...

personal investment firm (1) (~~except in SUP 16~~ and subject to *BIPRU* TP 1.3R (Revised definition of personal investment firm for certain transitional purposes)), ...

(2) (~~in SUP 16~~) as in (1) but excluding the words '*BIPRU investment firm*'.

...

securities and futures firm (1) (~~except in SUP 16~~ and subject to *BIPRU* TP 1.3R (Revised definition of securities and futures firm for certain transitional purposes)), ...

(2) (~~in SUP 16~~) as in (1) but excluding the words '*BIPRU investment firm*'.

...

Annex F

Amendments to the Supervision Manual (SUP)

In this Annex, underlining indicates new text and striking through indicates deleted text. Sections that are deleted in their entirety are marked '[deleted]'.
 ...

SUP 16.1 Application

...

16.1.3 R Application of different sections of SUP 16

(1) Section(s)	(2) Categories of firm to which section applies	(3) Applicable rules and guidance
...		
SUP 16.7	Bank, other than an EEA bank with permission for cross border services only	SUP 16.7.7R to SUP 16.7.15R
	Building society	SUP 16.7.16R to SUP 16.7.19R
	...	
	Credit Union	SUP 16.7.62R to SUP 16.7.63R
	...	
	Member of a financial conglomerate	SUP 16.7.82R to SUP 16.7.83R
	...	

...

SUP 16.7 Financial Reports

...

16.7.5 G Applicable rules and guidance on reports (see SUP 16.7.1 G)

Firm category	Applicable rules and guidance
Bank, other than an EEA bank with permission for cross border services only	SUP 16.7.7R — SUP 16.7.15R SUP 16.7.82R — SUP 16.7.83R
Building society	SUP 16.7.16R — SUP 16.7.19R SUP 16.7.82R — SUP 16.7.83R
...	
Credit Union	SUP 16.7.62R — SUP 16.7.63R
...	
Member of a financial conglomerate	SUP 16.7.82R — SUP 16.7.83R

...	
-----	--

...

Banks

16.7.7 R [deleted]

16.7.8 R [deleted]

16.7.8A R [deleted]

16.7.9 R [deleted]

16.7.10 R [deleted]

16.7.11 R [deleted]

16.7.12 R [deleted]

~~Method of submission~~

16.7.13 R [deleted]

16.7.14 G [deleted]

16.7.15 R [deleted]

~~Building societies~~

16.7.16 R [deleted]

16.7.17 R [deleted]

16.7.17A R [deleted]

16.7.18 G [deleted]

~~Method of submission~~

16.7.19 R [deleted]

...

16.7.25A R [deleted]

...

16.7.27A R [deleted]

...

16.7.36A R [deleted]

...

~~Credit Unions~~

16.7.62 R [deleted]

16.7.63 R [deleted]

16.7.63A R [deleted]

16.7.63B R [deleted]

16.7.63C R [deleted]

...

UCITS Management Companies firm

16.7.67 R A *UCITS management company firm* must submit reports to the FSA in accordance with SUP 16.7.68R and, in the case of an UCITS investment firm, SUP 16.7.68AR.

16.7.68 R Financial reports from a *UCITS management company firm* (see SUP 16.7.67R)

Report	Frequency	Due date
...		
Consolidated supervision return (Only for <i>UCITS investment firms</i>)	Half yearly	4 months after end of the relevant six-month period
If the <i>firm's</i> ultimate parent is a mixed-activity holding company, the annual accounts of the mixed-activity holding company (only for <i>UCITS investment firms</i>)	Annually	As soon as available after year end

...

16.7.68A R [deleted]

16.7.69 R A *UCITS management company firm* must submit reports in:

(1) SUP 16.7.68R in accordance with, and in the same format as:

...

...

Timely reporting

16.7.72 R A *UCITS management company firm* must notify the FSA in writing as soon as it has reason to believe it will ...

...

16.7.77A R [deleted]

...

~~Financial conglomerates~~

16.7.82 R [deleted]

16.7.83 R [deleted]

Annex G

Amendments to the Electronic Money sourcebook (ELM)

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

ELM 8 Small e-money issuers

8.3 Introduction

...

8.3.4 G ...

- (4) ELM 8.7 contains *rules* and *guidance* about the provision of information to the *FSA*, including the *rules* which require a *small e-money issuer* to give periodic reports and change reports to the *FSA* on ~~Form ELM-SI~~ data item FSA027 (which is set out in ELM 8 Annex 2R).

...

8.7 Provision of information

Periodic reports

8.7.1 R A *small e-money issuer* must:

- (1) complete a ~~Form ELM-SI~~ data item FSA027 (see ELM 8 Annex 2R) as at the end of each financial year and half financial year; and
- (2) within 10 *business days* of that date, ~~deliver it to the FSA in the manner indicated in the form~~ submit it to the FSA using the electronic systems designated by the FSA.

Change reports

8.7.2 R If none of the conditions referred to in ELM 8.4 continue to apply to a *small e-money issuer*, it must, within *two business days* of the change occurring:

- (1) complete a ~~Form ELM-SI~~ data item FSA027; and
- (2) ~~deliver it to the FSA in the manner indicated in the form~~ submit a paper version of it, downloaded from www.fsa.gov.uk/pubs/other/elm_8_annex2r.pdf, to the FSA.

8.7.3 R (1) If the total liabilities of a *small e-money issuer* with respect to *issuing e-money* exceed 5 million euro, it must, within *two business days* of the excess occurring:

- (a) complete a ~~Form ELM-SI~~ data item FSA027; and
- (b) ~~deliver it to the FSA in the manner indicated in the form~~ submit a paper version of it, downloaded from www.fsa.gov.uk/pubs/other/elm_8_annex2r.pdf, to the FSA.

...

8.7.5 G ...
FSA027

8.7.5A G ~~Form ELM~~ FSA027 is set out at ELM 8 Annex 2R. FSA027 will, for the purposes of periodic reports under ELM 8.7.1R, be submitted by the

electronic system designated by the FSA. However for change reports under ELM 8.7.2R and ELM 8.7.3R, the report must be submitted in paper to the FSA, and a copy of FSA027 may be downloaded and printed off from www.fsa.gov.uk/pubs/other/elm_8_annex2r.pdf.

...

Schedule 2
Notification requirements

ELM Sch 2.2 G

Handbook reference	Matter to be notified	Contents of notification	Trigger event	Time allowed
...				
ELM 8.7.1 R	Periodic reports	Form ELM-SI <u>data item</u> <u>FSA027</u>	End of each half financial year	Within ten <u>thirty</u> <i>business days</i> of the end of each half financial year
ELM 8.7.2 R	Change reports	Form ELM-SI <u>data item</u> <u>FSA027</u>	Fact of change	Within two <i>business days</i> of change occurring
ELM 8.7.3 R	Where <i>small e-money issuer's</i> total liabilities exceed 5 million euro	Form ELM-SI <u>data item</u> <u>FSA027</u>	Fact of excess	Within two <i>business days</i> of the fact occurring.

ELM 8 Annex 2R

Insert the following new text, which is not underlined, as *data item* FSA027, before Form ELM-SI.

FSA027
Small e-money issuer

A. Application of conditions

- 1 The first condition applies if:
 - (1) the small e-money issuer does not issue e-money except on terms that the electronic device on which the monetary value is stored is subject to a maximum storage amount of not more than 150 euro; and
 - (2) the small e-money issuer's total liabilities with respect to issuing e-money do not (and will not) usually exceed 5 million euro and do not (or will not) ever exceed 6 million euro.

- 2 The second condition applies if:
 - (1) paragraph 1 of the first condition is met;

A	B
Yes	No

Yes	No

- (2) the small e-money issuer's total liabilities with respect to the issuing of e-money do not (or will not) exceed 10 million euro; and
- (3) e-money issued by the small e-money issuer is accepted as a means of payment by:
 - (a) subsidiaries of the small e-money issuer which perform operational or other ancillary functions related to e-money issued or distributed by that small e-money issuer: or
 - (b) other members of the same group as the small e-money issuer (other than subsidiaries of that small e-money issuer).

3 The third condition applies if:

Yes	No

- (1) paragraph (1) of the first condition and (2) of the second condition are met; and
- (2) e-money issued by the small e-money issuer is accepted as a means of payment, in the course of business, by not more than one hundred persons where:
 - (a) those persons accept such e-money only at locations within the same premises or limited local area; or
 - (b) those persons have a close financial or business relationship with the small e-money issuer such as a common marketing or distribution scheme.

4 Have the relevant provisions referred to in 1 to 3 been met throughout the reporting period?

Yes	No

A

If no, please give details

5

B. E-money outstandings

A

6 Outstandings at the period end

7 Peak e-money outstandings during the period

If the first condition (1) applies, indicate the dates on which the e-money outstandings exceeded 5 or 6 million euro, and the amount of the e-money outstandings on these dates in the table below.

If the second condition (2) or the third condition (3) applies, indicate the dates on which e-money outstandings exceeded 10 million euro, and the amount of e-money outstanding on these dates, in the table below.

Dates on which electronic money outstandings exceeded				Amount of e-money outstandings
5 million euro	6 million euro	10 million euro		
A	B	C	D	
1				
2				
n				

**SUPERVISION MANUAL (INSURANCE CONGLOMERATES REPORTING
AMENDMENT) INSTRUMENT 2006**

Powers exercised

- A. The Financial Services Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):
- (1) section 138 (General rule-making power);
 - (2) section 156 (General supplementary powers); and
 - (3) section 340 (Appointment).
- B. The rule-making powers listed above are specified for the purpose of section 153(2) (Rule-making instruments) of the Act.

Commencement

- C. This instrument comes into force on 31 December 2006.

Amendments to the Handbook

- D. The Supervision manual (SUP) is amended in accordance with the Annex to this instrument.

Citation

- E. This instrument may be cited as the Supervision Manual (Insurance Conglomerates Reporting Amendment) Instrument 2006.

By order of the Board
21 December 2006

Annex

Amendments to the Supervision manual

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

...

16.7.83	R	Table: Financial reports from a member of a financial conglomerate (see SUP 16.7.82R)	
...			
		<p>...</p> <p>Note 2 = If Part 1 of PRU 8 Annex 1<u>R</u> (method 1), Part 2 of PRU 8 Annex 1<u>R</u> (method 2), or Part 3 of PRU 8 Annex 1<u>R</u> (method 3) applies, there is no specific form. Adequate information must be provided, and each <i>financial conglomerate</i> for which the FSA is the <i>co-ordinator</i> must discuss with the FSA how to do this.</p> <p>If Part 4 of PRU 8 Annex 1<u>R</u> applies (method 4):</p>	
		(1)	...
		(2)	...
		(3)	...
		(4)	<p>an <i>insurance conglomerate</i> must use:</p> <p>(a) <u>(where SUP 16.7.82R(1)(a) applies), Forms 1, 2 and 3 in Appendix 9.1 of IPRU(INS), as appropriate, prepared and audited in accordance with rule 9.35(1) of IPRU(INS); or</u></p> <p>(b) <u>(in any other case), the Parent Undertaking Insurance Group Capital Adequacy Reporting Format example (Form 95) in GN 10.1 Appendix 9.9 of IPRU(INS).</u></p> <p><u>For the purposes of (b) above, rules 9.40(1), 9.40(1A), 9.40(3) and 9.40(4) of IPRU(INS) apply as they would if the insurance conglomerate were an insurance group.</u></p>

COMPENSATION SOURCEBOOK (CONTRIBUTION FOR MESOTHELIOMA CLAIMS) INSTRUMENT 2006

Powers exercised

- A. The Financial Services Authority makes this instrument in the exercise of the powers and related provisions in or under
- (1) article 9A of the Financial Services and Markets Act 2000 (Transitional Provisions, Repeals and Savings) (Financial Services Compensation Scheme) Order 2001; and
 - (2) regulations 3 and 4 of the Compensation Act (2006) (Contribution for Mesothelioma Claims) Regulations 2006.
- B. The rule-making powers listed above are specified for the purpose of section 153(2) (Rule-making instruments) of the Act.

Commencement

- C. This instrument comes into force on 22 December 2006.

Amendments to the Handbook

- D. The Glossary is amended in accordance with Annex A to this instrument.
- E. The Compensation sourcebook (COMP) is amended in accordance with Annex B to this instrument.

Citation

- F. This instrument may be cited as the Compensation Sourcebook (Contribution for Mesothelioma Claims) Instrument 2006.

By order of the Board

21 December 2006

Annex A

Amendments to the Glossary of definitions

Add the following new definitions in the appropriate alphabetical position:

<u>authorised insurance company</u>	<u>(In COMP) (in accordance with the compensation transitionals order) a person who was, at any time before commencement, authorised under section 3 or 4 of the Insurance Companies Act 1982 to carry on insurance business of any class in the United Kingdom.</u>
<u>mesothelioma regulations</u>	<u>The Compensation Act 2006 (Contribution for Mesothelioma Claims) Regulations 2006 (SI 2006/3259).</u>
<u>mesothelioma victim</u>	<u>(in accordance with section 3 (1) of the Compensation Act 2006) a person who has contracted mesothelioma as a result of exposure to asbestos by a responsible person.</u>
<u>responsible person</u>	<u>(1) (except in COMP) ...</u> <u>(2) (in COMP) (in accordance with section 3 (1) of the Compensation Act 2006) a person who has negligently or in breach of statutory duty caused or permitted another person to be exposed to asbestos (including an insurer of such a person).</u>

Annex B

Amendments to the Compensation sourcebook (COMP)

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

...

4.2.1 R Unless *COMP* 4.2.3 R applies, an *eligible claimant* is any person who at any material time:

...

(2) did come within *COMP* 4.2.2 R, but satisfied the relevant exception in *COMP* 4.3 or *COMP* 4.4.

...

4.4 Exceptions: Relevant general insurance contracts: mesothelioma claims

Application

4.4.1 R This section applies in respect of any claim for a contribution by a *responsible person* made on or after 25 July 2006 in relation to a *mesothelioma victim's* claim which is determined by agreement in writing, a court or an arbitrator on or after 3 May 2006.

Claims for contribution by responsible persons

4.4.2 R The *rules* in this sourcebook shall have effect as modified to the extent necessary to enable the *FSCS* to receive, assess, determine and make payments in respect of applications for compensation from *responsible persons* in accordance with article 9A of the *compensation transitionals order* and regulation 3 of the *mesothelioma regulations*.

4.4.3 R In particular:

- (1) a *responsible person* is eligible to claim in accordance with the provisions of this section;
- (2) the *FSCS* may pay compensation to a *responsible person* where it is satisfied that an *eligible claimant* has a claim under a *protected contract of insurance* issued by an *insurer in default*, which, but for satisfaction of that claim by the *responsible person*, the *FSCS* would have paid;
- (3) a *responsible person* in (2) may claim compensation only if, having satisfied a claim in relation to a *mesothelioma victim*, he could claim contribution from an *insurer in default*;
- (4) the *FSCS* may pay compensation in respect of any contribution for which an *insurer in default* is liable by agreement in writing, or by a determination of a court or arbitrator; and

(5) in this section, references to an insurer include an authorised insurance company, and references to in default include an article 9 default.

4.4.4 G The provisions in this section establish a scheme for contribution claims by responsible persons. The requirement in COMP 12.2.7R to take into account payments to the claimant do not therefore require the FSCS, in paying compensation in respect of such a claim, to take into account any payments referred to in that rule made by a responsible person in calculating the claimant's overall net claim.

Limits to amounts payable for contribution claims

4.4.5 R The amount payable by the FSCS in respect of a claim in accordance with the provisions of this section may not exceed the amount that it would have paid if the mesothelioma victim (or a responsible person other than an insurer of such a person) to whom the contribution claim relates had made that claim directly against FSCS.

1 Transitional Provisions Table

1	COMP 5	R	<i>Protected claims</i>	Indefinitely	<i>Commencement</i>
			...		
		(2)	A claim must be treated as a claim in relation to a protected contract of insurance under COMP 5.4.5 R if the conditions in article 9A or 10(1)(a)-(d) of the compensation transitionals order are satisfied.		<i>Commencement but on 6 December 2006 for article 9A of the compensation transitionals order</i>
			...		

In *COMP* Schedule 4, Powers Exercised, insert the following new paragraphs in the appropriate numerical positions. The inserted text is not underlined.

- (12A) Article 9A (Contributions in relation to mesothelioma claims) of the *compensation transitionals order*.

- (15) Article 3 (Modification of FSMA 2000 in relation to FSA rules for mesothelioma claims) of the *mesothelioma regulations*.

**TRANSPARENCY OBLIGATIONS DIRECTIVE
(DISCLOSURE AND TRANSPARENCY RULES) INSTRUMENT 2006**

Powers exercised

- A. The Financial Services Authority makes this instrument in the exercise of the following powers and related provisions in the Financial Services and Markets Act 2000 (“the Act”):
- (1) section 73A (Part 6 rules);
 - (2) section 89A to 89G (Transparency rules);
 - (3) section 101 (Listing rules: general provisions); and
 - (4) section 157(1) (Guidance).

Commencement

- B. Amendments to the Glossary in Annex A and Transitional Provision 6 in Annex C shall come into force on 22 December 2006, otherwise this instrument comes into force on 20 January 2007.

Amendments to the Handbook

- C. The Transparency Obligations Directive (Disclosure and Transparency Rules) Instrument is amended:
- (1) by Annex A, amendments to the Glossary of definitions;
 - (2) Annex B to this instrument amends the Listing Rules sourcebook (LR); and
 - (3) Annex C to this instrument inserts into the Handbook new chapters in the Disclosure Rules and Transparency Rules sourcebook (DTR).

Notes

- D. In Annex C to this instrument, the “notes” (indicated by “**Note:**”) are included in for the convenience of readers but do not form part of the legislative text.

Citation

- E. This instrument may be cited as the Transparency Obligations Directive (Disclosure and Transparency Rules) Instrument 2006.

By order of the Board
21 December 2006

Annex A

Amendments to the Glossary of definitions

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

<i>admission to trading</i>	(in <i>PR</i> and <i>DTR</i>) admission to trading on a regulated market. (Glossary)
<i>controlled undertaking</i>	<u>means any subsidiary undertaking within the meaning of the Act other than section 258(4)(b) of the Companies Act 1985 or section 420(2)(b) of the Act;</u>
<i>debt security</i>	(1) (in <i>DTR 2</i> , <i>DTR 3</i> and <i>LR</i>) debentures, debenture stock, loan stock, bonds, certificates of deposit or any other instrument creating or acknowledging indebtedness. (2) <u>(in <i>DTR 4</i>, <i>DTR 5</i> and <i>DTR 6</i>) (in accordance with article 2.1(b) of the <i>Transparency Directive</i>) bonds or other forms of transferable securitised debts, with the exception of securities which are equivalent to <i>shares</i> in companies or which, if converted or if the rights conferred by them are exercised, give rise to a right to acquire <i>shares</i> or securities equivalent to <i>shares</i>.</u> (23) (except in <i>DTR</i> and <i>LR</i>) any of the following: a <i>debenture</i> ; a <i>government and public security</i> ; or a <i>warrant</i> which confers a right in respect of an <i>investment</i> in (a) or (b).
<i>DTR</i>	the <i>Disclosure Rules and Transparency Rules</i> sourcebook
<i>electronic means</i>	<u>are means of electronic equipment for the processing (including digital compression), storage and transmission of data, employing wires, radio optical technologies, or any other electromagnetic means;</u>
<i>financial instrument</i>	<u>the instruments specified in Section C of Annex 1 of <i>MiFID</i>;</u>
<i>Home Member State</i>	(in <i>DTR PR</i> and <i>LR</i>) Home State
<i>Home State</i>	(1) (in relation to a <i>credit institution</i>) the <i>EEA State</i> in which the <i>credit institution</i> has been authorised in accordance with the <i>Banking Consolidation Directive</i> ... (8) <u>(in <i>LR</i> and <i>PR</i>) (as defined in section 102C of the Act) in relation to an issuer of <i>transferable securities</i>, the <i>EEA State</i> which is the "home Member State" for the purposes of the</u>

prospectus directive (which is to be determined in accordance with Article 2.1(m) of that directive).

(9) (in DTR)

(a) in the case of an issuer of debt securities the denomination per unit of which is less than EUR 1 000 or an issuer of shares;

(i) where the issuer is incorporated in the Community, the Member State in which it has its registered office;

(ii) where the issuer is incorporated in a third country, the Member State in which it is required to file the annual information with the competent authority in accordance with Article 10 of Directive 2003/71/EC.

The definition of 'home' Member State shall be applicable to debt securities in a currency other than Euro, provided that the value of such denomination per unit is, at the date of the issue, less than EUR 1 000, unless it is nearly equivalent to EUR 1 000;

(b) for an issuer not covered by (i), the Member State chosen by the issuer from among the Member State in which the issuer has its registered office and those Member State which have admitted its securities to trading on a regulated market on their territory. The issuer may choose only one Member State as its home Member State. Its choice shall remain valid for at least three years unless its securities are no longer admitted to trading on any regulated market in the Community;

IFRS

International Financial Reporting Standards

International Financial Reporting Standards

international financial accounting standards within the meaning of EC Regulation No 1606/2002 of the European Parliament and of the Council of 19 July 2002 as adopted from time to time by the European Commission in accordance with that Regulation.

issuer

(1) (except in *CIS*, *LR*, *PR* and *DTR*) ...

(2) (in chapters 1, 2 and 3 of *DTR* and *FEES* in relation to *DTR*)
...

(2A) (in chapters 1A, 4, 6 of *DTR*) a legal entity governed by private or public law, including a State, whose securities are admitted to trading on a regulated market, the issuer being, in the case of depository receipts representing securities, the issuer of the securities represented;

(2B) (in chapter 5 of DTR)

(a) a legal entity governed by private or public law, including a State whose shares are admitted to trading on a regulated market, the issuer being in the case of depositary receipts representing securities, the issuer of the shares represented; or

(b) a public company within the meaning of section 1(3) of the Companies Act 1985 and any other body corporate incorporated in and having a principal place of business in Great Britain, whose shares are admitted to trading on a market which (not being a regulated market) is a prescribed market.

(c)

management company

means a company as defined in article 1a(2) of Council Directive 85/611/EEC of 20 December 1985 on the co-ordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS).

market maker

means a person who holds himself out on the financial markets on a continuous basis as being willing to deal on own account by buying and selling financial instruments against his proprietary capital at prices defined by him.

market operator

a person or persons who manages and/or operates the business of a regulated market. The market operator may be the regulated market itself.

parent undertaking

(1) (in accordance with section 420 of the Act
...

(2) a parent undertaking within the meaning of (1) of a controlled undertaking.

regulated information

all information which an issuer, or any other person who has applied for the admission of financial instruments to trading on a regulated market without the issuer's consent, is required to disclose under:

(a) the Transparency Directive;

(b) article 6 of the Market Abuse Directive; or

(c) LR, and DTR.

Regulatory Information Service or RIS

~~A Regulatory Information Service that is approved by the FSA as meeting the Primary Information Provider criteria and that is on the list of Regulatory Information Services maintained by the FSA.~~

either:

- (a) a Regulated Information Service; or
- (b) an incoming information society service that is established in an EEA State other than the United Kingdom and that disseminates regulated information in accordance with the minimum standards set out in [article 12 of the TD implementing Directive].

Regulated Information Service

a Regulated Information Service that is approved by the FSA as meeting the Criteria for Regulated Information Services and that is on the list of Regulated Information Services maintained by the FSA.

regulated market

(in accordance with article 4(1)(14) of MiFID) a multilateral system operated and/or managed by a market operator, which brings together or facilitates the bringing together of multiple third-party buying and selling interests in financial instruments – in the system and in accordance with its non-discretionary rules – in a way that results in a contract, in respect of the financial instruments admitted to trading under its rules and/or systems, and which is authorised and functions regularly and in accordance with the provisions [Title III of MiFID].

share

- (1) (except in CIS, LR and DTR) ...
- (2) (in CIS) ...
- (3) (in DTR and LR, and in FEES where relevant to DTR or LR,) (in accordance with section 744 of the Companies Act 1985) a share in the share capital of a company, and includes:
 - (a) stock (except where a distinction between shares and stock is express or implied); and
 - (b) Preference shares; and
 - (c) in chapters 4, 5 and 6 of DTR a convertible share.

shareholder

- (1) (in relation to an ICVC, and subject to CIS 11.2.2R (Special meaning of shareholder)):
 - (a) (in relation to a share that is represented by a bearer certificate) the person who holds the certificate;
 - (b) (in relation to a share that is not represented by a bearer certificate) the person whose name is entered on the register in relation to that share;
- (2) (in relation to chapters 5 [] of DTR) any natural person or legal entity governed by private or public law, who holds directly or indirectly:

- (a) shares of the issuer in its own name and on its own account;
- (b) shares of the issuer in its own name, but on behalf of another natural person or legal entity;
- (c) depository receipts, in which case the holder of the depository receipt shall be considered as the shareholder of the underlying shares represented by the depository receipts.

third country investment firm

a firm which would be a MiFID investment firm if it had its head office in the EEA;

trading day

a day included in the calendar of trading days published by FSA at www.fsa.gov.uk;

transferable securities

(as defined in section 102A of the Act) anything which is a transferable security for the purposes of ~~the investment services directive~~ MiFID, other than money-market instruments for the purposes of that directive which have a maturity of less than 12 months.

Transparency Directive/TD

the European Parliament and Council Directive on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market or through a comparable mechanism for the disclosure of information under national requirements of a Member State concerning the dissemination of information (No. 2004/109/EC).

Transparency rules

(in accordance with section 73A(6) of the Act) rules relating to the notification and dissemination of information in respect of issuers of transferable securities and relating to major shareholdings.

TD implementing Directive

Commission Directive implementing Directive 2004/109/EC of the European Parliament and of the Council laying down rules for the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market (No.2006/xx/EC);

Annex B

Amendments to the Listing Rules

In this Annex underlining indicates new text and striking through indicates deleted text. Sections that are deleted in their entirety are marked '[deleted]'.

(1)	(2) <u>Material to which the Transitional provisions applies</u>	(3)	(4) <u>Transitional provision</u>	(5) <u>Transitional Provision: dates in force</u>	(6) <u>Handbook Provision coming into force</u>
1	<u>All of the amendments to LR set out in this Annex</u>	R	<p><u>All of the amendments to LR set out in this Annex shall have effect as follows:</u></p> <p><u>(a) an issuer whose financial year starts on or after 20 January 2007 must comply with these amendments as of 20 January 2007; and</u></p> <p><u>(b) an issuer whose financial year starts before 20 January 2007 must comply with these amendments as of the start of its next financial year.</u></p>	<u>From 20 January 2007</u>	

1.4 Miscellaneous

...

Equivalent information

1.4.4 R ~~An issuer whose securities are listed on an overseas investment exchange operating in a non-EEA state, must notify to a RIS information equivalent to that notified to the market of the non-EEA state if the information may be of importance to evaluate the securities listed by the FSA. [Note: Articles 69 and 82-CARD] [deleted]~~

1.4.5 G ~~The information required under LR 1.4.4R is in addition to information that is required to be disclosed under the disclosure rules. [deleted]~~

...

Electronic Communication

- 1.4.9 R (1) If the *listing rules* require an *issuer* to send documents to its *security*
G holders, the *issuer* may, in accordance with *DTR 6.1.8R*, use
electronic means to send those documents.

~~If the *listing rules* require an *issuer* to send documents to its *security* holders in the *United Kingdom*, the *issuer* is taken to comply with the requirement for any specific holder if:~~

- ~~(1) the *issuer* and the *security* holder have agreed to the use of electronic communication for sending copies of documents to the holder and:~~
- ~~(a) the documents are documents to which the agreement applies; and~~
 - ~~(b) copies of the documents are sent using electronic communication to such address, number or other location as may for the time being be notified by the holder to the *issuer* for that purpose; or~~
- ~~(2) the *issuer* and the *security* holder have agreed to the holder having access to documents on a website (instead of the documents being sent to the holder) and: [deleted]~~
- ~~(a) the documents are documents to which the agreement applies; and~~
 - ~~(b) the holder is notified in a manner for the time being agreed for the purpose between the holder and the *issuer*, of:~~
 - ~~(i) the publication of the documents on a website;~~
 - ~~(ii) the address of that website;~~
 - ~~(iii) the place on that website where the documents may be accessed and how they may be accessed;~~
 - ~~(iv) the period of time for which the documents will be available on the website, which must be for a period of not less than 21 days from the date of notification or, if later, until the conclusion of any general meeting to which the documents relate; and~~

- (e) ~~the documents are published on that website throughout the period referred to in paragraph (b)(iv), provided that, if the documents are published on that website for a part but not all of that period, the documents will be treated as published throughout that period if the failure to publish those documents throughout the period is wholly attributable to circumstances which it would not be reasonable to have expected the issuer to prevent or avoid.~~

1.4.10 R ~~If an issuer makes use of LR 1.4.9R, it must make the documents available during normal business hours to security holders for a period of not less than 21 days from the date of communication or notification or, if later, until the conclusion of any general meeting to which the documents relate, in printed form and free of charge in sufficient numbers to satisfy demand from security holders at: [deleted]~~

(1) ~~the issuer's registered office in the United Kingdom (if any); and~~

(2) ~~the offices of any paying agent of the issuer in the United Kingdom.~~

9.1 Preliminary

...

Application: Preference shares

9.1.2 R A company that has a primary listing of preference shares must comply with:

(1) LR 9.2.1R to LR 9.2.6BR;

(2) LR 9.2.11R to LR 9.2.12G;

(3) LR 9.2.14R to LR 9.2.17G;

(4) LR 9.3.1R to LR 9.3.10G;

(5) LR 9.5.1R to LR 9.5.9R;

- (6) *LR 9.6.1R to LR 9.6.4R*;
- (7) *LR 9.6.6R*;
- (8) *LR 9.6.11R*;
- (9) *LR 9.6.19R to LR 9.6.22G*;
- (10) *LR 9.7A*; and
- (11) *LR 9.8*, but not:
 - (a) *LR 9.8.4R(3)*;
 - (b) ~~*LR 9.8.4R(5) and (6)*~~; [deleted]
 - (c) ~~*LR 9.8.4R(12) and (13)*~~; [deleted]
 - (d) *LR 9.8.6R(6) and (7)*; and
 - (e) *LR 9.8.8R*; and.
- (12) ~~*LR 9.9*~~; [deleted]

9.1.2A G For the purposes of compliance with the *transparency rules*, the *FSA* considers that a *listed company* that issues *preference shares* should comply with *DTR 4 (Periodic financial reporting)*, *DTR 5 (Vote holder and issuer notification rules)* and *DTR 6 (Access to information)* as if it were an issuer of debt securities as defined in the *transparency rules*.

Application: securities convertible into equity shares

- 9.1.3 R *A company that has a primary listing of securities convertible into equity shares must comply with:*
- (1) *LR 9.2.1R to LR 9.2.6BR*;
 - (2) *LR 9.2.11R*;
 - (3) *LR 9.2.13G*;
 - (4) ~~*LR 9.3.1R to LR 9.3.5R*~~; [deleted]
 - (5) *LR 9.5.11R to LR 9.5.12R*;

- (6) *LR 9.5.15R to LR 9.5.16R;*
- (7) *LR 9.6.1R;*
- (8) *LR 9.6.3R;*
- (9) *LR 9.6.4R to LR 9.6.6R;*
- (10) *LR 9.6.19R to LR 9.6.22G; and*
- (11) *LR 9.8 but not:*
 - (a) *LR 9.8.4R(3);*
 - ~~(b) *LR 9.8.4R(5) and (6);*~~
 - ~~(c) *LR 9.8.4R(12) and (13);*~~
 - (d) *LR 9.8.6R(6) and (7); and*
 - (e) *LR 9.8.8R.*

...

9.2 Requirements with continuing application

...

Registrar

- 9.2.4 R ~~*A listed company must appoint a registrar in the United Kingdom unless it provides financial services and itself performs the functions of a registrar in the United Kingdom. [Note: Article 65(2) CARD] [deleted]*~~

Compliance with the disclosure rules and transparency rules

- 9.2.5 G *A listed company, whose securities are admitted to trading on a regulated market in the United Kingdom, should consider its obligations under DTR 2 (Disclosure and control of inside information by issuers).*

- 9.2.6 R *A listed company* that is not already required to comply with *DTR 2* (Disclosure and control of inside information by issuers) (or with corresponding requirements imposed by another *EEA Member State*) must comply with *DTR 2* as if it were an *issuer* for the purposes of the *disclosure rules*.
- 9.2.6A G *A listed company, whose securities are admitted to trading on a regulated market, should consider its obligations under DTR 4 (Periodic financial reporting), DTR 5 (Vote holder and issuer notification rules) and DTR 6 (Access to information).*
- 9.2.6B R *A listed company that is not already required to comply with the transparency rules* (or with corresponding requirements imposed by another *EEA Member State*) must comply with *DTR 4, DTR 5* and *DTR 6* as if it were an *issuer* for the purposes of the *transparency rules*.

...

Amendments to constitution

- 9.2.14 R ~~*A listed company* must lodge two copies of any proposed amendment to its *constitution* with the *FSA* no later than when it sends the notice convening the meeting to decide on the amendment. [Note: Article 66 *CARD*] [deleted]~~

...

9.3 Continuing obligations - holders

Equality of treatment

- 9.3.1 R ~~*A listed company* must ensure equality of treatment for all holders of *listed equity securities* or *listed preference shares* who are in the same position. [Note: Article 65(1) *CARD*] [deleted]~~
- 9.3.2 G ~~*LR 9.3.1R* includes the obligation to post all *circulars* to overseas holders. [deleted]~~

Prescribed information to holders

- 9.3.3 R ~~*A listed company* must ensure that at least in each *EEA State* in which its *equity securities* or *preference shares* are listed all the necessary facilities and information are available to enable holders to exercise their rights. In particular it must: [deleted]~~

- (1) inform holders of meetings which they are entitled to attend;
- (2) enable them to exercise their vote, where applicable; and
- (3) ~~publish notices or distribute circulars giving information on:~~
 - (a) ~~the allocation and payment of dividends and/or interest;~~
 - (b) ~~the issue of new *securities*, including arrangements for the allotment, subscription, conversion or exchange of such *securities*; and~~
 - (c) ~~redemption or repayment of the *securities*. [Note: Article 65(2) *CARD*]~~

Use of airmail and first class mail

9.3.4 R ~~Where available, airmail or an equivalent service that is no slower must be used when sending documents to holders of *listed equity securities* or *listed preference shares in non-EEA States*. [deleted]~~

9.3.5 R ~~Where available, first class mail or an equivalent service that is no slower must be used when sending documents to holders of *listed equity securities* or *listed preference shares in the United Kingdom and other EEA States*. [deleted]~~

...

Communications with holders of bearer shares

9.3.8 R (1) ~~A *listed company* required to communicate with holders of its *listed bearer shares* must publish an advertisement in at least one national newspaper referring to the communication and giving the address or addresses from which copies of the communication can be obtained. [deleted]~~

(2) ~~A *listed company* is not required to comply with paragraph (1) if:~~

(a) ~~the *listed bearer shares* are in global form; and~~

(b) ~~the *listed company* can confirm that notices will be transmitted as soon as possible to all holders.~~

...

9.6 Notifications

Notifications relating to capital

- 9.6.4 R *A listed company must notify a RIS as soon as possible (unless otherwise indicated in this rule) of the following information relating to its capital:*
- (1) any proposed change in its capital structure including the structure of its *listed debt securities*, save that an announcement of a new issue may be delayed while marketing or underwriting is in progress;
 - (2) ~~any change in the rights attaching to any class of its *listed shares* or to any of its *listed equity securities* which are convertible into *equity shares*; [deleted]~~
 - (3) any redemption of *listed shares* including details of the number of *shares* redeemed and the number of *shares* of that class outstanding following the redemption;
 - (4) any extension of time granted for the currency of temporary documents of title; and
 - (5) ~~the effect, if any, of any issue of further *securities* on the terms of exercise of rights under options, warrants and other *securities* convertible into *equity shares*; and [deleted]~~
 - (6) the results of any new issue of *equity securities* or *preference shares* or of a public offering of existing *shares* or other *equity securities*.

- 9.6.5 R ~~*A listed company must notify a RIS as soon as possible of the basis of equity securities offered:* [deleted]~~

- (1) ~~generally to the public for cash; or~~
- (2) ~~by way of an *open offer* to shareholders.~~

...

~~Notification of major interests in shares~~

- 9.6.7 R ~~*A listed company must notify a RIS as soon as possible and in any event by the end of the *business day* following receipt of the information, of any information disclosed to it in accordance with sections 198 to 208 of the Companies Act 1985 (relating to the obligation to disclose certain major interests in the share capital of a company). The notification must also include the following details:* [deleted]~~

- (1) ~~the date on which the information was disclosed to the *company*; and~~
- (2) ~~the date on which the transaction was effected, if known.~~

9.6.8 R ~~A *listed company* must notify a *RIS* as soon as possible and in any event by the end of the *business day* following receipt of the information, of any information obtained by it pursuant to section 212 of the Companies Act 1985 (relating to persons interested in shares) or otherwise, where it is apparent that an interest exists or has been increased or reduced or ceased to exist and should have been disclosed under sections 198 to 208 of the Companies Act 1985 but has not previously been disclosed. [deleted]~~

Note: ~~A *listed company* may use the form entitled Notification of Major Interests in Shares to make the notifications required by *LR 9.6.7R* and *LR 9.6.8R*. The Notification of Major Interests in Shares form can be found on the UKLA section of the *FSA's* website.~~

9.6.9 G ~~The requirement to make a notification under *LR 9.6.7R* and *LR 9.6.8R* will be deemed to be discharged if the relevant interest has been notified to a *RIS* pursuant to the disclosure provisions of the *Takeover Code* or the *SARs*. [deleted]~~

9.6.10 G ~~An *overseas company* with a *primary listing* should notify a *RIS* as soon as possible of information equivalent to that required by *LR 9.6.7R* and *LR 9.6.8R* whenever it becomes aware of such information. [**Note:** Article 68 *CARD*] [deleted]~~

...

LR 9.7 is deleted in its entirety and is replaced with *LR 9.7A*.

9.7A Preliminary statement of annual results, statement of dividends and half-yearly reports

Preliminary statement of annual results

9.7A.1 R If a *listed company* prepares a preliminary statement of annual results:

- (1) the statement must be published as soon as possible after it has been approved by the board;
- (2) the statement must be agreed with the *company's* auditors prior to publication;

- (3) the statement must show the figures in the form of a table, including the items required for a half-yearly report, consistent with the presentation to be adopted in the annual accounts for that financial year;
- (4) the statement must give details of the nature of any likely modification that may be contained in the auditors report required to be included with the annual financial report; and
- (5) the statement must include any significant additional information necessary for the purpose of assessing the results being announced.

Statement of dividends

9.7A.2 R A listed company must notify a RIS as soon as possible after the board has approved any decision to pay or make any dividend or other distribution on listed equity or to withhold any dividend or interest payment on listed securities giving details of:

- (1) the exact net amount payable per share;
- (2) the payment date;
- (3) the record date (where applicable); and
- (4) any foreign income dividend election, together with any income tax treated as paid at the lower rate and not repayable.

Omission of information

9.7A.3 G The FSA may authorise the omission of information required by LR 9.7A.1R or LR 9.7A.2R if it considers that disclosure of such information would be contrary to the public interest or seriously detrimental to the listed company, provided that such omission would not be likely to mislead the public with regard to facts and circumstances, knowledge of which is essential for the assessment of the shares.

9.8 Annual financial report and ~~accounts~~

~~Publication of annual report and accounts~~

- 9.8.1 R (1) ~~A listed company must publish its annual report and accounts as soon as possible after they have been approved. [deleted]~~
- (2) ~~A listed company must approve and publish its annual report and accounts within six months of the end of the financial period to which they relate.~~
- 9.8.2 R ~~The annual report and accounts must: [deleted]~~
- (1) ~~have been prepared in accordance with the listed company's national law and, in all material respects, with national accounting standards or IAS;~~
- (2) ~~have been independently audited and reported on, in accordance with:~~
- (a) ~~the auditing standards applicable in an EEA State; or~~
- (b) ~~an equivalent auditing standard;~~
- (3) ~~be in consolidated form if the company has subsidiary undertakings; and~~
- (4) ~~if they do not give a true and fair view of the state of affairs, profit or loss and cash flows of the group, provide more detailed and additional information. [Note: Article 67 CARD]~~
- 9.8.3 R ~~A listed company must publish both own accounts and consolidated accounts if the own accounts contain additional significant information. [Note: Article 67(2) CARD] [deleted]~~

Information to be included in annual report and accounts

- 9.8.4 R In addition to the requirements set out in DTR 4.1 the annual report and accounts a listed company must include in its annual financial report, where applicable, the following:
- (1) ...
- ...

Additional information

9.8.6 R In the case of a *listed company* incorporated in the *United Kingdom*, the following additional items must be included in its annual financial report ~~and accounts~~:

(1) ...

...

LR 9.9 is deleted in its entirety.

...

LR 9 – Annex 1G

Table: The Model Code

Introduction

This code imposes restrictions on dealing in *securities* of a *listed company* beyond those imposed by law ...

Definitions

(1) In this code the following definitions, in addition to those contained in the *listing rules*, apply unless the context requires otherwise:

(a) "*close period*" means:

(i) the period of 60 days immediately preceding ~~a the~~ preliminary announcement of the *listed company's* annual results...; and

(ii) the period of 60 days immediately preceding the publication of its annual financial report or if shorter the period from the end of the relevant financial year up to and including the time of such publication;

~~(ii) if the *listed company* reports on a half yearly basis, the period of 60 days immediately preceding the publication of the half yearly report, in accordance with LR 9.9.3R or, if shorter the period from the end of the relevant financial period up to and including the time of such publication; ~~or~~ and~~

- (iv) if the *listed company* reports on a quarterly basis (or publishes interim management statements) the period of 30 days immediately preceding the announcement of the quarterly results (or interim management statement) or , if shorter ...

...

14.3 Continuing obligations

...

~~Amendments to constitution~~

- 14.3.5 R ~~An overseas company must lodge two copies of any proposed amendment to its constitution with the FSA by no later than when it sends the notice convening the meeting to decide on the amendment. [Note: Article 66 CARD] [deleted]~~

...

~~Equality of treatment~~

- 14.3.12 R ~~An overseas company must ensure equality of treatment for all holders of its equity securities who are in the same position. [Note: Article 65(1) CARD] [deleted]~~

- 14.3.13 G ~~LR 14.3.12R includes the obligation to post all circulars to overseas holders. [deleted]~~

~~Prescribed information to holders~~

- 14.3.14 R ~~An overseas company must ensure that at least in each EEA state in which its equity securities are listed all the necessary facilities and information are available to enable holders to exercise their rights. In particular it must: [deleted]~~

- ~~(1) inform holders of meetings which they are entitled to attend;~~
- ~~(2) enable them to exercise their vote, where applicable; and~~
- ~~(3) publish notices or distribute circulars giving information on:~~

- (a) ~~the allocation and payment of dividends and/or interest~~
- (b) ~~the issue of new *equity securities*, including arrangements for the allotment, subscription, conversion or exchange of such *securities*; and~~
- (e) ~~redemption or repayment of the *equity securities*. [Note: Article 65(2) CARD]~~

Registrar

14.3.15 R (1) This rule applies to an overseas company for whom the United Kingdom is a host Member State for the purposes of the Transparency Directive.

(2) An overseas company must appoint a registrar in the United Kingdom if:

- (a) there are 200 or more holders resident in the United Kingdom; or
- (b) 10% or more of the *equity securities* are held by persons resident in the United Kingdom.

14.3.15 A G An overseas company for whom the United Kingdom is the home Member State for the purposes of the Transparency Directive should see LR 14.3.22G and LR 14.3.23R.

14.3.16 G ~~An overseas company is not required to comply with LR 14.3.15R if the company provides financial services and itself performs the functions of a registrar in the United Kingdom. [Note: Article 65(2) CARD] [deleted]~~

Notifications relating to capital

14.3.17 R An overseas company must notify a RIS as soon as possible (unless otherwise indicated in this rule) of the following information relating to its capital:

- (1) any proposed change in its capital structure including the structure of its *listed debt securities*, save that an announcement of a new issue may be delayed while marketing or underwriting is in progress;
- (2) ~~any change in the rights attaching to any class of its *listed equity securities* or to any of its *securities* which are convertible into *equity shares*; [deleted]~~

- (3) any redemption of *listed equity securities* including details of the number of *equity securities* redeemed and the number of *equity securities* of that *class* outstanding following the redemption;
- (4) ~~the basis of *equity securities* offered: [deleted]~~
 - (a) ~~generally to the public for cash; or~~
 - (b) ~~by way of an *open offer* to shareholders;~~
- (5) any extension of time granted for the currency of temporary documents of title;
- (6) ~~the effect, if any, of any issue of further *securities* on the terms of exercise of rights under options, warrants and other securities convertible into *equity shares*; and [deleted]~~
- (7) the results of any new issue of *listed equity securities* or of a public offering of existing *shares* or other *equity securities*.

...

Notification of major interests in shares

- 14.3.19 R (1) ~~An *overseas company* that is incorporated in a *non-EEA state* must notify a *RIS* of the information set out in paragraph (2) when it becomes aware that a *person* or entity has acquired or disposed of a number of *shares* in the *overseas company* such that the *person's* or entity's holding of the voting rights of the *company* (determined in accordance with Article 92 *CARD*) reaches, exceeds or falls below 10%, 20%, one third or 50% and two thirds of the total voting rights. [deleted]~~
- (2) ~~The information to be notified to a *RIS* is:~~
- (a) ~~the proportion of voting rights held; and~~
 - (b) ~~the date on which the *company* became aware of the acquisition or disposal. [Note: Article 68(3) *CARD*]~~
- 14.3.20 R ~~The notification required by *LR 14.3.19R* must be made as soon as possible and in any event by 7.30 a.m. on the *business day* following the date on which the *company* becomes aware of the acquisition or disposal. [deleted]~~

- 14.3.21 R ~~An overseas company that is incorporated in an EEA state must notify a RIS as soon as possible and in any event by 7.30 a.m. on the business day following receipt of the information of details of the interests of which the company is aware in the shares of the company as communicated to the company pursuant to the law of its country of incorporation and (if different) the requirements of the competent authority of the EEA state where the company has a listing. [Note: Article 68(3) CARD] [deleted]~~

Compliance with the transparency rules

- 14.3.22 G An overseas company, whose securities are admitted to trading on a regulated market, should consider its obligations under DTR 4 (Periodic financial reporting), DTR 5 (Vote holder and issuer notification rules) and DTR 6 (Access to information).
- 14.3.23 R A listed company that is not already required to comply with the transparency rules (or with corresponding requirements imposed by another EEA Member State) must comply with DTR 4, DTR 5 and DTR 6 as if it were an issuer for the purposes of the transparency rules.

LR 14.4 is deleted in its entirety.

- 17.3 Requirements with continuing application

...

- ~~17.3.3 Equality of treatment [deleted]~~

~~An issuer must ensure equal treatment for all holders of its listed securities of the same class in respect of all rights attaching to such securities. [Note: Article 78(1) CARD]~~

Annual accounts

- 17.3.3A R LR 17.3.4R to LR 17.3.6G apply to an issuer that is not already required to comply with DTR 4.
- 17.3.4 R (1) An issuer must publish its annual report and annual accounts as soon as possible after they have been approved. ~~[Note: Article 80(1) CARD]~~

- (2) An *issuer* must approve and publish its annual report and accounts within six months of the end of the financial period to which they relate.
- (3) The annual report and accounts must:
 - (a) have been prepared in accordance with the issuer's national law and, in all material respects, with national accounting standards or IAS; and
 - (b) have been independently audited and reported on, in accordance with:
 - (i) the auditing standards applicable in an EEA State; or
 - (ii) an equivalent auditing standard.

- 17.3.5 G (1) If an *issuer* prepares both own and consolidated annual accounts it may publish either form provided that the unpublished accounts do not contain any significant additional information. [~~Note: Article 80(2) CARD~~]
- (2) If the annual accounts do not give a true and fair view of the assets and liabilities, financial position and profits or losses of the *issuer* or *group*, additional information must be provided to the satisfaction of the FSA. [~~Note: Article 80(3) CARD~~]
- (3) An *issuer* incorporated or established in a *non-EEA State* which is not required to draw up its accounts so as to give a true and fair view but is required to draw them up to an equivalent standard, may draw up its accounts to this equivalent standard.

- 17.3.6 G An *issuer* that meets the following criteria is not required to comply with LR 17.3.4R:
- (1) ~~the issuer is an issuer of asset backed securities and is not required to comply with any other requirement for the publications of annual report and accounts; or~~ The issuer is an issuer of asset backed securities and would if it were a debt issuer to which DTR 4 applied be relieved of the obligations to draw up and publish annual, half yearly financial reports and interim management statements in accordance with DTR 4.4.2R provided the issuer is not otherwise required to comply with any other requirement for the publication of annual reports and accounts.

- (2) (a) the *issuer*:

- (i) is a wholly owned subsidiary of a *listed company*;
 - (ii) issues *listed securities* that are unconditionally and irrevocably guaranteed by the *issuer's listed holding company* or equivalent arrangements are in place;
 - (iii) is included in the consolidated accounts of its *listed holding company*; and
 - (iv) is not required to comply with any other requirement for the preparation of annual report and accounts; and
- (b) non publication of the *issuer's* accounts would not be likely to mislead the public with regard to facts and circumstances that are essential for assessing the securities.

Paying agent

- 17.3.7 R ~~An issuer must appoint and retain a paying agent in the United Kingdom until the date on which the listed securities are finally redeemed unless the issuer: [deleted]~~
- ~~(1) provides financial services; and~~
 - ~~(2) itself performs the functions of a paying agent in the United Kingdom. [Note: Article 78(2) CARD]~~

Disclosure Rules and Transparency Rules

- 17.3.8 G An issuer, whose securities are admitted to trading on a regulated market in the United Kingdom, should consider its obligations under *DTR 2* (Disclosure and control of inside information by issuers).
- 17.3.9 R An issuer that is not already required to comply with *DTR 2* must comply with *DR 2* as if it were an issuer for the purposes of the disclosure rules.
- 17.3.9A G An issuer, whose securities are admitted to trading on a regulated market, should consider its obligations under *DTR 4* (Periodic financial reporting), *DTR 5* (Vote holder and issuer notification rules) and *DTR 6* (Access to information).
- 17.3.9B R An issuer that is not already required to comply with the transparency rules must comply with *DTR 6.3* as if it were an issuer for the purposes of the transparency rules.

...

Amendments to constitution

17.3.11 R ~~An issuer must submit two copies of any proposed amendment to its constitution that affects the rights of securities holders to the FSA by no later than when it sends the notice convening the meeting to decide on the amendment. [Note: Article 79 CARD]~~

...

17.4 Disclosures [deleted]

17.4.1 R ~~An issuer must notify a RIS as soon as possible of: [deleted]~~

- ~~(1) any new issues and guarantee or security related to such new issues; [Note: Article 81 CARD]~~
- ~~(2) any change of guarantor or security of its listed securities where this information is important for the purposes of assessing the securities in question;~~
- ~~(3) any change in the rights attaching to listed securities (including any change in loan terms or in the rate of interest carried by the listed securities); [Note: Article 81 CARD]~~
- ~~(4) when any document has been submitted to the FSA for publication through the document viewing facility under LR 17.3.1R, unless the full text of the document is provided to a RIS;~~
- ~~(5) any change of paying agent in the United Kingdom; and~~
- ~~(6) the publication of:
 - ~~(a) its annual report and accounts;~~
 - ~~(b) in the case of debt securities guaranteed by another company, the annual report and accounts of the company that is providing the guarantee unless that company is listed or adequate information is otherwise available; and~~
 - ~~(c) in the case of convertible securities which are exchangeable for securities of another company, the annual report and accounts of that other company unless that company is listed or adequate information is otherwise available.~~~~

Disclosure to holders: exercise of rights

- 17.4.2 R ~~An issuer must ensure that at least in each EEA state in which its securities are listed, all the necessary facilities and information are available to enable holders of such securities to exercise their rights. In particular, it must:~~
[deleted]
- ~~(1) inform holders of meetings which they are entitled to attend;~~
 - ~~(2) enable them to exercise their vote, where applicable; and~~
 - ~~(3) publish notices or distribute circulars giving information on:~~
 - ~~(a) the payment of interest in respect of such securities; and~~
 - ~~(b) the exercise of any conversion, exchange, subscription or renunciation rights and repayment of its securities. [Note: Article 78(2) CARD]~~
- 17.4.3 R ~~An issuer of bearer securities must comply with LR 17.4.2R by publishing an advertisement in at least one national newspaper in the United Kingdom.~~
[deleted]
- 17.4.4 G ~~An issuer of bearer securities is not required to comply with LR 17.4.3R if:~~
[deleted]
- ~~(1) the securities are in global form; and~~
 - ~~(2) the issuer can confirm that notices will be transmitted without delay to all holders.~~

Communications with holders

- 17.4.5 R (1) ~~An issuer must notify a RIS of all notices to holders of its listed securities no later than the date the notices are sent to holders.~~
[deleted]
- (2) ~~An issuer must submit to the FSA draft copies of any proposed amendment to its constitution which would affect the rights of holders. [Note: Article 79 CARD]~~

Disclosure: convertible and guaranteed securities

- 17.4.6 R ~~Any changes to conversion rights attaching to convertible securities must be notified to a RIS as soon as possible. [Note: Article 81 CARD] [deleted]~~

17.5 Requirements for states, regional and local authorities and public international bodies

- 17.5.1 R This chapter does not apply to a state, a regional or local authority and a *public international body with listed debt securities* except that such an *issuer* must comply with:
- (1) ~~LR 17.3.2R (Admission to trading);~~
 - (2) ~~LR 17.3.3R (Equality of treatment);~~
 - (3) ~~LR 17.4.1R(3) (Disclosures to be made without delay to an RIS); and~~
 - (4) ~~LR 17.4.2R to LR 17.4.4G (Disclosure to holders—exercise of rights).~~

Compliance with transparency rules

- 17.5.2 R (1) This rule applies to a state, a regional or local authority and a *public international body with listed debt securities* for whom the *United Kingdom* is its home Member State for the purposes of the *Transparency Directive*.
- (2) An issuer referred to in paragraph (1) that is not already required to comply with the *transparency rules* must comply with:
- (a) DTR 5.6.3R (disclosure of changes in rights);
 - (b) DTR 6.1.2R (amendments to constitution);
 - (c) DTR 6.1.3R(2) (equality of treatment);
 - (d) DTR 6.2 (Filing information and use of language); and
 - (e) DTR 6.3 (Dissemination of information).

18.4 Continuing obligations

- 18.4.1 R An issuer of debt securities which the certificates represent must comply with the continuing obligations set out in LR 17.3 (Requirements with continuing application) ~~and LR 17.4 (Disclosures)~~ in addition to the

requirements of this section.

...

- 18.4.3 R *An overseas company that is the issuer of the equity shares which the certificates represent must comply with:*
- (1) the requirements of this section;
 - (2) the continuing obligations set out in *LR 14.3 (Continuing obligations)* and ~~*LR 14.4 (Continuing obligations — financial information)*~~; and
 - (3) *DTR 2 (Disclosure and control of inside information by issuers)*, as if it were an *issuer* for the purposes of the *disclosure rules*.

...

Compliance with Transparency Rules

- 18.4.7 G *An issuer, whose securities are admitted to trading on a regulated market, should consider its obligations under DTR 4 (Periodic financial reporting), DTR 5 (Vote holder and issuer notification rules) and DTR 6 (Access to information).*
- 18.4.9 R *An issuer that is not already required to comply with the transparency rules must comply with DTR 6.3 as if it were an issuer for the purposes of the transparency rules.*

19.4 Continuing obligations

...

~~Equality of treatment~~

- 19.4.4 ~~*An issuer must ensure equal treatment for all holders of listed securitised derivatives of the same series in respect of all rights attaching to such securitised derivatives.* [deleted]~~

~~Annual accounts~~

- 19.4.5 R (1) ~~An issuer must publish its annual accounts as soon as possible after they have been approved. [deleted]~~
- (2) ~~An issuer must approve and publish its annual accounts within six months of the end of the financial period to which they relate.~~
- 19.4.6 R (1) ~~Annual accounts must be drawn up and be independently audited. [deleted]~~
- (2) ~~If an issuer prepares both own and consolidated annual accounts, it may publish either form provided that the unpublished accounts do not contain any significant additional information.~~
- ...
- 19.4.8 R ~~The FSA may dispense with LR 19.4.5R and LR 19.4.6R if: [deleted]~~
- (1) ~~the issue is guaranteed;~~
- (2) ~~the guarantor is a listed company;~~
- (3) ~~the issuer is included in the consolidated accounts of the guarantor;~~
- (4) ~~no other requirement for the preparation of annual reports and accounts exists; and~~
- (5) ~~non-publication of the issuer's accounts would not be likely to mislead the public with regard to facts and circumstances, knowledge of which is essential for the assessment of the securitised derivatives in question.~~

Paying agent

- 19.4.9 R ~~An issuer must maintain a paying agent in the United Kingdom until the maturity date of the securitised derivatives unless the issuer: [deleted]~~
- (1) ~~provides financial services; and~~
- (2) ~~itself performs the function of a paying agent in the United Kingdom.~~
- ...

Disclosure rules and transparency rules

- 19.4.11 R An issuer must comply with DTR 2.1 to DTR 2.7 as if it were an issuer for

the purposes of the *disclosure rules*.

- 19.4.11 A G An issuer, whose securities are admitted to trading on a regulated market, should consider its obligations under DTR 4 (Periodic financial reporting), DTR 5 (Vote holder and issuer notification rules) and DTR 6 (Access to information).
- 19.4.11B R For the purposes of compliance with the transparency rules, the FSA considers that an issuer of securitised derivatives should comply with DTR 4, DTR 5 and DTR 6 as if it were an issuer of debt securities as defined in the transparency rules.
- 19.4.11C G An issuer that is not already required to comply with the transparency rules must comply with DTR 6.3 as if it were an issuer for the purposes of the transparency rules.

19.5 Disclosures

...

Changes to rights

- 19.5.2 R ~~Any change in the rights attaching to listed securitised derivatives must be notified to a RIS as soon as possible. [deleted]~~
- 19.5.3 R ~~An issuer must notify a RIS as soon as possible of: [deleted]~~
- (1) ~~any new issues and guarantee or security related to such new issues; and~~
 - (2) ~~any change of guarantor or security for the securitised derivatives where this information is important for the purposes of assessing the securities in question.~~

Annual accounts

- 19.5.4 R ~~Immediately following the publication of its annual accounts an issuer must notify a RIS of where securitised derivative holders can obtain a copy of the annual accounts free of charge. [deleted]~~
- 19.5.5 R ~~Where an issuer has been granted a dispensation under LR 19.4.8R from publishing annual accounts, it must notify a RIS once the accounts have been published of where securitised derivative holders can obtain a copy of the~~

~~guarantor's accounts free of charge. [deleted]~~

~~Communications with holders~~

- 19.5.6 R ~~All notices to holders must be made either by: [deleted]~~
- ~~(1) publishing an advertisement in at least one national newspaper circulating in the *United Kingdom*;~~
 - ~~(2) despatch of the notice to the holders registered address; or~~
 - ~~(3) sending the notice electronically to the holder's e-mail address.~~

~~...~~

~~Paying agent~~

- 19.5.8 R ~~Any change of paying agent within the *United Kingdom* must be notified to a *RIS* as soon as possible. [deleted]~~

Annex C

Amendments to the Disclosure Rules

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

Insert the following transitional provision.

Disclosure and transparency rules

DTR Sourcebook – Transitional Provisions

(1)	(2) Material to which the Transitional provisions applies	(3)	(4) Transitional provision	(5) Transitional Provision: dates in force	(6) Handbook Provision: coming into force
1	All of <i>DTR</i> chapter 4	R	<p><i>DTR</i> 4 shall have effect as follows:</p> <p>(a) an <i>issuer</i> whose financial year begins on or after 20 January 2007 must comply with <i>DTR</i> 4 as of 20 January 2007; and</p> <p>(b) an <i>issuer</i> whose financial year starts before 20 January 2007 must comply with <i>DTR</i> 4 as of the beginning of its next financial year.</p>	From 20 January 2007	
2	<i>DTR</i> 4.2	R	<p>(1) This provision applies to an <i>issuer</i> of <i>debt securities</i> which were admitted to the <i>official list</i> before 1 January 2005 pursuant to Chapter 23 of the Listing Rules.</p> <p>(2) An <i>issuer</i> need not disclose its half-yearly financial report in accordance with <i>DTR</i> 4.2.</p> <p>(3) This provision has effect for 10 years following 1 January 2005.</p> <p>[Note: article 30.4 TD]</p>	From 20 January 2007 till 10 years following 1 January 2005.	
3	4.1.6 and 4.2.4	R	An <i>issuer</i> need not prepare its financial statement in accordance with <i>DTR</i> 4.1.6R or <i>DR</i> 4.2.4R for	From 20 January 2007	

			<p>any financial year beginning before 1 January 2007 if:</p> <p>(a) the <i>issuer's</i> registered office is in a <i>non-EEA State</i>; and</p> <p>(b) the <i>issuer</i> prepares its financial statements in accordance with internationally accepted standards.</p> <p>[Note: article 23.2 TD]</p>		
4	4.2.4	R	<p>(1) This provision applies to an <i>issuer</i>:</p> <p>(a) whose <i>debt securities</i> only are <i>admitted to trading</i>; and</p> <p>(b) whose <i>Home State</i> is the <i>United Kingdom</i>.</p> <p>(2) An <i>issuer</i> is not required to disclose financial statements in accordance with <i>DTR 4.2.4R(1)</i> for the financial year beginning on or after 1 January 2006.</p> <p>[Note: article 30.1 TD]</p>	From 20 January 2007	
5	4.1.6 and 4.1.8 to 4.1.11	R	<p>(1) This provision applies to an <i>issuer</i> of <i>debt securities</i>:</p> <p>(a) that is incorporated in a <i>non-EEA State</i>;</p> <p>(b) whose <i>Home State</i> is the <i>United Kingdom</i>; and</p> <p>(c) whose <i>debt securities</i> were <i>admitted to trading</i> in the <i>EEA</i> prior to 1 January 2005.</p> <p>(2) An <i>issuer</i> need not draw up its financial statements in accordance with <i>DTR 4.1.6R</i> or its management report in accordance with <i>DTR 4.1.8R</i> to <i>DTR 4.1.11R</i> provided:</p> <p>(a) the annual financial statements prepared by <i>issuers</i> from that <i>non-EEA State</i> give a true and fair view of the <i>issuer's</i> assets and liabilities, financial position and</p>	From 20 January 2007	

			<p>results;</p> <p>(b) the <i>non-EEA State</i> where the <i>issuer</i> is incorporated has not made mandatory the application of <i>IAS</i> or <i>IFRS</i>; and</p> <p>(c) the Commission has not taken any decision, in accordance with article 23.4(ii) of the <i>TD</i>, as to whether there is an equivalence between <i>IAS</i> and <i>IFRS</i> and:</p> <p>(i) the accounting standards laid down in the law, regulations or administrative provisions of the <i>non-EEA State</i> where the <i>issuer</i> is incorporated; or</p> <p>(ii) the accounting standards of the <i>non-EEA State</i> such an <i>issuer</i> has elected to comply with.</p> <p>[Note: article 30.3 TD]</p>		
6	5.6.1	R	<p>DTR 5.6.1 has effect as if it required, additionally, each <i>issuer</i> to make public (in the case of a <i>regulated market issuer</i> by publication to a <i>RIS</i>):</p> <p>(i) by not later than 31 December 2006 the total number of voting rights in respect of each class of <i>share</i> which it issues and which is admitted to trading on a <i>regulated market</i> or <i>UK prescribed market</i> and distinguishing the number of voting rights attaching to any shares held by the <i>issuer</i> in treasury;</p> <p>(ii) any subsequent alteration of that total number of voting rights and of voting rights attaching to treasury shares occurring between the date on which the disclosure in (i) is made and 20 January 2007.</p>	16 December 2006	
7	5.8.3	R	Notwithstanding <i>DTR 5.8.3</i> a <i>person</i> who, holds a notifiable percentage of	From 20	

			<p>voting rights, must notify the <i>issuer</i> by not later than 20 March 2007 of the percentage of voting rights he holds unless it has already made a notification in accordance with <i>DTR</i> 5.1.2R before that date.</p> <p>[TD article 30(2)]</p>	January 2007	
8	5.8.11	R	<p>Notwithstanding <i>DTR</i> 5.8.11, an <i>issuer</i> must disclose the information received under <i>TP</i> 7 by not later than 20 April 2007</p> <p>[TD article 30(2)]</p>	From 20 January 2007	
9	TP 7 and TP 8	G	<p>TP 7 and TP 8 are default provisions which will ensure that a <i>person</i> with a substantial proportion of voting rights which is at or above a threshold makes a notification to the <i>issuer</i> of those voting rights by not later than 20 March 2007 if such a <i>person</i> has not otherwise since 20 January 2006 made a notification at an earlier date (because for example of an acquisition or disposal of voting rights or because of a change in the total of voting rights in issue). Where such a notification is made the <i>issuer</i> must publish the information by not later than 20 April 2007.</p>		
10	All of <i>DTR</i> chapter 5	R	<p>(1)References to a <i>person</i> who is authorised under <i>MIFID</i> shall be taken as references to a <i>person</i> who is authorised under the <i>ISD</i>.</p> <p>(2)The reference in <i>DTR</i> 5.4.9R to portfolio management under point 4 of Section A of Annex 1 to <i>MiFID</i> shall be read as referring to the service of portfolio management under point 3 of Annex A of the <i>ISD</i>.</p>	From 20 January 2007 to 31 October 2007	
11	All of <i>DTR</i> chapter 5	R	<p>References to a <i>regulated market</i> shall be taken as references to a market as defined by point 13 of article 1 of the <i>ISD</i>.</p>	From 20 January 2007 to 31 October 2007	
12	6.1.8(1)	R	<p>In the case of an <i>issuer</i> which is a company within the meaning of the</p>	From 20	

		Companies Act 2006, nothing in <i>DTR</i> 6.1.8R (1) requires a decision to use electronic means to convey information to holders to be taken in a general meeting to the extent to which the <i>issuer</i> could lawfully use such means before 20 January 2007.	January 2007	
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Amend Chapter 1 of *DTR* as follows:

1 Introduction

1.1 Application and purpose (*Disclosure rules*) ...

Insert new Chapter 1A as follows (all new text):

1A Introduction (*Transparency rules*)

1A.1 Application and purpose (*Transparency rules*)

1A.1.1 G The application of Chapters 4, 5 and 6 of *DTR* is set out at the beginning of each chapter and, where necessary, section.

1A.1.2 R (1) Neither this chapter nor Chapters 4, 5 or 6 of *DTR* shall apply in relation to an undertaking that falls within paragraph (2) or units of such an undertaking that fall within paragraph (3). [**Note: article 1.2 TD**].

(2) The exemption set out in paragraph (1) applies to an undertaking if it is a unit trust or investment company:

(a) the object of which is the collective investment of capital provided by the public, and which operates on the principle of risk spreading; and

(b) the units of which are, at the request of the holder of such units, repurchased or redeemed, directly or indirectly, out of the assets of that undertaking. [**Note: article 2.1(g) TD**]

(3) Units of an undertaking that falls within paragraph (2) are securities issued by such an undertaking and representing the rights of the participants in such an undertaking. [**Note: article 2.1(h) TD**]

Purpose

1A.1.3 G The purpose of the *transparency rules* is to implement the *Transparency Directive* and to make other rules to ensure there is adequate transparency of and access to information in the UK financial markets.

FSA performing functions as competent authority

- 1A.1.4 G In relation to the *transparency rules*, the *FSA* is exercising its functions as the competent authority under Part VI of the *Act* (see section 72(1) of the *Act*).

Other relevant parts of Handbook

Note: Other parts of the *Handbook* that may also be relevant to *persons* to whom the *transparency rules* apply include *DEC* (the Decision making manual), Chapter 9 of *SUP* (the Supervision manual) and Chapter 21 of *ENF* (the Enforcement manual).

Note: A list of *regulated markets* can be found on the *FSA* website at the following address: http://www.fsa.gov.uk/register-res/html/prof_exchanges_fram.html

1A.2 Modifying rules and consulting the FSA

Modifying or dispensing with rules

- 1A.2.1 R (1) The *FSA* may dispense with, or modify, the *transparency rules* in such cases and by reference to such circumstances as it considers appropriate (subject to the terms of directives and the *Act*).
- (2) A dispensation or modification may be either unconditional or subject to specified conditions.
- (3) If an *issuer*, or other *person* has applied for, or been granted, a dispensation or modification, it must notify the *FSA* immediately it becomes aware of any matter which is material to the relevance or appropriateness of the dispensation or modification.
- (4) The *FSA* may revoke or modify a dispensation or modification.
- 1A.2.2 R (1) An application to the *FSA* to dispense with or modify, a *transparency rule* must be in writing.
- (2) The application must:
- (a) contain a clear explanation of why the dispensation or modification is requested;
 - (b) include details of any special requirements, for example, the date by which the dispensation or modification is required;
 - (c) contain all relevant information that should reasonably be brought to the *FSA*'s attention;
 - (d) contain any statement or information that is required by the *transparency rules* to be included for a specific type of dispensation or modification; and

(e) include copies of all documents relevant to the application.

- 1A.2.3 G An application to dispense with or modify a *transparency rule* should ordinarily be made at least five *business days* before the proposed dispensation or modification is to take effect.

Early consultation with FSA

- 1A.2.4 G An *issuer* or other *person* should consult with the *FSA* at the earliest possible stage if they:
- (1) are in doubt about how the *transparency rules* apply in a particular situation; or
 - (2) consider that it may be necessary for the *FSA* to dispense with or modify a *transparency rule*.

Address for correspondence

Note: The *FSA's* address for correspondence in relation to the *disclosure rules* is:

Company Monitoring Team
Markets Division
The Financial Services Authority
25 The North Colonnade
Canary Wharf
London E14 5HS

Fax: 020 7066 8368

1A.3 FSA may require the publication of information

- 1A.3.1 R (1) The *FSA* may, at any time, require an *issuer* to publish such information in such form and within such time limits as it considers appropriate to protect investors or to ensure the smooth operation of the market.
- (2) If an *issuer* fails to comply with a requirement under paragraph (1) the *FSA* may itself publish the information (after giving the *issuer* an opportunity to make representations as to why it should not be published).

Misleading information not to be published

- 1A.3.2 R An *issuer* must take all reasonable care to ensure that any information it notifies to a *RIS* is not misleading, false or deceptive and does not omit anything likely to affect the import of the information.

Notification when a *RIS* is not open for business

- 1A.3.3 R If an *issuer* is required to notify information to a *RIS* at a time when a *RIS* is not open for business, it must distribute the information as soon as possible

to:

- (1) not less than two national newspapers in the *United Kingdom*;
- (2) two newswire services operating in the *United Kingdom*; and
- (3) a *RIS* for release as soon as it opens.

1A.4 Fees

1A.4.1 R An *issuer* must pay the fees set out in *DTR* App 2R to the *FSA* when they are due.

Insert new Chapter 4 as follows:

DTR 4: PERIODIC FINANCIAL REPORTING

4.1 Annual financial report

Application

4.1.1 R Subject to the exemptions set out in *DTR 4.4 (Exemptions)* this section applies to an *issuer*:

- (1) whose *transferable securities* are *admitted to trading*; and
- (2) whose *Home State* is the *United Kingdom*.

Compliance with the Listing Rules

4.1.2 G An *issuer* that is also admitted to the *official list* should consider its obligations under the *Listing Rules* in addition to the requirements in these *rules*.

Publication of annual financial reports

4.1.3 R An *issuer* must make public its annual financial report at the latest four months after the end of each financial year. [**Note: article 4(1) of the TD**]

4.1.4 R An *issuer* must ensure that its annual financial report remains publicly available for at least five years. [**Note: article 4(1) of the TD**]

Content of annual financial reports

4.1.5 R The annual financial report must include:

- (1) the audited financial statements;
- (2) a management report; and
- (3) responsibility statements.

[Note: article 4(2) of the TD]

Audited financial statements

4.1.6 R (1) If an *issuer* is required to prepare consolidated accounts according to the Seventh Council Directive 83/349/EEC, the audited financial statements must comprise:

- (a) consolidated accounts prepared in accordance with *IFRS*, and
- (b) accounts of the parent *company* prepared in accordance with the national law of the *EEA State* in which the parent *company* is incorporated.

[Note: article 4(3) of the TD]

- (2) If an *issuer* is not required to prepare consolidated accounts, the audited financial statements must comprise accounts prepared in accordance with the national law of the *EEA State* in which the *issuer* is incorporated. **[Note: article 4(3) of the TD]**

Auditing of financial statements

- 4.1.7 R (1) If an *issuer* is required to prepare consolidated accounts, the financial statements must be audited in accordance with Article 37 of the Seventh Council Directive 83/349/EEC.
- (2) If an *issuer* is not required to prepare consolidated accounts the financial statements must be audited in accordance with Articles 51 and 51a of the Fourth Council Directive 78/660/EEC.
- (3) The audit report, signed by the person or persons responsible for auditing the financial statements must be disclosed in full to the public together with the annual financial report.

[Note: article 4(4) of the TD]

Content of management report

- 4.1.8 R The management report must contain:
- (1) a fair review of the *issuer's* business; and
- (2) a description of the principal risks and uncertainties facing the *issuer*.
- 4.1.9 R The review required by *DTR* 4.1.8R must:
- (1) be a balanced and comprehensive analysis of:
- (a) the development and performance of the *issuer's* business during the financial year; and
- (b) the position of the *issuer's* business at the end of that year, consistent with the size and complexity of the business;
- (2) include, to the extent necessary for an understanding of the development, performance or position of the *issuer's* business:
- (a) analysis using financial key performance indicators; and

- (b) where appropriate, analysis using other key performance indicators including information relating to environmental matters and employee matters; and
 - (3) include references to, and additional explanations of, amounts included in the *issuer's* annual financial statements, where appropriate.
- 4.1.10 G In *DTR* 4.1.9R(2), key performance indicators are factors by reference to which the development, performance or position of the *issuer's* business can be measured effectively.
- 4.1.11 R The management report required by *DTR* 4.1.8R must also give an indication of:
- (1) any important events that have occurred since the end of the financial year;
 - (2) the *issuer's* likely future development;
 - (3) activities in the field of research and development;
 - (4) the information concerning acquisitions of own *shares* prescribed by Article 22 (2) of Directive 77/91/EEC;
 - (5) the existence of branches of the *issuer*; and
 - (6) in relation to the *issuer's* use of *financial instruments* and where material for the assessment of its assets, liabilities, financial position and profit or loss:
 - (a) the *issuer's* financial risk management objectives and policies, including its policy for hedging each major type of forecasted transaction for which hedge accounting is used, and
 - (b) the *issuer's* exposure to price risk, credit risk, liquidity risk and cash flow risk.

Responsibility statements

- 4.1.12 R
- (1) Responsibility statements must be made by the *persons* responsible within the *issuer*.
 - (2) The name and function of any *person* who makes a responsibility statement must be clearly indicated in the responsibility statement.
 - (3) For each *person* making a responsibility statement, the statement must set out that to the best of his or her knowledge:

- (a) the financial statements, prepared in accordance with the applicable set of accounting standards, give a true and fair view of the assets, liabilities, financial position and profit or loss of the *issuer* and the undertakings included in the consolidation taken as a whole; and
- (b) the management report includes a fair review of the development and performance of the business and the position of the *issuer* and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face.

[Note: article 4(2)(c) of the TD]

4.1.13 R The *issuer* is responsible for all information drawn up and made public in accordance with this section.

4.2 Half-yearly financial reports

Application

4.2.1 R Subject to the exemptions set out in *DTR* 4.4 (Exemptions) this section applies to an *issuer*:

- (1) whose *shares* or *debt securities* are *admitted to trading*; and
- (2) whose *Home State* is the *United Kingdom*.

Publication of half-yearly financial reports

- 4.2.2 R
- (1) An *issuer* must make public a half-yearly financial report covering the first six months of the financial year.
 - (2) The half-yearly financial report must be made public as soon as possible, but no later than two months, after the end of the period to which the report relates.
 - (3) An *issuer* must ensure that the half-yearly financial report remains available to the public for at least five years.

[Note: article 5(1) of the TD]

Content of half-yearly financial reports

- 4.2.3 R The half-yearly financial report must include:
- (1) a condensed set of financial statements;
 - (2) an interim management report; and
 - (3) responsibility statements.

[Note: article 5(2) of the TD]

Preparation and content of condensed set of financial statements

- 4.2.4 R (1) If an *issuer* is required to prepare consolidated accounts, the condensed set of financial statements must be prepared in accordance with IAS 34. **[Note: article 5(3) of the TD]**
- (2) If an *issuer* is not required to prepare consolidated accounts, the condensed set of financial statements must contain, as a minimum the following:
- (a) a condensed balance sheet;
 - (b) a condensed profit and loss account; and
 - (c) explanatory notes on these accounts.

[Note article 5(3) of the TD]

- 4.2.5 R (1) This *rule* applies to an *issuer* that is not required to prepare consolidated accounts.
- (2) In preparing the condensed balance sheet and the condensed profit and loss account an *issuer* must follow the same principles for recognising and measuring as when preparing annual financial reports. **[Note article 5(3) of the TD]**
- (3) The balance sheet and the profit and loss account must show each of the headings and subtotals included in the most recent annual financial statements of the *issuer*. Additional line items must be included if, as a result of their omission, the half-yearly financial statements would give a misleading view of the assets, liabilities, financial position and profit or loss of the *issuer*. **[Note: article 3(2) of the TD implementing Directive]**
- (4) The half-yearly financial information must include comparative information presented as follows:
- (a) balance sheet as at the end of the first six months of the current financial year and comparative balance sheet as at the end of the immediate preceding financial year; and
 - (b) profit and loss account for the first six months of the current financial year with, from two years after 20 January 2007, comparative information for the comparable period for the preceding financial year.

[Note: article 3(2) of the TD implementing Directive]

- (5) The explanatory notes must include the following:
- (a) sufficient information to ensure the comparability of the condensed half-yearly financial statements with the annual

financial statements; and

- (b) sufficient information and explanations to ensure a user's proper understanding of any material changes in amounts and of any developments in the half-year period concerned, which are reflected in the balance sheet and the profit and loss account.

[Note: article 3(3) of the *TD implementing Directive*]

4.2.6 R The accounting policies and presentation applied to half-yearly figures must be consistent with those applied in the latest published annual accounts except where:

- (1) the accounting policies and presentation are to be changed in the subsequent annual financial statements, in which case the new accounting policies and presentation should be followed and the changes and the reasons for the changes should be disclosed in the half-yearly report; or
- (2) the *FSA* otherwise agrees.

Content of interim management report

4.2.7 R The interim management report must include at least:

- (1) an indication of important events that have occurred during the first six months of the financial year, and their impact on the condensed set of financial statements, and
- (2) a description of the principal risks and uncertainties for the remaining six months of the financial year.

[Note: article 5(4) of the *TD*]

4.2.8 R (1) In addition to the requirement set out in *DTR* 4.2.7R, an *issuer* of *shares* must disclose in the interim management report the following information, as a minimum:

- (a) related parties' transactions that have taken place in the first six months of the current financial year and that have materially affected the financial position or the performance of the enterprise during that period; and
 - (b) any changes in the related parties transactions described in the last annual report that could have a material effect on the financial position or performance of the enterprise in the first six months of the current financial year.
- (2) If an *issuer* of *shares* is not required to prepare consolidated accounts, it must disclose, as a minimum, any transactions which have been entered into with related parties by the *issuer*, including the amount of such transactions, the nature of the related party

relationship and other information about the transactions necessary for an understanding of the financial position of the *issuer*, if such transactions are material and have not been concluded under normal market conditions. **[Note: Article 43(1)(7b) of Directive 78/660/EC]**

- (3) In relation to transactions described in paragraph (2) information about such transactions may be aggregated according to their nature except where separate information is necessary for an understanding of the effects of related party transactions on the financial position of the *issuer*. **[Note: Article 43(1)(7b) of Directive 78/660/EC]**

Auditing of the condensed set of financial statements

- 4.2.9 R (1) If the half-yearly financial report has been audited or reviewed by auditors pursuant to the Auditing Practices Board guidance on Review of Interim Financial Information, the audit report or review report must be reproduced in full.
- (2) If the half-yearly financial report has not been audited or reviewed by auditors pursuant to the Auditing Practices Board guidance on Review of Interim Financial Information, an *issuer* must make a statement to this effect in its report.

[Note: article 5(5) of the TD]

Responsibility statements

- 4.2.10 R (1) Responsibility statements must be made by the *persons* responsible within the *issuer*. **[Note: article 5(2)(c) of the TD]**
- (2) The name and function of any *person* who makes a responsibility statement must be clearly indicated in the responsibility statement. **[Note: article 5(2)(c) of the TD]**
- (3) For each *person* making a responsibility statement, the statement must confirm that to the best of his or her knowledge:
- (a) the condensed set of financial statements, which has been prepared in accordance with the applicable set of accounting standards, gives a true and fair view of the assets, liabilities, financial position and profit or loss of the *issuer*, or the undertakings included in the consolidation as a whole as required by *DTR 4.2.4R*;
 - (b) the interim management report includes a fair review of the information required by *DTR 4.2.7R*; and
 - (c) the interim management report includes a fair review of the information required by *DTR 4.2.8R*, in the case of an *issuer* of *shares*.

[Note: article 5(2)(c) of the TD]

- (4) A *person* making a responsibility statement will satisfy the requirement in (3) (a) above to confirm that the condensed set of financial statements gives a true and fair view of the assets, liabilities, financial position and profit or loss of the *issuer* (or the undertakings included in the consolidation as a whole) by including a statement that the condensed set of financial statements have been prepared in accordance with:
- (a) *IAS* 34; or
 - (b) for *UK issuers* not using *IFRS*, pronouncements on interim reporting issued by the Accounting Standards Board; or
 - (c) for all other *issuers* not using *IFRS*, a national accounting standard relating to interim reporting,

provided always that a *person* making such a statement has reasonable grounds to be satisfied that the condensed set of financial statements prepared in accordance with such a standard is not misleading.

4.2.11 R The *issuer* is responsible for all information drawn up and made public in accordance with this section.

4.3 Interim management statements

Application

4.3.1 R Subject to the exemptions set out in *DTR* 4.4 (Exemptions) this section applies to an *issuer*:

- (1) whose *shares* are *admitted to trading*; and
- (2) whose *Home State* is the *United Kingdom*.

Publication of interim management statements

4.3.2 R An *issuer* must make public a statement by its management during the first six-month period of the financial year and another statement by its management during the second six month period of the financial year.
[Note: article 6(1) of the TD]

4.3.3 R The statement required by *DTR* 4.3.2R must be made in a period between ten weeks after the beginning, and six weeks before, the end of the relevant six-month period. **[Note: article 6(1) of the TD]**

Content of interim management statements

4.3.4 R The interim management statement must contain information that covers the period between the beginning of the relevant six-month period and the date of publication of the statement. **[Note: article 6(1) of the TD]**

- 4.3.5 R The interim management statement must provide:
- (1) an explanation of material events and transactions that have taken place during the relevant period and their impact on the financial position of the *issuer* and its *controlled undertakings*, and
 - (2) a general description of the financial position and performance of the *issuer* and its *controlled undertakings* during the relevant period.

[Note: article 6(1) of the TD]

- 4.3.6 R An *issuer* which publishes quarterly financial reports:
- (1) in accordance with national legislation; or
 - (2) in accordance with the rules of the *regulated market*; or
 - (3) of its own initiative,

will be taken as satisfying the requirement to make public the statements required by *DTR 4.3.2R*. **[Note: article 6(2) of the TD]**

4.4 Exemptions

Public sector issuers

- 4.4.1 R The *rules* on annual financial reports (*DTR 4.1*), half-yearly financial reports (*DTR 4.2*) and interim management statements (*DTR 4.3*) do not apply to a state, a regional or local authority of a state, a public international body of which are least one *EEA State* is a member, the ECB and *EEA States'* national central banks. **[Note: article 8(1)(a) of the TD]**

Debt issuers

- 4.4.2 R The *rules* on annual financial reports (*DTR 4.1*), half-yearly financial reports (*DTR 4.2*) and interim management statements (*DTR 4.3*) do not apply to an *issuer* that issues exclusively *debt securities admitted to trading* the denomination per unit of which is at least 50,000 Euros (or an equivalent amount). **[Note: article 8(1)(b) of the TD]**

- 4.4.3 R The *rules* on half-yearly financial reports (*DTR 4.2*) do not apply to a *credit institution* whose *shares* are not *admitted to trading* and which has, in a continuous or repeated manner, only issued *debt securities* provided that:

- (1) the total nominal amount of all such *debt securities* remains below 100,000,000 Euros; and
- (2) the *credit institution* has not published a prospectus in accordance with the *prospectus directive*.

[Note: article 8(2) of the TD]

- 4.4.4 R The *rules* on half-yearly financial reports do not apply to an *issuer* already existing on 31 December 2003 which exclusively issue *debt securities*

unconditionally and irrevocably guaranteed by the *issuer's Home Member State* or by a regional or local authority of that state, on a *regulated market*.

[Note: article 8(3) of the TD]

Issuers of convertible securities

- 4.4.5 R The *rules* on half-yearly financial reports (*DTR 4.2*) and Interim management statements (*DTR 4.3*) do not apply to an *issuer of transferable securities* convertible into *shares*.

Issuers of preference shares

- 4.4.6 R The *rules* on interim management statements (*DTR 4.3*) do not apply to an *issuer of preference shares*.

Issuers of depository receipts

- 4.4.7 R The *rules* on half-yearly financial reports (*DTR 4.2*) and interim management statements (*DTR 4.3*) do not apply to an *issuer of depository receipts*.

Non-EEA States - Equivalence

- 4.4.8 R An *issuer* whose registered office is in a *non-EEA State* whose relevant laws are considered equivalent by the *FSA* is exempted from the *rules* on annual financial reports (*DTR 4.1*), half-yearly financial reports (*DTR 4.2*) and interim management statements (*DTR 4.3*).
- 4.4.9 G The *FSA* maintains a published list of *non-EEA States* which, for the purpose of article 23.1 of the *TD*, are judged to have laws which lay down requirements equivalent to those imposed upon *issuers* by this chapter. Such *issuers* remain subject to the following requirements of *DTR 6*:
- (1) the filing of information with the *FSA*;
 - (2) the language provisions; and
 - (3) the dissemination of information provisions.

Insert new Chapter 5 as follows:

DTR 5: VOTE HOLDER AND ISSUER NOTIFICATION RULES

5.1 Notification of the acquisition or disposal of major shareholdings

5.1.1 R In this chapter:

- (1) references to "*issuer*", in relation to *shares* admitted to trading on a *regulated market*, are to an *issuer* whose *Home State* is the *United Kingdom*; and
- (2) references to a "*non-UK issuer*" are to an *issuer* whose *shares* are admitted to trading on a *regulated market* and whose *Home State* is the *United Kingdom* other than:
 - (a) a public company within the meaning of section 1(3) of the Companies Act 1985; and
 - (b) a company which is otherwise incorporated in, and whose principal place of business is in, the *UK*.
- (3) references to "*shares*" are to *shares* which are:
 - (a) already issued and carry rights to vote in all circumstances at general meetings of the *issuer* including *shares* (such as preference *shares*) which, following the exercise of an option for their conversion, event of default or otherwise, have become fully enfranchised for voting purposes; and
 - (b) admitted to trading on a *regulated* or *prescribed market*.
- (4) an acquisition or disposal of *shares* is to be regarded as effective when the relevant transaction is executed unless the transaction provides for settlement to be subject to conditions which are beyond the control of the parties in which case the acquisition or disposal is to be regarded as effective on the settlement of the transaction;
- (5) a stock-lending agreement which provides for the outright transfer of securities and which provides the lender with a right to call for re-delivery of the lent stock (or its equivalent) is not (as respects the lender) to be taken as involving a disposal of any *shares* which may be the subject of the stock loan; and
- (6) for the purposes of calculating whether any percentage threshold is reached, exceeded or fallen below and in any resulting notification, the proportion of voting rights held shall if necessary be rounded down to the next whole number.

5.1.2 R Subject to the exemption for certain third country *issuers* (DTR 5.11.6R), a *person* must notify the *issuer* of the percentage of its voting rights if the percentage of voting rights which he holds as *shareholder* or through his

direct or indirect holding of *financial instruments* falling within *DTR*

5.1.3R (or a combination of such holdings):

- (1) reaches, exceeds or falls below 3%, 4%, 5%, 6%, 7%, 8%, 9%, 10% and each 1% threshold thereafter up to 100% (or in the case of a non-*UK issuer* on the basis of thresholds at 5%, 10%, 15%, 20%, 25%, 30%, 50% and 75% as a result of an acquisition or disposal of *shares* or *financial instruments* falling within *DTR* 5.3.1R); or
- (2) reaches, exceeds or falls below an applicable threshold in (1) as a result of events changing the breakdown of voting rights and on the basis of information disclosed by the *issuer* in accordance with *DTR* 5.6.1R;

and in the case of an *issuer* which is not incorporated in an *EEA state* a notification under (2) must be made on the basis of equivalent events and disclosed information. [Note: articles 9(1) and 9(2) of the *TD*]

Certain voting rights to be disregarded

5.1.3 R Voting rights attaching to the following *shares* are to be disregarded for the purposes of determining whether a person has a notification obligation in accordance with the thresholds in *DTR* 5.1.2 R:

- (1) *shares* acquired for the sole purpose of clearing and settlement within a settlement cycle not exceeding the period beginning with the transaction and ending at the close of the third *trading day* following the day of the execution of the transaction (irrespective of whether the transaction is conducted on-exchange);
- (2) *shares* held by a custodian (or nominee) in its custodian (or nominee) capacity (whether operating from an establishment in the *UK* or elsewhere) provided such a *person* can only exercise the voting rights attached to such *shares* under instructions given in writing or by *electronic means*;
- (3) *shares* held by a *market maker* acting in that capacity subject to the percentage of such *shares* not being equal to or in excess of 10% and subject to the *market maker* satisfying the criteria and complying with the conditions and operating requirements set out in *DTR* 5.1.4R;
- (4) *shares* held by a *credit institution* or *investment firm* provided that:
 - (a) the *shares* are held within the *trading book* of the *credit institution* or *investment firm*;
 - (b) the voting rights attached to such *shares* do not exceed 5%; and
 - (c) the *credit institution*, or as the case may be *investment firm*, ensures that the voting rights attached to *shares* in the *trading book* are not exercised or otherwise used to intervene in the

management of the *issuer*.

- (5) *shares* held by a collateral taker under a collateral transaction which involves the outright transfer of *securities* provided the collateral taker does not declare any intention of exercising (and does not exercise) the voting rights attaching to such *shares*.
- (6) *shares* acquired by a borrower under a stock lending agreement provided :
 - (a) such *shares* (or equivalent stock) are on-lent or otherwise disposed of by the borrower by not later than close of business on the next *trading day*; and
 - (b) the borrower does not declare any intention of exercising (and does not exercise) the voting rights attaching to the *shares*.

[Note: articles 9(4), 9(5), 9(6) and 10(c) of the TD]

- 5.1.4 R (1) References to a *market maker* are to a *market maker* which:
- (a) (subject to (3) below) is authorised by its *Home State* under *MiFID*;
 - (b) does not intervene in the management of the *issuer* concerned; and
 - (c) does not exert any influence on the *issuer* to buy such *shares* or back the *share* price. **[Note: articles 9(5) and 9(6) of the TD]**
- (2) A *market maker* relying upon the exemption for *shares* held by it in that capacity must notify the *competent authority* of the *Home Member State* of the *issuer*, at the latest within the time limit provided for by *DTR 5.8.3R*, that it conducts or intends to conduct market making activities on a particular *issuer* (and shall equally make such a notification if it ceases such activity).
- [Note: article 6(1) of the TD implementing Directive]**
- (3) References to a *market maker* also include a *third country investment firm* and a *credit institution* when acting as a *market maker* and which, in relation to that activity, is subject to regulatory supervision under the laws of a *Member State*.

Certain voting rights to be disregarded (except at 5% 10% and higher thresholds)

- 5.1.5 R (1) The following are to be disregarded for the purposes of determining whether a *person* has a notification obligation in accordance with the thresholds in *DTR 5.1.2R* except at the thresholds of 5% and 10% and above:

- (a) voting rights attaching to *shares* forming part of property belonging to another which that *person* lawfully manages under an agreement in, or evidenced in, writing;
 - (b) voting rights attaching to *shares* which may be exercisable by a *person* in his capacity as the operator of:
 - (i) an *authorised unit trust scheme*;
 - (ii) a *recognised scheme*; or
 - (iii) a *UCITS scheme*;
 - (c) voting rights attaching to *shares* which may be exercisable by an *ICVC*;
 - (d) voting rights attaching to *shares* which may be exercised by a category of investment entity which for this purpose is prescribed by the *FSA*.
- (2) For the purposes of *DTR 5.1.5R(1)(a)*, a *person* ("A") may lawfully manage *investments* belonging to another if:
- (a) A can manage those *investments* in accordance with a *Part IV permission*;
 - (b) A is an *EEA* firm other than one mentioned in sub-paragraphs (c) or (e) of paragraph 5 of Schedule 3 to the *Act* and can manage those *investments* in accordance with its *EEA* authorisation;
 - (c) A can, in accordance with section 327 of the *Act*, manage those *investments* without contravening the prohibition contained in section 19 of the *Act*;
 - (d) A can lawfully manage those *investments* in another *EEA State* and would, if he were to manage those *investments* in the *UK*, require a *Part IV permission*; or
 - (e) A is a category of investment manager prescribed for this purpose by the *FSA*.

5.2 Acquisition or disposal of major proportions of voting rights

- 5.2.1 R A *person* is an indirect holder of *shares* for the purpose of the applicable definition of *shareholder* to the extent that he is entitled to acquire, to dispose of, or to exercise voting rights in any of the following cases or a combination of them:

Case	
(a)	voting rights held by a third party with whom that <i>person</i> has concluded an agreement, which obliges them to adopt, by concerted exercise of the voting rights they hold, a lasting common policy towards the management of the <i>issuer</i> in question;
(b)	voting rights held by a third party under an agreement concluded with that <i>person</i> providing for the temporary transfer for consideration of the voting rights in question;
(c)	voting rights attaching to <i>shares</i> which are lodged as collateral with that <i>person</i> provided that <i>person</i> controls the voting rights and declares its intention of exercising them;
(d)	voting rights attaching to <i>shares</i> in which that <i>person</i> has the life interest;
(e)	voting rights which are held, or may be exercised within the meaning of points (a) to (d) or, in cases (f) and (h) by a <i>firm</i> undertaking investment management, or by a <i>management company</i> , by an undertaking controlled by that <i>person</i> ;
(f)	voting rights attaching to <i>shares</i> deposited with that <i>person</i> which the <i>person</i> can exercise at its discretion in the absence of specific instructions from the <i>shareholders</i> ;
(g)	voting rights held by a third party in his own name on behalf of that <i>person</i> ;
(h)	voting rights which that <i>person</i> may exercise as a proxy where that <i>person</i> can exercise the voting rights at his discretion in the absence of specific instructions from the <i>shareholders</i> ;

[Note: article 10 of the TD]

- 5.2.2 G Cases (a) to (h) in DTR 5.2.1R identify situations where a *person* may be able to control the manner in which voting rights are exercised and where, (taking account of any aggregation with other holdings) a notification to the *issuer* may need to be made. In the FSA's view:
- (1) Case (e) produces the result that it is always necessary for the *parent undertaking* of a *controlled undertaking* to aggregate its holding with any holding of the *controlled undertaking* (subject to the exemptions implicit in Case (e) and others in DTR 5.4);
 - (2) Case (f) includes a *person* carrying on investment management and which is also the custodian of *shares* to which voting rights are attached;
 - (3) Case (g) does not result in a unit holder in a *collective investment scheme* or other investment entity being treated as the holder of voting rights in the scheme property (provided always such persons

do not have any entitlement to exercise, or control the exercise of, such voting rights); neither are such persons to be regarded as holding *shares* "indirectly";

- (4) Case (h), although referring to proxies, also describes and applies to a *person* undertaking investment management, and to a *management company*, and which is able effectively to determine the manner in which voting rights attached to *shares* under its control are exercised (for example through instructions given directly or indirectly to a nominee or independent custodian). Case (e) provides for the voting rights which are under the control of such a *person* to be aggregated with those of its *parent undertaking*.

5.2.3 G A *person* falling within Cases (a) to (h) is an indirect holder of *shares* for the purpose of the definition of *shareholder*. These indirect holdings have to be aggregated, but also separately identified in a notification to the *issuer*. Apart from those identified in the Cases (a) to (h), the FSA does not expect any other significant category "indirect shareholder" to be identified. Cases (a) to (h) are also relevant in determining whether a *person* is an indirect holder of qualifying *financial instruments* which result in an entitlement to acquire *shares*.

5.2.4 R *DTR* 5.1.2R and case (c) of *DTR* 5.2.1R do not apply in respect of voting rights attaching to *shares* provided to or by a member of the European System of Central Banks in carrying out their functions as monetary authorities, including *shares* provided to or by any such member under a pledge or repurchase of similar agreement for liquidity granted for monetary policy purposes or within a payments system provided:

- (1) this shall apply only for a short period following the provision of the *shares*; and
- (2) the voting rights attached to the *shares* during this period are not exercised. [**Note: article 11 of the TD**].

5.2.5 R (1) A *person* who is required to make a notification may, without affecting their responsibility, appoint another *person* to make the notification on his behalf.

(2) Where two or more *persons* are required to make a notification such *persons* may, without affecting their responsibility, arrange for a single notification to be made. [**Note: article 8(3) of the TD implementing Directive**].

5.3 Notification of voting rights arising from the holding of certain financial instruments

5.3.1 R A *person* must make a notification in accordance with the applicable thresholds in *DTR* 5.1.2R in respect of any qualifying *financial instruments* which they hold, directly or indirectly, which result in an entitlement to acquire, on such holder's own initiative alone, under a formal agreement, *shares* to which voting rights are attached, already issued, of an *issuer*.

[Note: article 13(1) of the TD].

- 5.3.2 R (1) *Transferable securities and options, futures, swaps, forward rate agreements* and any other *derivative* contracts, as referred to in Section C of Annex 1 of *MiFID*, shall be considered to be qualifying *financial instruments* provided that they result in an entitlement to acquire, on the holder's own initiative alone, under a formal agreement, *shares* to which voting rights are attached, already issued of an *issuer whose shares are* admitted to trading on a *regulated market* or a *UK prescribed market*.
- (2) The *instrument* holder must enjoy, on maturity, either the unconditional right to acquire the underlying *shares* or the discretion as to his right to acquire such *shares* or not.
- (3) A "formal agreement" means an agreement which is binding under applicable law.

[Note: Article 11(1) of the TD implementing Directive]

- 5.3.3 G For the purposes of Directive 2004/109/EC (TD), financial instruments should be taken into account in the context of notifying major holdings, to the extent that such instruments give the holder an unconditional right to acquire the underlying shares or cash on maturity. Consequently, financial instruments should not be considered to include instruments entitling the holder to receive shares depending on the price of the underlying share reaching a certain level at a certain moment in time. Nor should they be considered to cover those instruments that allow the instrument issuer or a third party to give shares or cash to the instrument holder on maturity.

[Note: Recital 13 of the TD implementing Directive]

- 5.3.4 R The holder of qualifying *financial instruments* is required to aggregate and, if necessary, notify all such instruments as relate to the same underlying *issuer*.

[Note: article 11(2) of the TD implementing Directive]

5.4 Aggregation of managed holdings

- 5.4.1 R (1) The *parent undertaking* of a *management company* shall not be required to aggregate its holdings with the holdings managed by the *management company* under the conditions laid down in the *UCITS Directive*, provided such *management company* exercises its voting rights independently from the *parent undertaking*.
- (2) But the requirements for the aggregation of holdings applies if the *parent undertaking*, or another *controlled undertaking* of the *parent undertaking*, has invested in holdings managed by such *management company* and the *management company* has no discretion to exercise the voting rights attached to such holdings and may only exercise such voting rights under direct or indirect instructions from the *parent* or another *controlled undertaking* of the *parent undertaking*.

[Note: articles 12(4) of the TD]

- 5.4.2 R (1) The *parent undertaking* of an *investment firm* authorised under *MiFID* shall not be required to aggregate its holdings with the holdings which such *investment firm* manages on a client-by-client basis within the meaning of Article 4(1), point 9, of *MiFID*, provided that:
- (a) the *investment firm* is authorised to provide such portfolio management;
 - (b) it may only exercise the voting rights attached to such *shares* under instructions given in writing or by *electronic means* or it ensures that individual portfolio management services are conducted independently of any other services under conditions equivalent to those provided for under the *UCITS Directive* by putting into place appropriate mechanisms; and
 - (c) the *investment firm* exercises its voting rights independently from the *parent undertaking*.
- (2) But the requirements for the aggregation of holdings applies if the *parent undertaking*, or another *controlled undertaking* of the *parent undertaking*, has invested in holdings managed by such *investment firm* and the *investment firm* has no discretion to exercise the voting rights attached to such holdings and may only exercise such voting rights under direct or indirect instructions from the parent or another *controlled undertaking* of the *parent undertaking*. **[Note: article 12(5) of the TD]**

- 5.4.3 R For the purposes of the exemption to the aggregation of holdings provided in *DTR 5.4.1R* or *DTR 5.4.2R*, a *parent undertaking* of a *management company* or of an *investment firm* shall comply with the following conditions:
- (1) it must not interfere by giving direct or indirect instructions or in any other way in the exercise of the voting rights held by the *management company* or *investment firm*; and
 - (2) that *management company* or *investment firm* must be free to exercise, independently of the *parent undertaking*, the voting rights attached to the assets it manages.

[Note: article 10(1) of the TD implementing Directive]

- 5.4.4 R A *parent undertaking* which wishes to make use of the exemption in relation to *issuers* subject to this chapter whose *shares* which are admitted to trading on a *regulated market* must without delay, notify the following to the *FSA*:
- (1) a list of the names of those *management companies*, *investment firms* or other entities, indicating the *competent authorities* that supervise them, but with no reference to the *issuers* concerned; and

- (2) a statement that, in the case of each such *management company* or *investment firm*, the *parent undertaking* complies with the conditions laid down *DTR 5.4.3R*.

The *parent undertaking* shall update the list referred to in paragraph (1) on an ongoing basis.

[Note: article 10(2) of the *TD implementing Directive*]

- 5.4.5 R Where the *parent undertaking* intends to benefit from the exemptions only in relation to the *financial instruments* referred to in Article 13 of the *TD*, it shall (in relation to *financial instruments* giving an entitlement to acquire *shares* which are admitted to trading on a *regulated market*) notify to the *FSA* only the list referred to in paragraph (1) of *DTR 5.4.4R*.

[Note: article 10(3) of the *TD implementing Directive*]

- 5.4.6 R A *parent undertaking* of a *management company* or of an *investment firm* must in relation to *issuers* subject to this chapter whose *shares* which are admitted to trading on a *regulated market* be able to demonstrate to the *FSA* on request that:

- (1) the organisational structures of the *parent undertaking* and the *management company* or *investment firm* are such that the voting rights are exercised independently of the *parent undertaking*;
- (2) the persons who decide how the voting rights are exercised act independently;
- (3) if the *parent undertaking* is a client of its *management company* or *investment firm* or has a holding in the assets managed by the *management company* or *investment firm*, there is a clear written mandate for an arms-length customer relationship between the *parent undertaking* and the *management company* or *investment firm*.

The requirement in (1) shall imply as a minimum that the *parent undertaking* and the *management company* or *investment firm* must have established written policies and procedures reasonably designed to prevent the distribution of information between the *parent undertaking* and the *management company* or *investment firm* in relation to the exercise of voting rights.

[Note: article 10(4) of the *TD implementing Directive*]

- 5.4.7 R For the purposes of paragraph (1) of *DTR 5.4.3R* “direct instruction” means any instruction given by the *parent undertaking*, or another *controlled undertaking* of the *parent undertaking*, specifying how the voting rights are to be exercised by the *management company* or *investment firm* in particular cases.
- 5.4.8 R “Indirect instruction” means any general or particular instruction, regardless of the form, given by the *parent undertaking*, or another *controlled*

undertaking of the *parent undertaking*, that limits the discretion of the *management company* or *investment firm* in relation to the exercise of voting rights in order to serve specific business interests of the *parent undertaking* or another *controlled undertaking* of the *parent undertaking*.

[Note: article 10(5) of the TD implementing Directive]

- 5.4.9 R Undertakings whose registered office is in a third country which would have required authorisation in accordance with Article 5 (1) of the *UCITS directive* or with regard to portfolio management under point 4 of section A of Annex 1 to *MiFID* if it had its registered office or, only in the case of an *investment firm*, its head office within the Community, shall be exempted from aggregating holdings with the holdings of its *parent undertaking* under this *rule* provide that they comply with equivalent conditions of independence as *management companies* or *investment firms*.

[Article 23(6) TD]

- 5.4.10 R A third country shall be deemed to set conditions of independence equivalent to those set out in this *rule* where under the law of that country, a *management company* or *investment firm* is required to meet the following conditions:

- (1) the *management company* or *investment firm* must be free in all situations to exercise, independently of its *parent undertaking*, the voting rights attached to the assets it manages;
- (2) the *management company* or *investment firm* must disregard the interests of the *parent undertaking* or of any other *controlled undertaking* of the *parent undertaking* whenever conflicts of interest arise.

- 5.4.11 R A *parent undertaking* of a third country undertaking must comply with the notification requirements in *DTR 5.4.4 (1)R* and *DTR5.4.5R* and in addition:

- (1) must make a statement that in respect of each *management company* or *investment firm* concerned, the *parent undertaking* complies with the conditions of independence set down in *DTR 5.4.10R*; and
- (2) Must be able to demonstrate to the *FSA* on request that the requirements of *DTR5.4.6R* are respected.

[Note: article 23 of the TD implementing Directive]

- 5.5 Acquisition or disposal by issuer of shares

- 5.5.1 R An *issuer* of *shares* must, if it acquires or disposes of its own *shares*, either itself or through a *person* acting in his own name but on the *issuer's* behalf, make public the percentage of voting rights attributable to those *shares* as soon as possible, but not later than four *trading days* following such acquisition or disposal where that percentage reaches, exceeds or falls below the thresholds of 5% or 10% of the voting rights.

- 5.5.2 R The percentage shall be calculated on the basis of the total number of *shares* to which voting rights are attached. [**Note: article 14 of the TD**].
- 5.5.3 G Additional requirements in relation to a *listed company* which purchases its own *equity shares* are contained in LR 12.4.6R.
- 5.6 Disclosures by issuers
- 5.6.1 R An *issuer* must, at the end of each calendar month during which an increase or decrease has occurred, disclose to the public:
- (1) the total number of voting rights and capital in respect of each class of *share* which it issues. [**Note: article 15 of the TD**]; and
 - (2) the total number of voting rights attaching to *shares* of the *issuer* which are held by it in treasury.
- 5.6.2 G The disclosure of the total number of voting rights should be in respect of each class of *share* which is admitted to trading on a *regulated or prescribed market*.
- 5.6.3 R Responsibility for all information drawn up and made public in accordance with DTR 5.6.1R lies with the *issuer*.
- 5.7 Notification of combined holdings
- 5.7.1 R A *person* making a notification in accordance with DTR 5.1.2R must do so by reference to each of the following:
- (1) the aggregate of all voting rights which the *person* holds as *shareholder* and as the direct or indirect holder of *financial instruments*;
 - (2) the aggregate of all voting rights held as direct or indirect *shareholder* (disregarding for this purpose holdings of *financial instruments*); and
 - (3) the aggregate of all direct and indirect holdings of *financial instruments*.
- 5.7.2 G The effect of DTR 5.7.1R is that a *person* may have to make a notification if the overall percentage level of his voting rights remains same but there is notifiable change in the percentage level of one or more of the categories of voting rights held.
- 5.8 Procedures for the notification and disclosure of major holdings
- 5.8.1 R A notification given in accordance with DTR 5.1.2R shall include the following information:
- (1) the resulting situation in terms of voting rights;
 - (2) the chain of *controlled undertakings* through which voting rights are

effectively held, if applicable;

- (3) the date on which the threshold was reached or crossed; and
- (4) the identity of the *shareholder*, even if that *shareholder* is not entitled to exercise voting rights under the conditions laid down in *DTR 5.2.1R* and of the *person* entitled to exercise voting rights on behalf of that *shareholder*.

- 5.8.2 R (1) A notification required of voting rights arising from the holding of *financial instruments* must include the following information:
- (a) the resulting situation in terms of voting rights;
 - (b) if applicable, the chain of *controlled undertakings* through which *financial instruments* are effectively held;
 - (c) the date on which the threshold was reached or crossed;
 - (d) for instruments with an exercise period, an indication of the date or time period where *shares* will or can be acquired, if applicable
 - (e) date of maturity or expiration of the instrument;
 - (f) identity of the holder; and
 - (g) name of the underlying *issuer*.
- (2) The notification must be made to the *issuer* of each of the underlying *shares* to which the *financial instrument* relates and, in the case of *shares* admitted to trading on a *regulated market*, to each *competent authority* of the *Home States* of such *issuers*.
- (3) If a *financial instrument* relates to more than one underlying *share*, a separate notification shall be made to each *issuer* of the underlying *shares*.

[Note: articles 11(3), (4) and (5) of the *TD implementing Directive*]

- 5.8.3 R The notification to the *issuer* shall be effected as soon as possible, but not later than four *trading days* in the case of a *non-UK issuer* and two *trading days* in all other cases, the first of which shall be the day after the date on which the relevant *person*:
- (1) learns of the acquisition or disposal or of the possibility of exercising voting rights, or on which, having regard to the circumstances, should have learned of it, regardless of the date on which the acquisition, disposal or possibility of exercising voting rights takes effect; or
 - (2) is informed about the event mentioned in *DTR 5.1.2R(2)*.

And for the purposes of (1) above a *person* shall, in relation to a transaction to which he is a party or which he has instructed, be deemed to have knowledge of the acquisition, disposal or possibility to exercise voting rights no later than two trading days following the transaction in question and where a transaction is conditional upon the approval by public authorities of the transaction or on a future uncertain event the occurrence of which is outside the control of the parties to the agreement, the parties are deemed to have knowledge of the acquisition, disposal or possibility of exercising voting rights only when the relevant approvals are obtained or when the event happens.

[Note: articles 12(1), and 12(2) of the TD and article 9 of the TD implementing Directive]

- 5.8.4 R
- (1) The notification obligation following transactions of a kind mentioned in *DTR 5.2.1R* are individual obligations incumbent upon each direct *shareholder* or indirect *shareholder* mentioned in *DTR 5.2.1R* or both if the proportion of voting rights held by each party reaches, exceeds or falls below an applicable threshold.
 - (2) In the circumstances in *DTR 5.2.1R* Case (h) if a *shareholder* gives the proxy in relation to one *shareholder* meeting, notification may be made by means of a single notification when the proxy is given provided it is made clear in the notification what the resulting situation in terms of voting rights will be when the proxy may no longer exercise the voting rights discretion;
 - (3) If in the circumstances in *DTR 5.2.1R* Case (h) the proxy holder receives one or several proxies in relation to one *shareholder* meeting, notification may be made by means of a single notification on or after the deadline for receiving proxies provided that it is made clear in the notification what the resulting situation in terms of voting rights will be when the proxy may no longer exercise the voting rights at its discretion;
 - (4) When the duty to make notification lies with more than one *person*, notification may be made by means of a single common notification but this does not release any of those *persons* from their responsibilities in relation to the notification.

[Note: article 8 of the TD implementing Directive]

- 5.8.5 G
- It may be necessary for both the relevant *shareholder* and proxy holder to make a notification. For example, if a direct holder of *shares* has a notifiable holding of voting rights and gives a proxy in respect of those rights (such that the recipient has discretion as to how the votes are cast) then for the purposes of *DTR 5.1.2R* this is a disposal of such rights giving rise to a notification obligation. The proxy holder may also have such an obligation by virtue of his holding under *DTR 5.2.1R*. Separate notifications will not however be necessary provided a single notification (whether made by the direct holder of the *shares* or by the proxy holder) makes clear what the situation will be when the proxy has expired. Where a proxy holder

receives several proxies then one notification may be made in respect of the aggregated voting rights held by the proxy holder on or as soon as is reasonably practicable following the proxy deadline. Unless it discloses what the position will be in respect of each proxy after the proxies have expired, such a notification will not relieve any direct holder of the *shares* of its notification obligation (if there is a notifiable disposal). A proxy which confers only minor and residual discretions (such as to vote on an adjournment) will not result in the proxy holder (or *shareholder*) having a notification obligation.

- 5.8.6 R An undertaking is not required to make a notification if instead it is made by its *parent undertaking* or, where the *parent undertaking* is itself a *controlled undertaking*, by its own *parent undertaking*. [**Note: article 12(3) of the TD**]
- 5.8.7 R Voting rights must be calculated on the basis of all the *shares* to which voting rights are attached even if the exercise of such rights is suspended and shall be given in respect of all *shares* to which voting rights are attached. [**Note: article 9(1) of the TD**]
- 5.8.8 R The number of voting rights to be considered when calculating whether a threshold is reached, exceeded or fallen below is the number of voting rights in existence according to the *issuer's* most recent disclosure made in accordance with *DTR 5.6.1 R* but disregarding voting rights attached to any treasury *shares* held by the *issuer* (in accordance with the *issuer's* most recent disclosure of such holdings). [**Note: article 9(2) of the TD and article 11(3) of the TD implementing Directive**]
- 5.8.9 G The *FSA* maintains and publishes on its website at www.fsa.gov.uk a calendar of *trading days* which applies in the *United Kingdom* for the purposes of this chapter. [**Note: article 7 of the TD implementing Directive**]
- 5.8.10 R A notification in relation to *shares* admitted to trading on a *regulated market*, must be made using the form TR1 available in electronic format at the *FSA's* website at www.fsa.gov.uk.
- 5.8.11 R In determining whether a notification is required a *person's* net (direct or indirect) holding in a *share* (and of relevant *financial instruments*) may be assessed by reference to that *person's* holdings at a point in time up to midnight of the day for which the determination is made (taking account of acquisitions and disposals executed during that day).
- 5.8.12 R (1) An *issuer* not falling within (2) must, in relation to *shares* admitted to trading on a *regulated market*, on receipt of a notification as soon as possible and in any event by not later than the end of the *trading day* following receipt of the notification make public all of the information contained in the notification.
- (2) A non-UK *issuer* and any other *issuers* whose *shares* are admitted to trading on a *prescribed* (but not a *regulated*) *market* must, on receipt

of a notification, as soon as possible and in any event by not later than the end of the third *trading day* following receipt of the notification, make public all of the information contained in the notification.

[Note: article 12(6) of the TD]

- 5.9 Filing of information with competent authority
- 5.9.1 R (1) A *person* making a notification to an *issuer* to which this chapter applies must, if the notification relates to *shares* admitted to trading on a *regulated market*, at the same time file a copy of such notification with the *FSA*.
- (2) The information to be filed with the *FSA* must include a contact address of the *person* making the notification (but such details must be in a separate annex and not included on the form which is sent to the *issuer*). **[Note: article 19(3) of the TD]**.
- 5.10 Use of electronic means for notifications and filing
- 5.10.1 R Information filed with the *FSA* for the purposes of the chapter must be filed using *electronic means*.
- 5.11 Non EEA state issuers
- 5.11.1 R An *issuer* whose registered office is in a *non-EEA State* will be treated as meeting equivalent requirements to those set out in *DTR 5.8.12R (2)* (*issuer* to make public notifications of major shareholdings by close of third day following receipt) provided that the period of time within which the notification of the major holdings is to be effected to the *issuer* and is to be made public by the *issuer* is in total equal to or shorter than seven *trading days*. **[Note: article 19 of the TD implementing Directive]**
- 5.11.2 R An *issuer* whose registered office is in a *non-EEA State* will be treated as meeting equivalent requirements in respect of treasury *shares* to those set out in *DTR 5.5.1R* provided that:
- (1) if the *issuer* is only allowed to hold up a maximum of 5% of its own *shares* to which voting rights are attached, a notification requirement is triggered under the law of the third country whenever this the maximum threshold of 5% of the voting rights is reached or crossed;
- (2) if the *issuer* is allowed to hold up to maximum of between 5% and 10% of its own *shares* to which voting rights are attached, a notification requirement is triggered under the law of the *non-EEA state* whenever this maximum threshold and or the 5% threshold of the voting rights are reached or crossed;
- (3) if the *issuer* is allowed to hold more than 10% of its own *shares* to which voting rights are attached, a notification requirement is triggered under the law of the *non-EEA state* whenever the 5% or 10% thresholds of the voting rights are reached or crossed.

Notification above the 10% threshold is not required for this purpose.

[Note: article 20 of the *TD implementing Directive*]

- 5.11.3 R An *issuer* whose registered office is in a *non-EEA State* will be treated as meeting equivalent requirements to those set out in *DTR 5.6.1R* (Disclosure by *issuers* of total voting rights) provided that the *issuer* is required under the law of the *non-EEA State* to disclose to the public the total number of voting rights and capital within 30 calendar days after an increase or decrease of such total number has occurred. **[Note: article 21 of the *TD implementing Directive*]**
- 5.11.4 R An *issuer* whose registered office is in a *non-EEA State* whose relevant laws are considered equivalent by the *FSA* is exempted from the corresponding obligation in this chapter.
- 5.11.5 G The *FSA* maintains a published list of *non-EEA States* which, for the purpose of article 23.1 of the *TD*, are judged to have laws which lay down requirements equivalent to those imposed upon *issuers* by this chapter. Such *issuers* remain subject to the following requirements of *DTR 6*:
- (1) the filing of information with the *FSA*;
 - (2) the language provisions; and
 - (3) the dissemination of information provisions.
- 5.11.6 R The notification requirements in *DTR 5.1.2R* do not apply to a *person* in respect of the *shares* of an *issuer* which has its registered office in a *non-EEA State* whose laws have been considered equivalent for the purposes of article 23 of the *TD*.

Insert new Chapter 6 as follows:

DTR 6: CONTINUING OBLIGATIONS AND ACCESS TO INFORMATION

6.1 Information requirements for issuers of shares and debt securities

Application

- 6.1.1 R (1) Subject to the exemptions set out in *DTR 6.1.16R – DTR 6.1.19R* this section applies in relation to an *issuer* whose *Home State* is the *United Kingdom*.
- (2) References to *transferable securities, shares* and *debt securities* are to such instruments as are *admitted to trading*.

Amendments to constitution

- 6.1.2 R (1) If an *issuer* of *transferable securities* proposes to amend its *constitution* it must communicate the draft amendment to:
- (a) the *FSA*; and
- (b) the *regulated market* on which its *securities* have been admitted to trading.
- (2) The communication referred to in paragraph (1) must be effected without delay but at the latest on the date of calling the general meeting which is to vote on, or be informed of, the amendment.

[Note: article 19(1) of the TD]

Equality of treatment

- 6.1.3 R (1) An *issuer* of *shares* must ensure equal treatment for all holders of *shares* who are in the same position. **[Note: article 17(1) of the TD]**
- (2) An *issuer* of *debt securities* must ensure that all holders of *debt securities* ranking *pari passu* are given equal treatment in respect of all the rights attaching to those *debt securities*. **[Note: article 18(1) of the TD]**

Exercise of rights by holders

- 6.1.4 R An *issuer* of *shares* or *debt securities* must ensure that all the facilities and information necessary to enable holders of *shares* or *debt securities* to exercise their rights are available in the *Home State* and that the integrity of data is preserved. **[Note: articles 17(2) and 18(2) of the TD]**

Exercise of rights by proxy

- 6.1.5 R (1) *Shareholders* and *debt securities* holders must not be prevented from exercising their rights by proxy, subject to the law of the country in which the *issuer* is incorporated. **[Note: articles 17(2) and 18(2) of**

the TD]

- (2) An issuer of shares or debt securities must make available a proxy form, on paper or, where applicable, by *electronic means* to each person entitled to vote at a meeting of *shareholders* or a meeting of *debt securities* holders. [Note: articles 17(2)(b) and 18(2)(b) of the TD]
- (3) The proxy form must be made available either:
 - (a) together with the notice concerning the meeting; or
 - (b) after the announcement of the meeting.

[Note: articles 17(2)(b) and 18(2)(b) of the TD]

Appointment of a financial agent

- 6.1.6 R An issuer of shares or debt securities must designate, as its agent, a financial institution through which *shareholders* or *debt securities* holders may exercise their financial rights. [Note: articles 17(2)(c) and 18(2)(c) of the TD]

Electronic Communications

- 6.1.7 G An issuer of shares or debt securities may use *electronic means* to convey information to *shareholders* or *debt securities* holders. [Note: articles 17(3) and 18(4) of the TD]
- 6.1.8 R To use *electronic means* to convey information to holders, an issuer must comply with the following:
 - (1) a decision to use *electronic means* to convey information to *shareholders* or *debt securities* holders must be taken in a general meeting;
 - (2) the use of *electronic means* must not depend upon the location of the seat or residence of:
 - (a) the *shareholder*; or
 - (b) persons referred to in rows (a) to (h) of the table set out in DTR 5.2.1R; or
 - (c) the *debt security* holder; or
 - (d) a proxy representing a *debt security* holder;
 - (3) identification arrangements must be put in place so that the *shareholders*, *debt security* holders or other persons entitled to exercise or to direct the exercise of voting rights are effectively informed;

- (4) *shareholders, debt security holders or persons* referred to in rows (a) to (e) of the table set out in *DTR 5.2.1R* who are entitled to acquire, dispose of or exercise voting rights must be:
- (a) contacted in writing to request their consent for the use of *electronic means* for conveying information and if they do not object within a reasonable period of time, their consent can be considered to have been given; and
 - (b) able to request at any time in the future that information be conveyed in writing; and
- (5) any apportionment of the costs entailed in the conveyance of information by *electronic means* must be determined by the *issuer* in compliance with the principle of equal treatment set out in *DTR 6.1.3R*.

But paragraph (4) above does not apply in any case where schedule 5 to the Companies Act 2006 applies.

[Note: articles 17(3) and 18(4) of the TD]

Information about changes in rights attaching to securities

- 6.1.9 R An *issuer* of *shares* must without delay disclose to the public any change in the rights attaching to its various classes of *shares*, including changes in the rights attaching to *derivative securities* issued by the *issuer* giving access to the *shares* of that *issuer*. **[Note: article 16(1) of the TD]**.
- 6.1.10 R An *issuer* of *securities* other than *shares* admitted to trading on a *regulated market* must disclose to the public without delay any changes in the rights of holders of *securities* other than *shares*, including changes in the terms and conditions of such *securities* which could indirectly affect those rights, resulting in particular from a change in loan terms or in interest rates. **[Note article 16(2) of the TD]**.
- 6.1.11 R An *issuer* of *securities* admitted to trading on a *regulated market* (other than an *issuer* which is a public international body of which at least one *EEA State* is a member) must disclose to the public without delay any new loan issues and in particular any guarantee or security in respect of such issues. **[Note: article 16(3) of the TD]**.

Information about meetings, issue of new shares and payment of dividends – share issuers

- 6.1.12 R An *issuer* of *shares* must provide information to holders on:
- (1) the place, time and agenda of meetings;
 - (2) the total number of *shares* and voting rights; and
 - (3) the rights of holders to participate in meetings. **[Note: article**

17(2)(a) of the TD]

- 6.1.13 R An *issuer* of *shares* must publish notices or distribute circulars concerning the allocation and payment of dividends and the issue of new *shares*, including information on any arrangements for allotment, subscription, cancellation or conversion. [Note: article 17(2)(d) of the TD]

Information about meetings, and payment of interest – debt security issuers

- 6.1.14 R An *issuer* of *debt securities* must publish notices or distribute circulars concerning:
- (1) the place, time and agenda of meetings of *debt securities* holders;
 - (2) the payment of interest;
 - (3) the exercise of any conversion, exchange, subscription or cancellation rights and repayment; and
 - (4) the rights of holders to exercise their rights in relation to paragraphs (1) – (3).

[Note: article 18(2)(a) of the TD]

- 6.1.15 R If only holders of *debt securities* whose denomination per unit amounts to at least 50,000 Euros (or an equivalent amount) are to be invited to a meeting, the *issuer* may choose as a venue any *EEA State*, provided that all the facilities and information necessary to enable such holders to exercise their rights are made available in that *EEA State*. [Note: article 18(3) of the TD]

Non-EEA State exemption

- 6.1.16 R An *issuer* whose registered office is in a *non-EEA State* whose relevant laws are considered equivalent by the *FSA* is exempted from *DTR* 6.1.3R to *DTR* 6.1.15R.
- 6.1.17 G The *FSA* maintains a published list of *non-EEA States* which, for the purpose of article 23.1 of the *TD*, are judged to have laws which lay down requirements equivalent to those imposed upon *issuers* by this chapter. Such *issuers* remain subject to the following requirements of *DTR* 6:
- (1) the filing of information with the *FSA*;
 - (2) the language provisions; and
 - (3) the dissemination of information provisions.

Regional and local authority exemption

- 6.1.18 R A regional or local authority with *securities admitted to trading* is not required to comply with the following:
- (1) *DTR* 6.1.4R to *DTR* 6.1.8R; and

- (2) *DTR 6.1.14R to DTR 6.1.15R.*

[Note: article 1(3) of the TD]

Exemption for issuers of convertible securities, preference *shares* and depository receipts

- 6.1.19 R *DTR 6.1.3R to DTR 6.1.8R and DTR 6.1.12R to DTR 6.1.15R do not apply to:*
- (1) *an issuer of transferable securities convertible into shares;*
 - (2) *an issuer of preference shares; and*
 - (3) *an issuer of depository receipts.*

6.2 Filing information and use of language

Application

- 6.2.1 R This section applies to:
- (1) *an issuer:*
 - (a) *whose transferable securities are admitted to trading; and*
 - (b) *whose Home State is the United Kingdom; and*
 - (2) *a person who has requested, without the issuer's consent, the admission of its transferable securities to trading on a regulated market.*

Filing of information with FSA

- 6.2.2 R *An issuer or person that discloses regulated information must, at the same time, file that information with the FSA. [Note: article 19(1) of the TD]*
- 6.2.3 G *An issuer or person that discloses regulated information may comply with DTR 6.2.2R by using a RIS to disseminate the information in accordance with DTR 6.3.*

Language

- 6.2.4 R *If transferable securities are admitted to trading only in the United Kingdom and the United Kingdom is the Home State, regulated information must be disclosed in English. [Note: article 20(1) of the TD]*
- 6.2.5 R *If transferable securities are admitted to trading in more than one EEA State including the United Kingdom and the United Kingdom is the Home State, regulated information must be disclosed:*
- (1) *in English; and*

- (2) either in a language accepted by the competent authorities of each *Host State* or in a language customary in the sphere of international finance, at the choice of the *issuer*.

[Note: article 20(2) of the TD]

- 6.2.6 R (1) If *transferable securities* are admitted to trading in one or more *EEA States* excluding the *United Kingdom* and the *United Kingdom* is the *Home State*, regulated information must be disclosed either:
- (a) in a language accepted by the competent authorities of those *Host States*; or
- (b) in a language customary in the sphere of international finance,
- at the choice of the *issuer*.
- (2) Where the *United Kingdom* is the *Home State*, regulated information must be disclosed either in English or in another language customary in the sphere of international finance, at the choice of the *issuer*.

[Note: article 20(3) of the TD]

- 6.2.7 R If *transferable securities* are admitted to trading without the *issuer's* consent:
- (1) *DTR 6.2.4R* to *DTR 6.2.6R* do not apply to the *issuer*; and
- (2) *DTR 6.2.4R* to *DTR 6.2.6R* apply to the *person* who has requested such admission without the *issuer's* consent.

[Note: article 20(4) of the TD]

- 6.2.8 R If *transferable securities* whose denomination per unit amounts to at least 50,000 Euros (or an equivalent amount) are admitted to trading in the *United Kingdom* or in one or more *EEA States*, regulated information must be disclosed to the public in either a language accepted by the competent authorities of the *Home State* and *Host States* or in a language customary in the sphere of international finance, at the choice of the *issuer* or of the *person* who, without the *issuer's* consent, has requested such admission.

[Note: article 20(6) of the TD]

English language

- 6.2.9 G English is a language accepted by the *FSA* where the *United Kingdom* is a *Home State* or *Host State*.

6.3 Dissemination of information

Application

- 6.3.1 R This section applies to:

- (1) an *issuer*:
 - (a) whose *transferable securities* are admitted to trading; and
 - (b) whose *Home State* is the *United Kingdom*; [**Note: article 21(1) of the TD**]
 - (2) a *person* who has applied, without the *issuer's* consent, for the admission of its *transferable securities* to trading on a *regulated market*; and [**Note: article 21(1) of the TD**]
 - (3) *transferable securities* that are admitted to trading only in the *United Kingdom* which is the *Host State* and not in the *Home State*. [**Note: article 21(3) of the TD**]
- 6.3.2 R An *issuer* or *person* must disclose *regulated information* in the manner set out in *DTR 6.3.3R* to *DTR 6.3.8R*. [**Note: article 21(1) of the TD**]
- 6.3.3 R (1) When disseminating *regulated information* an *issuer* or other *person* must ensure that the minimum standards contained in *DTR 6.3.4R* to *DTR 6.3.8R* are met.
- (2) An *issuer* or *person* must entrust a *RIS* with the disclosure of *regulated information* to the public and must ensure that the *RIS* complies with the minimum standards contained in *DTR 6.3.4R* to *DTR 6.3.8R*.
- [**Note: article 12(1) of the TD implementing Directive**]
- 6.3.4 R *Regulated information* must be disseminated in a manner ensuring that it is capable of being disseminated to as wide a public as possible, and as close to simultaneously as possible in the *Home Member State* and in other *EEA States*. [**Note: article 12(2) of the TD implementing Directive**]
- 6.3.5 R (1) *Regulated information*, other than *regulated information* described in paragraph (2), must be communicated to the media in unedited full text. [**Note: article 12(3) of the TD implementing Directive**]
- (2) (a) An annual financial report that is required by *DTR 4.1* to be made public is not required to be communicated to the media in unedited full text except for the information described in paragraph (b).
- (b) If information is of a type that would be required to be disseminated in a half-yearly financial report then information of such a type that is contained in an annual financial report must be communicated to the media in unedited full text.
- (3) The announcement relating to the publication of the following *regulated information* must include an indication of which website the relevant documents are available:

- (a) an annual financial report that is required by *DTR* 4.1 to be made public;
- (b) a half-yearly financial report that is required by *DTR* 4.2 to be made public; and
- (c) an interim management statement that is required by *DTR* 4.3 to be made public or an equivalent quarterly financial report.

[Note: article 12(3) of the *TD implementing Directive*]

6.3.6 R *Regulated information* must be communicated to the media in a manner which ensures the security of the communication, minimises the risk of data corruption and unauthorised access, and provides certainty as to the source of the *regulated information*. Security of receipt must be ensured by remedying as soon as possible any failure or disruption in the communication of *regulated information*. An *issuer* or *person* is not responsible for systemic errors or shortcomings at the media to which the *regulated information* has been communicated. **[Note: article 12(4) of the *TD implementing Directive*]**

6.3.7 R *Regulated information* must be communicated to a *RIS* in a way which:

- (1) makes clear that the information is *regulated information*;
- (2) identifies clearly:
 - (a) the *issuer* concerned;
 - (b) the subject matter of the *regulated information*; and
 - (c) the time and date of the communication of the *regulated information* by the *issuer* or the *person*.

[Note: article 12(5) of the *TD implementing Directive*]

6.3.8 R Upon request, an *issuer* or other *person* must be able to communicate to the *FSA*, in relation to any disclosure of *regulated information*:

- (1) the name of the *person* who communicated the *regulated information* to the *RIS*;
- (2) the security validation details;
- (3) the time and date on which the *regulated information* was communicated to the *RIS*;
- (4) the medium in which the *regulated information* was communicated; and
- (5) details of any embargo placed by the *issuer* on the *regulated information*, if applicable.

[Note: article 12(5) of the TD implementing Directive]

- 6.3.9 R An *issuer* or *person* must not charge investors any specific cost for providing *regulated information*. **[Note: article 21(1) of the TD]**

Disclosure of information in a non-EEA State

- 6.3.10 R (1) Information that is disclosed in a *non-EEA State* which may be of importance to the public in the *EEA* must be disclosed in accordance with the provisions set out in *DTR* 6.2 and *DTR* 6.3.
- (2) Paragraph (1) applies additionally to information that is not *regulated information*.

[Note: article 23(3) of the TD]

6.4 Choice of Home State and notifications by third country issuers

Application

- 6.4.1 R In respect of *transferable securities* which are admitted to *trading* on a *regulated market*, this section applies to:
- (1) an *issuer* whose *Home State* is the *United Kingdom* in accordance with article 2.1(i)(i) of the *TD*; and
- (2) an *issuer* who chooses the *United Kingdom* as its *Home State* in accordance with article 2.1(i)(ii) of the *TD*.

Choice of Home State

- 6.4.2 R An *issuer* that chooses the *United Kingdom* as its *Home State*, pursuant to article 2.1(i)(ii), must disclose that choice in accordance with *DTR* 6.3. **[Note: article 2 of the TD implementing Directive]**